Neutral citation [2013] CAT 6 Case No.: 1166/5/7/10

IN THE COMPETITION APPEAL TRIBUNAL

Victoria House
Bloomsbury Place
London WC1A 2EB 28 March 2013

Before:

VIVIEN ROSE
(Chairman)
TIM COWEN
BRIAN LANDERS

Sitting as a Tribunal in England and Wales

B E T W E E N:

ALBION WATER LIMITED

Claimant

- v -

DŴR CYMRU CYFYNGEDIG

Defendant

Heard at Victoria House on
15, 16, 17, 18, 19, 22, 23, 24, 25 and 26 October 2012, and on 5 and 6 November 2012

JUDGMENT

APPEARANCES

Mr Thomas Sharpe Q.C., Mr Matthew Cook and Mr Mehdi Baiou (instructed by Shepherd and Wedderburn LLP) appeared on behalf of the Claimant.

Mr Daniel Beard Q.C., Mr Meredith Pickford and Ms Ligia Osepciu (instructed by Hogan Lovells International LLP) appeared on behalf of the Defendant.

[Note: Excisions in this judgment (marked "[…][✂]") relate to commercially confidential information: Schedule 4, paragraph 1 to the Enterprise Act 2002.]

CONTENTS

I. THE BACKGROUND TO THE CLAIM

1. Albion brings this claim for damages pursuant to section 47A of the Competition Act 1998 ('the Competition Act'). It asserts that it has suffered loss and damage as the result of Dŵr Cymru's infringement of the Chapter II prohibition. That infringement occurred when Dŵr Cymru informed Albion, on 2 March 2001, that the price at which it was prepared to offer Albion a common carriage service to carry water through its pipes from the River Dee pumping station to the premises of Albion's customer, Shotton Paper, was 23.2p/m^3. This price has come to be known as the 'First Access Price'.

2. Ofwat, in a decision dated 26 May 2004 ('the 2004 Decision'), found that there had been no infringement of the Chapter II prohibition by Dŵr Cymru in offering the First Access Price to Albion. On appeal by Albion, the Tribunal (differently constituted from the Tribunal hearing this claim) found that Dŵr Cymru held a dominant position in the relevant market and that the First Access Price of 23.2p/m^3 imposed on Albion a margin squeeze, amounting to an abuse of that dominant position within the meaning of the Chapter II prohibition. This conclusion was set out in the Tribunal's Margin Squeeze Judgment. In the later Unfair Pricing Judgment, the Tribunal went on to hold that the First Access Price constituted a further abuse by Dŵr Cymru of its dominant position in that that price was both excessive and unfair in itself.

3. Albion asserts in these proceedings that if Dŵr Cymru had not infringed the Chapter II prohibition, Albion would have accepted the offer of a reasonable price for common carriage and would have carried on its business of supplying non-potable water to Shotton Paper using a common carriage arrangement with Dŵr Cymru. Under a common carriage arrangement, Albion would only have purchased the treatment and carriage of the water from Dŵr Cymru. The water itself, Albion would have purchased separately. That would, Albion says, have been more profitable than the so-called bulk supply business which it has in fact operated whereby it buys both the water and carriage of it from Dŵr Cymru. Albion also says that, if it had been able to operate on the basis of a common carriage arrangement for its supply of water to Shotton Paper, it would have had the opportunity of tendering to supply another customer, Corus Shotton. It is Albion's case that it would have won that

contract and would have made money from that supply. That opportunity, Albion says, has therefore been lost because of Dŵr Cymru's abusive conduct.

4. Finally, Albion argues that Dŵr Cymru's conduct, in the lead up to, and in offering the First Access Price of 23.2p/m^3 fell within the class of conduct which the case law says justifies the imposition of an award of exemplary damages. The Tribunal has previously held that since Dŵr Cymru has not been subject to a fine for its infringement of the Chapter II prohibition, the Tribunal is not precluded from awarding exemplary damages in these proceedings: see *Albion Water v Dŵr Cymru* [2010] CAT 30 (ruling of 8 December 2010), paragraphs 27 onwards.

5. Attached to this Judgment is a glossary of defined terms brought forward from earlier Rulings of the Tribunal in this case, amended as appropriate.

A. The parties

6. The water industry in the England and Wales was privatised in 1989. Albion, initially a subsidiary of Enviro-Logic Ltd ('ELL'), was the first licensed new entrant to the water industry post-privatisation. ELL was established in 1991 by Dr Jeremy Bryan, who is the driving force behind Albion, to provide consultancy services to water-intensive industries following privatisation.

7. In 1997, Pennon Group plc ('Pennon') (the holding company of South West Water) purchased 50 per cent of the shares in ELL, with an option to acquire the remainder, and agreed to provide financial and technical support to the joint venture, Albion. That remained the position until 2003 when Pennon exercised its option and acquired the entire issued share capital of ELL. In early 2004, Pennon transferred Albion to a new company founded by Dr Bryan called Waterlevel Limited. In 2007, Waterlevel Limited changed its name to Albion Water Group Limited, which is now the holding company of the Claimant, Albion.

8. Dŵr Cymru is a statutory undertaker providing water and sewerage services in Wales and some adjoining parts of England. When the water industry was privatised, Dŵr Cymru took on the functions of what had previously been the Welsh Water Authority. It was previously owned by Hyder plc but in May 2001 Dŵr Cymru was acquired by Glas Cymru

Cyfyngedig. Dŵr Cymru is a substantial undertaking with cash reserves of approximately £1 billion.

B. The water supply to Shotton Paper

9. The Water Industry Act 1991, as amended ('the Water Industry Act') made it possible for licensed companies to apply to Ofwat for an 'inset appointment' under which the applicant company would replace the former monopoly provider as the supplier of water or sewerage services in respect of a particular customer or area.

10. Shotton Paper produces newspaper print at its site at Shotton, North Wales and uses an average of about 6,800 megalitres ('Ml') (6.8 billion litres) of non-potable water a year.[1] This level of consumption is equivalent to about 40 – 50,000 households. Before the events which gave rise to this litigation, Shotton Paper was supplied by Dŵr Cymru and was Dŵr Cymru's second largest customer. The water supplied by Dŵr Cymru to Shotton Paper, and also to Corus Shotton (a steelworks formerly owned by British Steel), was (and indeed still is) abstracted from the River Dee by United Utilities at its Heronbridge pumping station. The majority of the water taken from the River Dee at Heronbridge was directed into United Utilities' pipe network for supply to its own customers. Some 22 per cent of the water was pumped into the Ashgrove system, which is owned by Dŵr Cymru. At the point it enters the Ashgrove system, the water is 'raw' river water. The Ashgrove system comprises a treatment works, in which solids are removed from the water, and approximately 15 kilometres of pipe which takes the partially-treated but still non-potable water to the site of two industrial premises, namely Shotton Paper and Corus Shotton. These are the only premises served by the Ashgrove system.

11. In the mid-1990s, Shotton Paper had been trying unsuccessfully to negotiate with Dŵr Cymru for a reduction in the price it paid for water. Shotton Paper approached ELL, Albion's then parent company, to ask whether the provisions of the Water Industry Act could be used to achieve a lower price. In February 1996, Albion applied to Ofwat for an inset appointment to replace Dŵr Cymru as the supplier of water to Shotton Paper pursuant to section 7(4)(bb) of the Water Industry Act. Albion also asked Dŵr Cymru for a bulk

[1] A megalitre (Ml) is one million litres; a cubic metre (m^3) contains one thousand litres. There are, therefore, one thousand cubic metres in a megalitre.

supply agreement,[2] that is for an agreement under which Dŵr Cymru would supply water to Albion at the Shotton Paper site for Albion then to sell on to Shotton Paper.

12. Albion approached Ofwat for a determination of the terms of the bulk supply agreement to be entered into between it and Dŵr Cymru. It asked Ofwat to settle the unit price for non-potable and potable water in exercise of its powers under section 40 of the Water Industry Act. By a letter dated 12 December 1996, Ofwat notified Albion that, having considered the prices put forward by each party, it was minded to recommend a volumetric price of 59p/m^3 for potable water and 26p/m^3 for non-potable water. That non-potable price was stated by Ofwat to be 'similar to prices charged by Dŵr Cymru for other bulk supplies'. The letter did not amount to a formal decision by Ofwat (and no such decision was ever in fact adopted) and has come to be referred to, therefore, as the 'minded-to decision' and 26p/m^3 as the 'minded-to price' for bulk supply of non-potable water.

13. On 10 March 1999, Albion and Dŵr Cymru entered into the Second Bulk Supply Agreement for the supply of potable and non-potable water by Dŵr Cymru to Albion. This provided for a supply to Albion of up to 18 Ml per day ('Ml/d') of non-potable water, with a further 4 Ml/d to be supplied on request by Albion, subject to availability. The charges set out in clause 4 of that Agreement reflected Ofwat's minded-to decision.

14. At the time of the minded-to decision in 1996, Dŵr Cymru had been supplying non-potable water to Shotton Paper at the price of 27.47p/m^3. At or shortly after the conclusion of the Second Bulk Supply Agreement, Dŵr Cymru reduced the retail price it offered to Shotton Paper to approximately 26p/m^3. That was, of course, the same price that Albion was required to pay to Dŵr Cymru for the bulk supply of the water under the Second Bulk Supply Agreement.

15. Two things then occurred on 19 March 1999. First, and notwithstanding Dŵr Cymru's price reduction, Shotton Paper entered into an agreement with Albion for the supply of potable and non-potable water. Under the agreement, Shotton Paper was to pay Albion 26p/m^3 for non-potable water. This meant that Albion was selling the water to Shotton Paper at the same price as it was buying it from Dŵr Cymru and was not making any profit.

---

[2] The term 'bulk supply' is commonly used in the industry to denote a sale of water from one water-undertaker to another, rather than from one water-undertaker to a water-user.

We will return to the precise terms and interpretation of the charging provisions in the agreement between Albion and Shotton Paper later in this judgment. At this point we note simply that its terms included a benefit sharing arrangement whereby the 'savings in the cost of supply' were to be shared between Shotton Paper and Albion 'in the proportion 70:30 respectively'.

16. Also on 19 March 1999, Ofwat formally approved Albion's inset appointment and, with effect from 1 May 1999, Albion became the supplier of water to Shotton Paper.

C. The commencement of the Competition Act and its application to the water industry

17. The Competition Act received the Royal Assent on 9 November 1998. Before the main provisions came into effect on 1 March 2000, Ofwat published guidance to undertakings in the water industry as to how the Act was likely to affect them. In a document published jointly with the OFT in February 2000, entitled 'The Competition Act 1998 – The Application in the Water and Sewerage Sectors', Ofwat explained the following:

> '4.16 [Ofwat] regards 'common carriage' as the shared use of assets by undertakings. In many circumstances it would be uneconomic for a competitor to duplicate the provision of large assets, such as a pipe network or treatment facility. Common carriage, therefore, has the potential to increase customer choice by facilitating the entry of competitors (whether existing undertakers or new entrants) into a local market.
>
> 4.17 There is no specific statutory framework for common carriage, but this does not prevent undertakings from agreeing to such arrangements, including the associated terms and conditions. In general, however, incumbent undertakers may have little incentive to offer access to their facilities to other suppliers. In some cases refusal to allow a competitor to access or share facilities may be objectively justifiable - where, for example, the competitor refused to give adequate assurances on water quality or refused to make a reasonable contribution to necessary reinforcement costs. In other cases the refusal may be without any objective justification. Under the [Competition] Act, such a refusal by a dominant undertaking to grant access to facilities that would allow another undertaking to compete in a related market may be an abuse of a dominant position. Similarly, the imposition of unreasonable price or non-price terms for access could infringe the Chapter II prohibition.
>
> ...
>
> 4.20 [Ofwat] will, therefore, use [its] powers under the Act to deal with abusive conduct by dominant undertakings. This will allow common carriage to develop where there are genuine opportunities for improved services to customers.'

18. Ofwat also issued a series of letters designated 'MD' [Managing Director] or 'RD' [Regulatory Director] according to whom within the water-undertakers they were

addressed. The MD and RD letters invited consultation and provided detailed guidance as to how Ofwat would apply the Competition Act to the water and sewerage sectors. Thus, on 12 November 1999, Ofwat issued MD 154, entitled 'Development of Common Carriage', which stated in the opening paragraph that the Competition Act 'opens up the scope for market competition through shared networks, ie common carriage'. MD 154 emphasised the following points and invited discussions between water companies and Ofwat:

(a) Each company was to be ready to respond positively and substantively to enquiries about, or applications for, common carriage by 1 March 2000 and to this end should have ready a 'statement of principles that would govern this shared use';

(b) It was not for Ofwat to prescribe how each company should govern access to its network or networks; rather it was for the companies to 'set out the prices and operating conditions, ensuring that they are properly related to costs and are consistent with comparable components of your company's charges';

(c) Underlying any common carriage agreement should be a commitment by the incumbent undertaker to equal, fair treatment of entrants and their customers; and

(d) In relation to access charges, each company should charge entrants as it would charge itself but such charges should allow incumbents to recover reasonable network costs and capital maintenance charges, without over- or under-recovery. Such charges might be based on either average costs or long run marginal costs ('LRMC').

19. On 11 February 2000 Ofwat issued MD 159 which stated that the LRMC of supply networks is relevant to determining charges for access to companies' networks in the context of common carriage.

20. On 25 February 2000, Dŵr Cymru's Managing Director, Dr Mike Brooker, wrote to Ofwat enclosing the company's Statement of Principles for common carriage. Dŵr Cymru stated that it was willing to 'work with any entrant who would like to use our network to ensure that competition is opened up for the benefit of everybody.' The Statement set out the high level principles which would govern common carriage on the company's network. As to

access prices, the Statement said that '[a]ccess and use charges will be consistent with the charges levied to existing [Dŵr Cymru] customers and will reflect [Dŵr Cymru]'s methods of recovering its costs from its customer base'.

21. Each incumbent was required by MD 158 to transform its statement of principles into an access code governing access to its network. Dŵr Cymru's Network Access Code, produced in August 2000, did not provide much more detail about charges than the Statement of Principles. The Network Access Code said that regional average pricing would remain the charging principle for domestic customers and that charging for transport of water through the network, i.e. common carriage, would be on the basis of 'recovery of average costs'.

22. MD 163 was issued on 30 June 2000 after the entry into force of the Competition Act and provided the most comprehensive guidance on pricing issues for common carriage. MD 163 repeated the statement expressed in MD 154 that incumbent companies should charge entrants as they would charge themselves and went on to emphasise that those companies 'should be able to demonstrate this both to entrants and to the regulator, if asked to do so'.

23. MD 163 recognised that there are many ways of calculating access prices but stated that such prices could be based on:

> '1. Accounting costs (i.e. the book value of the assets to which access is sought).
>
> 2. The long-run marginal cost (LRMC) of that part of the incumbent's system to which access is sought.
>
> 3. The Efficient Component Pricing Rule (ECPR).'

24. MD 163 records that most companies had, at that time, indicated they intended to charge for access principally by reference to the book value of their assets and that, whilst a few had indicated that there might also be a charge for incremental costs, none had suggested they would charge purely on the basis of LRMC.

D. Albion's application for common carriage

25. Under the bulk supply arrangements under which Albion was supplying Shotton Paper, it was making zero margin. On 28 September 2000, Albion formally applied to Dŵr Cymru for common carriage of water to its customer Shotton Paper through the Ashgrove system.

The application was the first of its kind in England and Wales. Dr Bryan, Albion's managing director, emphasised in the application that, as Albion viewed the matter, the arrangement would be a very simple application of the common carriage principle with no apparent hydraulic, quality or liability concerns. Dr Bryan requested that, by 6 October 2000, Dŵr Cymru supply Albion with, amongst other things, an access price which should 'reflect the dedicated nature of the pipeline where there are only two sites served [Shotton Paper and Corus Shotton] ... and the fact that [Dŵr Cymru has] voluntarily de-averaged the tariffs for this supply and that the appropriate costs are those relating to this system alone'.

26. Over the next few months there were a number of meetings between the parties, both of which also engaged in substantial correspondence. In essence, Albion pressed Dŵr Cymru both to offer an access price and to explain, in detail, how that price had been derived. Under some pressure from Ofwat, Dŵr Cymru issued what it referred to as an 'indicative' access price of 20p/m^3 to Albion at a meeting on 16 January 2001.

27. On 20 February 2001, Dŵr Cymru wrote to Ofwat stating that the price it was minded to charge Albion for common carriage was 23.2p/m^3, a price which was stated to have been calculated on a whole company average basis, in line with Dŵr Cymru's Network Access Code. An appendix was attached to the letter comprising various schedules detailing how the price had been calculated. Dŵr Cymru went on to state that 'detailed analysis of common carriage pricing is ongoing and the company may refine its approach in due course in accordance with the objective of preparing a comprehensive and fair access pricing scheme for all situations'. Finally, Dŵr Cymru indicated that it would release the price to Albion as soon as it was approved by Ofwat.

28. Ofwat responded to Dŵr Cymru on 1 March 2001 stating that there was no question of Ofwat approving the price. It said that the price should be issued to Albion without further delay. On 2 March 2001, therefore, Dŵr Cymru wrote to Albion enclosing its letter of 20 February 2001 to Ofwat, which included the 'access price for 2000/1 and supporting information'. This letter constituted the offer of the First Access Price to Albion and led to the extended proceedings before Ofwat and, ultimately, to the finding by the Tribunal in Case 1046 (as to which see paragraph 36 and following, below) that Dŵr Cymru had abused its dominant position in breach of the Chapter II prohibition.

29. Albion was also negotiating on another front. Had Albion progressed from bulk supply to common carriage of water, it would have needed to purchase for itself the raw water, sometimes referred to as the 'resource'. In parallel with the negotiations with Dŵr Cymru, Albion was therefore negotiating with United Utilities to secure a bulk supply of raw water abstracted from the River Dee. Albion first approached United Utilities in writing in March 2000 and negotiations began in June 2000.

30. Dŵr Cymru purchased its water resource from United Utilities pursuant to an agreement, which Dŵr Cymru and United Utilities entered into on 10 May 1994, but which was deemed to have commenced on 1 July 1986 (the 'Heronbridge Agreement'). The terms of this are considered in more detail below but we note here that in the financial year 2000/01, Dŵr Cymru paid an average unit price of 3.01p/m^3 for the water it bought from United Utilities at Heronbridge.

31. United Utilities was far from content with the price it was receiving from Dŵr Cymru. Notwithstanding the recognition in a United Utilities Board paper dated 2 September 1999 that the Heronbridge Agreement required it to supply Dŵr Cymru 'at cost', United Utilities considered that a much higher price for the water was appropriate. It sought, without success, to renegotiate the Heronbridge Agreement with Dŵr Cymru.

32. In early February 2001, after some 11 months of sporadic negotiations, United Utilities offered Albion a bulk supply price of 12.1p/m^3. United Utilities has maintained throughout that that price was calculated on the basis of, and reflected, its regional average LRMC. United Utilities states that this was consistent with Ofwat guidance, or at least with its understanding of Ofwat guidance at the time. The offered price was subsequently reduced to 9p/m^3. Albion neither accepted nor rejected that price and, to date, no agreement has been entered into between Albion and United Utilities.

E. Relations between Albion and Shotton Paper

33. It seems that throughout this period and indeed to date Shotton Paper continued to be supportive of Albion's attempts to make a commercial success of operating the inset appointment, in the hope that this would secure it a lower price for water. We noted above the benefit sharing clause built into the charging provisions of the supply agreement that Albion concluded with Shotton Paper on 19 March 1999 (see paragraph 15 above). In

October 2002, once Albion's challenge to the lawfulness of the First Access Price was being investigated by Ofwat (as to which see paragraph 35 below), Shotton Paper agreed to vary that benefit sharing provision. The revision related only to monies received as a result of Albion's claims against Dŵr Cymru 'for the recovery of monies due and for a reduction in future charges'. The revision to the agreement provided that 'the benefits of any claim' would be apportioned on the following basis: (i) recovery of Albion and ELL's costs to date; (ii) the remaining net benefit relating to historic overpayment and associated damages would be apportioned to Shotton Paper and to Albion in the proportion 30:70 respectively, which reversed the proportions set out in the original agreement; (iii) the apportionment of ongoing net benefits would continue to be apportioned 70:30 in Shotton Paper's favour.

34. Shotton Paper also agreed to pay to Albion a voluntary uplift, in addition to the price it had agreed to pay for water, of 3p/m^3 between October 2002 and 1 July 2004, and of 1.5p/m^3 from 1 July 2004 to 1 November 2006. This does not appear to have been recorded in writing and it was Dr Bryan's evidence that Albion remains liable to repay that money to Shotton Paper as a matter of contract. The uplift was paid, it appears, with a view to supporting Albion at least until the conclusion of proceedings before Ofwat and the Tribunal. Regrettably those proceedings have continued for some time beyond November 2006.

F. Albion's complaint to Ofwat and Case 1046

35. On 8 March 2001, Albion submitted a formal complaint to Ofwat alleging, among other things, that the First Access Price was an abuse of a dominant position by Dŵr Cymru, contrary to the Chapter II prohibition. Ofwat's investigation lasted some three years and resulted in the 2004 Decision. On the question of dominance Ofwat did not express a final view. On the question of abuse, Ofwat found that the First Access Price did contain some cost misallocation but concluded that the price could not be described as excessive. Ofwat also rejected all Albion's other complaints, including the complaint that Dŵr Cymru had imposed a margin squeeze.

36. Albion appealed the 2004 Decision to the Tribunal pursuant to section 47 of the Competition Act. The case was allocated Case No. 1046/2/4/04 ('Case 1046'). There followed a series of judgments and rulings from the Tribunal, a judgment from the Court of

Appeal and a very substantial further report from Ofwat addressing a number of matters referred to it by the Tribunal. It is necessary to set out some of this history here.

i. Interim Relief

37. With the consent of the parties, the Tribunal ordered on 2 June 2004 that, with effect from 1 July 2004, the price payable by Albion under the Second Bulk Supply Agreement to Dŵr Cymru for non-potable water be reduced by 2.05p/m^3, that is to 23.95p/m^3 (the 'Interim Relief Order'). The Interim Relief Order was, by virtue of a ruling handed down on 11 May 2005 (see [2005] CAT 19), continued until 1 August 2005.

38. As noted above, Shotton Paper ceased paying the voluntary uplift of 1.5p/m^3 to Albion in November 2006. In a ruling handed down on 20 November 2006 (see [2006] CAT 33), the Tribunal varied the terms of the Interim Relief Order so as to replace the figure of 2.05p/m^3 with one of 3.55p/m^3, that is to 22.45p/m^3. The interim relief continued on those terms until the Tribunal's Remedies Judgment was handed down on 9 April 2009. The parties to the present claim agree that credit for the interim relief granted by the Tribunal, and paid by Dŵr Cymru, must be offset against any award of damages to Albion.

ii. The Interim Judgment [2005] CAT 40 (22 December 2005)

39. The Interim Judgment reached some provisional conclusions on Albion's appeal but determined that further evidence was required from the parties on various issues before any final decisions could be reached. Those issues were set out at paragraph 427 of that judgment and included gathering further evidence about the level of distribution costs of potable and non-potable water respectively, and considering whether it was necessary or practicable as a cross-check to work out the stand-alone costs of the supply of non-potable water on a bottom-up basis, either in relation to non-potable users generally or the Ashgrove system in particular.

iii. The 1046 Main Judgment [2006] CAT 23 (6 October 2006)

40. In the 1046 Main Judgment, the Tribunal concluded that Ofwat had made a number of errors in concluding that the First Access Price was not excessive. Moreover, the Tribunal held that Ofwat had been wrong to find that there was no margin squeeze, since the First Access Price was not shown to be cost related and the evidence suggested it was excessive.

Furthermore, the First Access Price had been set at a level which did not allow Albion to earn a normal profit.

iv. The Margin Squeeze Judgment [2006] CAT 36 (18 December 2006)

41. In the Margin Squeeze Judgment, the Tribunal concluded that Dŵr Cymru was in a dominant position on the relevant market, namely the market for the transportation and partial treatment, via the Ashgrove system, of water abstracted from the Heronbridge abstraction point for supply to Shotton Paper and Corus Shotton. The Tribunal also held that Dŵr Cymru had abused its dominant position, contrary to the Chapter II prohibition, by imposing a margin squeeze on Albion. Dŵr Cymru's appeal against the Margin Squeeze Judgment was dismissed by the Court of Appeal on 22 May 2008: see [2008] EWCA Civ 536.

42. Also in the Margin Squeeze Judgment, the Tribunal decided to exercise its power under Rule 19(2)(j) of the Tribunal's Rules to remit certain matters to Ofwat to investigate, so that the Tribunal would be in a position to address the excessive pricing allegation as a separate abuse by Dŵr Cymru of its dominant position.

v. The Referred Work

43. The report tendered to the Tribunal by Ofwat on 18 June 2007 in response to the direction in the Margin Squeeze Judgment has come to be known in these proceedings as the 'Referred Work'. In the Referred Work, Ofwat undertook a further investigation of the actual costs of the services to be provided by Dŵr Cymru to Albion for the purposes of common carriage. Ofwat concluded that, given the complexity of the issue and given the number of assumptions that must be made, there was no single appropriate methodology for this assessment. It looked at the matter on the basis of the following methodologies: average accounting costs plus ('AAC+'), which it indicated was its preferred methodology since it most closely reflected that used in the regulatory context of 2000/01; long-run incremental costs ('LRIC'); and a local accounting costs ('LAC') approach. Ofwat then set out what it considered would have been a proper access price using each of those methodologies: on the AAC+ approach, 19.3p/m^3 (which the First Access Price exceeded by 20 per cent); using LRIC, 20p/m^3 (which the First Access Price exceeded by 16 per

cent); and using the LAC approach, 18.5p/m^3 (which the First Access Price exceeded by 25 per cent).

44. Applying the two stage test laid down by the Court of Justice in Case 27/76 *United Brands v Commission* [1978] ECR 207, Ofwat concluded that although the First Access Price was excessive, there was no cogent evidence that the excess was unfair in itself. In Ofwat's view, it was not established that the First Access Price bore no reasonable relation to the economic value of the service to be provided.

vi. The Unfair Pricing Judgment [2008] CAT 31 (7 November 2008)

45. The Tribunal considered the Referred Work in its Unfair Pricing Judgment. It agreed with Ofwat that, as the Tribunal put it:

> 'there is no single "correct" or completely straightforward way in which to calculate costs in the water industry. There will always be a degree of judgment involved in choosing which cost methodologies to apply when assessing the lawfulness of an access price.' (paragraph 103).

46. However, the Tribunal rejected LRIC as an appropriate methodology and made a number of adjustments to Ofwat's calculations under the other two methodologies. It concluded that a proper access price using the corrected methodologies would have been: AAC+ of non-potable users generally, 15.8p/m^3 (which the First Access Price exceeded by at least 46.8 per cent); AAC+ of the Ashgrove system, 13.8p/m^3 (which the First Access Price exceeded by at least 68.1 per cent); and LAC of the Ashgrove system, 13.6p/m^3 (which the First Access Price exceeded by at least 70.6 per cent) (see paragraph 197).

47. The Tribunal held that, even allowing for the 'unavoidable uncertainties in the costs calculation' the First Access Price exceeded the cost reasonably attributable to the service of the transportation and partial treatment of non-potable water by Dŵr Cymru generally and through the Ashgrove system in particular (see paragraph 198). The Tribunal accepted that, in order to find a price excessive for the purposes of the Chapter II prohibition, it was necessary to show that a price exceeds the attributable costs by a material extent. It did not define what a 'material extent' might be but held that a price that was at least 46.8 per cent above the costs reasonably attributable to the cost of supply was excessive to a material extent (paragraph 199).

48. The Tribunal then gave detailed consideration to the question of whether or not the First Access Price could be said to be unfair and concluded, at paragraph 274, that:

> 'the First Access Price bore no reasonable relation to the economic value of the services to be supplied and was unfair. The First Access Price Dŵr Cymru proposed to charge Albion would have effectively insulated it from competitive pressure and/or enabled it to exploit its control over customers within its appointed area. In specifying that price, Dŵr Cymru made use of the opportunities arising from its dominant position so as to seek advantages which it should not be permitted under the Chapter II prohibition.'

vii. The Remedies Judgment [2009] CAT 12 (9 April 2009)

49. Following a further hearing as to the appropriate remedies to be ordered as Case 1046 finally drew to a close, the Tribunal made a declaration as to the two abuses of a dominant position found against Dŵr Cymru and ordered that Dŵr Cymru bring the infringement to an end, and that it refrain from engaging in any conduct having the same or equivalent effect. It further ordered that '[a]ny common carriage access price offered by Dŵr Cymru to Albion [Water] ... not exceeding 14.4p/m^3 in 2000/2001 prices shall not be conduct having the same or equivalent effect as the infringement' found against Dŵr Cymru. That figure of 14.4p/m^3 was a price agreed by the parties as being a 'fair and reasonable' common carriage price in 2000/1 prices.

G. The Second Access Price

50. In a letter of 16 January 2004, Dŵr Cymru responded to an Ofwat request for a common carriage price for non-potable water payable by Albion for supplying Shotton Paper for the 2003/04 financial year. Dŵr Cymru stated that an 'indicative' access price would be 17.74p/m^3 (defined by Ofwat in the 2004 Decision as the 'Second Access Price') made up of 3.31p/m^3 for treatment and 14.43p/m^3 for transport costs. Dŵr Cymru further stated in that letter that, should Albion apply for common carriage again, that price would 'form the basis of the starting point for any new application and would not include any other administrative and associated costs.' Dŵr Cymru did not communicate this revised price to Albion, which first became aware of the Second Access Price on or around 17 March 2004 when Ofwat forwarded Dŵr Cymru's letter of 16 January 2004 to Dr Bryan.

H. Dŵr Cymru's offer of a revised access price of 14.4p/m^3

51. On 7 November 2008, the date the Unfair Pricing Judgment was handed down, Dŵr Cymru wrote to Albion offering it common carriage at a price of 14.4p/m^3 adjusted for inflation

from 2000/01 prices to 2008/09 prices. In that letter Dŵr Cymru explained that the price of 14.4p/m^3 was an average of the three figures calculated by the Tribunal at paragraph 197 of the Unfair Pricing Judgment, and a figure which Dŵr Cymru believed to be 'fair and reasonable'. That figure could be updated to then current prices and the offer was stated to be open for a period of six months. Although Albion initially rejected this offer by way of a letter dated 18 November 2008, the following day Albion wrote again indicating that the figure of 14.4p/m^3 was:

> 'agreed as a compromise remedy to give effect to the findings of the Tribunal in relation to the excessive pricing abuse. Such agreement is without prejudice to the rights of Albion to maintain that the costs attributable to the services provided by Dŵr Cymru are in fact substantially lower.'

52. Albion accepts that the date of 7 November 2008 marks the end of the period for which it can claim damages in relation to Shotton Paper. Notwithstanding Albion's acceptance of the figure of 14.4p/m^3 for the purposes of giving effect to the findings of the Tribunal, however, Albion has not in fact accepted the offer and common carriage has never commenced. At present Albion continues to supply Shotton Paper on a bulk supply basis, as it has done since 1999.

II. THE EVIDENCE

53. Albion brings its claim under section 47A of the Competition Act. As such it is a so-called 'follow-on' claim and relies on the findings of infringement made by the Tribunal in the Margin Squeeze Judgment and the Unfair Pricing Judgment (see section 47A(6)(c) and (9)). The Tribunal's jurisdiction in a follow-on claim is limited to questions of causation and quantum: see *Enron Coal Service Ltd (in liquidation) v English Welsh & Scottish Railway Ltd* [2011] EWCA Civ 2 ('*Enron Coal*') (see, in particular, paragraphs 8, 142, 143 and 148 to 150).[3]

54. The Tribunal heard evidence on behalf of Albion from Dr Jeremy Bryan who was cross-examined at length about every aspect of the case. We found Dr Bryan to be an impressive witness who demonstrated a comprehensive understanding of the technical and commercial details of water supply through the Ashgrove system, and of the water industry more

[3] See also the earlier decision of the Court of Appeal in the same litigation, [2009] EWCA Civ 647 at paragraphs 30 and 31.

generally. He has had a close personal involvement with this claim and with Case 1046. Dr Bryan gave his evidence in a measured and helpful manner and it was plain to the Tribunal that he was seeking to assist us as far as he was able. He did, on a couple of occasions, make assertions as to misconduct on the part of others which were rapidly shown to be misguided by Counsel for Dŵr Cymru. But when he was shown to be wrong he immediately accepted the inaccuracy of his statements and withdrew them.

55. We also heard evidence from three witnesses tendered by Dŵr Cymru. Mr Jeffrey Williams was, at the material time for the claim, the Customer Policy and Income Director at Dŵr Cymru. This was an executive director position on the main Dŵr Cymru Board, a position to which he was appointed in early 1999. Mr Williams was also a member of the License Company Executive (referred to as the 'LCE') which was the management committee of the company (the License Company, referred to as the 'LiCo') that owned the licences operated by Dŵr Cymru. The LCE comprised a number of the Dŵr Cymru executive directors and was responsible for the operations and regulatory aspects of Dŵr Cymru's water business.[4] Mr Williams' evidence was directed to the issues arising from the claim for exemplary damages and we set out our view of his evidence in that section of this judgment (see paragraphs 238 to 250 below).

56. Dŵr Cymru's second witness was Ms Janine White who started working for United Utilities in 1987. Initially Ms White trained and worked as an accountant but, in September 1999, she was transferred to work on a project to ensure that United Utilities was prepared for the implementation of the Competition Act. In July 2000, she was appointed to the position of Competition Strategy Manager, effectively heading up United Utilities' compliance programme. She was, it seems, charged with computing the LRMC attributable to the cost of that bulk supply by United Utilities to Albion. Ms White was not, however, involved in any of the direct negotiations with Albion which were carried out by the United Utilities' commercial team. She also engaged in a certain amount of correspondence with Ofwat. Ms White's evidence was principally directed to the question of what price Albion would have paid United Utilities for the bulk supply of raw water at Heronbridge, had it entered into a common carriage arrangement with Dŵr Cymru. We set out our views on Ms White's evidence later in this judgment (see paragraphs 112 to 124).

[4] The LCE was also responsible for the electricity business operated by another Hyder plc subsidiary, SWALEC.

57. Dŵr Cymru's third witness Mr Paul Edwards took up employment with Dŵr Cymru in 1989 and is still employed there now. In 1992, three years after joining Dŵr Cymru, he took up the post of financial analyst within the Economic Regulation Department. Mr Edwards was the person primarily responsible within Dŵr Cymru for calculating the First Access Price, at least as from January 2001. Mr Edwards' evidence also covered different aspects of the counterfactual and so was relevant to all three heads of claim. As regards Mr Edwards' evidence about the calculation of the First Access Price we accept that he performed this task conscientiously although there were clearly aspects of what he did that he now concedes were wrong. We have rejected much of his evidence as regards other aspects of the case. We have borne in mind that Mr Edwards did not claim to be an independent witness but that he has been put forward by Dŵr Cymru to fight its corner on all those parts of the case which needed evidence from Dŵr Cymru to refute the evidence given by Dr Bryan.

58. It is appropriate to record that towards the end of the main part of the hearing before us, a significant number of documents were disclosed by Dŵr Cymru, some of which were directly relevant and should have been disclosed much earlier (possibly during the Ofwat investigation that led to the 2004 Decision and certainly during Case 1046). With regard to some of these documents, they arrived in time for Albion to be able to refer to them in its closing submissions but too late for it to be able to put them to the Dŵr Cymru witnesses in cross examination.

III. THE COMPENSATION CLAIM FOR ALBION'S SUPPLY TO SHOTTON PAPER

59. The first head of claim arises from Albion's assertion that, if it had been offered a reasonable price for common carriage by Dŵr Cymru, it would have accepted that offer and made more money on its supply of water to Shotton Paper than it in fact made over the relevant period operating under the Second Bulk Supply Agreement. Dŵr Cymru's case is that this loss is illusory and that, in fact, the bulk supply arrangements that were in operation during the course of the litigation, taking into account the interim relief granted by the Tribunal, were more profitable than any common carriage arrangements that were likely to have been made, assuming Dŵr Cymru had offered a non-abusive access price.

60. The Tribunal must, therefore, decide what would have happened in the counterfactual, or 'but for' world, had Dŵr Cymru not committed the abuses on which this claim is based. We must then compare the money that Albion would have made in that counterfactual world with the money it in fact made from the supply to Shotton Paper to see if Albion has suffered any loss as a result of Dŵr Cymru's abuse of its dominant position. The parties dispute many of the elements that go to make up the counterfactual world.

61. The Tribunal has undertaken a similar exercise in two other follow-on damages claims, namely in *Enron Coal* and *2 Travel Group Plc (In Liquidation) v Cardiff City Transport Services Limited* [2012] CAT 19 ('*2 Travel*'). In *Enron Coal*, the Tribunal held that the counterfactual is 'purged' not only of the abusive conduct and its consequences but also of any other unlawful conduct on the Defendant's part: see paragraph 90. We can, therefore, assume, for the purposes of the counterfactual that, in addition to offering a lawful First Access Price, the *dramatis personae* in this counterfactual would not have engaged in any illegal behaviour, including any violation of competition law.

62. We have already set out above some parts of the guidance given by Ofwat in the MD letters and in the February 2000 guidance, issued jointly with the OFT. Each party placed substantial, albeit of course differing, reliance on this guidance as supporting its case. Implicit in that reliance is a recognition that in the counterfactual world we are entitled to assume that Dŵr Cymru would comply with a reasonable interpretation of that Ofwat guidance.

63. It is also the case that in the counterfactual world all the parties would bear in mind that they were subject not only to competition rules but also to sections 40 and 40A of the Water Industry Act. Those sections provide, so far as relevant:

> '**40 Bulk supplies**
>
> (1) Where, on the application of any qualifying person—
>
> (a) it appears to [Ofwat] that it is necessary or expedient for the purposes of securing the efficient use of water resources, or the efficient supply of water, that the water undertaker specified in the application ("the supplier") should give a supply of water in bulk to the applicant, and
>
> (b) [Ofwat] is satisfied that the giving and taking of such a supply cannot be secured by agreement,

[Ofwat] may by order require the supplier to give and the applicant to take such a supply for such period and on such terms and conditions as may be provided in the order.

…

40A Variation and termination of bulk supply agreements

(1) This section applies where, on the application of any party to a bulk supply agreement—

(a) it appears to [Ofwat] that it is necessary or expedient for the purpose of securing the efficient use of water resources, or the efficient supply of water, to vary the agreement or to terminate it, and

(b) [Ofwat] is satisfied that that cannot be achieved by agreement between the parties to the agreement.

(2) [Ofwat] may by order—

(a) vary the agreement by—

(i) varying the period for which the supply of water is to be given; or

(ii) varying any of the terms or conditions on which that supply is to be given; or

(b) terminate the agreement.'

64. Section 40 thus gives Ofwat the power, on an application by a party to a bulk supply agreement, to require a supplier to give, and the applicant to take, such a supply for such period and on such terms and conditions as may be provided in the order. Similarly, on an application by a party to a bulk supply agreement, section 40A provides that Ofwat may vary the duration or terms of, or terminate, any bulk supply agreement. In the background to the negotiations would be the knowledge on all sides that referring the matter to Ofwat for its determination was an option open to each of them if they were not satisfied with what was on offer from the other party. It is clear from the correspondence that the parties did act on this basis and, indeed, that it was an option pursued.

65. Finally, though subject to one important exception, the parties are agreed that the Tribunal is also entitled to assume, when constructing the counterfactual, that the relevant people would have approached any negotiations between them reasonably, rather than with a view to obstructing progress. As Mr Pickford, acting for Dŵr Cymru, put it, the parties would 'not necessarily [be] falling over backwards to accommodate each other, just acting in a normal commercial manner'. The exception relates to the question as to what the common carriage price should be in the counterfactual world.

66. The issues that we have to decide under this head of claim can be grouped as follows:

(a) Albion's costs of supply in the counterfactual world. This involves identifying the costs Albion would have incurred in order to supply water to Shotton Paper, including the cost of the raw water itself, the common carriage price and, according to Dŵr Cymru, various additional costs such as augmentation of capacity at the Heronbridge pumping station and the reservation of a back-up supply of potable water.

(b) Albion's income from Shotton Paper in the counterfactual world. In order to compare Albion's position in the real and counterfactual worlds, we must work out how the supply agreement between Albion and Shotton Paper would have operated as regards the price that Shotton Paper would have paid Albion for the water.

(c) Is there a loss which is attributable to Dŵr Cymru's infringement? We must then compute the difference between the actual monies earned by Albion in the real world over the period and the monies it would have earned in the counterfactual world and, in particular, consider what part of that difference should be treated as having been caused by Dŵr Cymru's abusive conduct? This involves a consideration of the length of the period during which the effect of the abusive conduct continued to be felt.

A. The counterfactual common carriage price

i. The test to apply to find the common carriage price for the counterfactual

67. The first 'input' into the costs incurred by Albion to supply Shotton Paper is, of course, the cost of common carriage itself. Dŵr Cymru argued that the Tribunal's task here was not to find a reasonable access price but rather to find the highest price that Dŵr Cymru could have charged without committing an infringement of the Chapter II prohibition. That, Dŵr Cymru says, is because the Tribunal should strip out of the counterfactual only the unlawful element of Dŵr Cymru's actual behaviour. Dŵr Cymru accepts that the 14.4p/m^3 may be a reasonable access price. It argues, however, that the Tribunal in Case 1046 did not rule that any price above 14.4p/m^3 would be unlawful. As the Unfair Pricing Judgment makes clear, an abusive price is a price which is not only excessive (that is too high in comparison with costs) but also unfair (in terms of the economic value of the product or

service in the eyes of the would-be purchaser). In Dŵr Cymru's submission the Tribunal must in principle, first, work out what is the highest margin above the cost price that Dŵr Cymru could have charged and, then, assess what is the maximum value that Albion would have placed on the service.

68. Dŵr Cymru did not, however, press its submissions to their logical conclusion. It limited its claim to a common carriage price of 16.5p/m^3. That figure is arrived at by taking the figure of 15.8p/m^3, the highest of the three prices found by the Tribunal in the Unfair Pricing Judgment (using the AAC+ of non-potable users generally (see paragraph 46 above)) and increasing it by approximately 5 per cent. This was said to be justified on the basis that, first, the Tribunal in Case 1046 did not find that a price based solely on an AAC+ measure would be abusive and, secondly, to be abusive a price must be *materially* in excess of costs. Dŵr Cymru invited us to find that a price which is 5 per cent above a reasonable cost measure would be within, what it calls, a 'proper band of tolerance' and so not materially above cost. Dŵr Cymru's further concession was that it did not require the Tribunal to pursue the second limb of the unfair pricing test to determine what the maximum value of the common carriage service was in Albion's eyes.

69. We reject Dŵr Cymru's submissions on this point as wrong in principle, as well as entirely impracticable. It will be very rare that an infringement decision, whether adopted by a domestic competition authority or by the European Commission, or indeed on appeal as in Case 1046, will determine the precise borderline between lawful and unlawful conduct. If Dŵr Cymru is right that the claimant in a follow-on damages claim will have to show precisely where that line should be drawn, that will often involve the court in re-doing much of the work done in the earlier infringement decision. Further, it is a task that is almost impossible to accomplish, as is demonstrated in this case. If 16.5p/m^3 is not abusive (a point we do not decide), what about 16.6p/m^3 or 16.7p/m^3, or 16.8p/m^3? We do not see how a claimant could prove that one rather than the other is the tipping point between lawful and unlawful conduct. Dŵr Cymru has recognised the impracticability of the test by making the two tactical concessions that we have described. The fact that the Tribunal's task would be impossible in the absence of those concessions (which Dŵr Cymru was not of course obliged to make) indicates to us that the test proposed cannot be the right one.

70. Albion helpfully referred us to the case of *Banque Bruxelles v Eagle Star* [1997] A.C. 191. In that case the House of Lords considered the issue of counterfactuals in respect of a negligent valuation. Their Lordships held that if the figure put forward by the valuer is found to be wrong, the correct figure for the purposes of calculating the loss caused is the *average* one which a non-negligent valuation would have produced. At page 221, Lord Hoffmann said:

> 'I must notice an argument advanced by the defendants concerning the calculation of damages. They say that the damage falling within the scope of the duty should not be the loss which flows from the valuation having been in excess of the true value but should be limited to the excess over the highest valuation which would not have been negligent. This seems to me to confuse the standard of care with the question of the damage which falls within the scope of the duty. The valuer is not liable unless he is negligent. ... But once the valuer has been found to have been negligent, the loss for which he is responsible is that which has been caused by the valuation being wrong. For this purpose the court must form a view as to what a correct valuation would have been. This means the figure which it considers most likely that a reasonable valuer, using the information available at the relevant date, would have put forward as the amount which the property was most likely to fetch if sold upon the open market. While it is true that there would have been a range of figures which the reasonable valuer might have put forward, the figure most likely to have been put forward would have been the mean figure of that range. There is no basis for calculating damages upon the basis that it would have been a figure at one or other extreme of the range. Either of these would have been less likely than the mean.' (emphasis added)

71. That same principle applies by analogy in this case. There is a range of lawful access prices that Dŵr Cymru could have offered and we should take the figure in the middle of that range. The counterfactual must be based on an assumption that Dŵr Cymru would have offered a reasonable access price, rather than an access price which is the highest it could lawfully have charged. That, consistent with the principle described by Lord Hoffmann in the *Banque Bruxelles* case, is the price most likely to have been offered.

72. We also note that the Ofwat guidance sent to incumbent companies in June 2000 (in MD 163), that is in advance of Albion's application for common carriage, expressly stated that Ofwat had a 'duty to facilitate effective competition. Consistent with this duty, and with the Competition Act 1998, companies will be expected to offer access to essential facilities on reasonable terms'. As we have said, we assume that in the counterfactual world Dŵr Cymru would have complied with this guidance and would have been prepared to negotiate with Albion in a normal commercial manner rather than insisting on the highest price that it thought could lawfully charge.

ii. What a reasonable common carriage price would have been

73. Albion's claim is based on an assumption that Dŵr Cymru would have offered common carriage at 14.4p/m^3. That price is derived from the Unfair Pricing Judgment where the Tribunal, having set out its findings as to what cost components were properly included in the common carriage price, calculated the revised costs of that service using three different methods: see paragraph 46 above. The 'AAC+' methodology produced a price of either 15.8p/m^3 or 13.8p/m^3, depending on whether one considered the costs of supply to non-potable users generally or the Ashgrove system more specifically. Under the 'LAC' approach, the cost of the service was 13.6p/m^3. At paragraph 21 of the Remedies Judgment, the Tribunal concluded that a common carriage access price not exceeding 14.4p/m^3 (in 2000/01 prices) would not constitute conduct having the same or equivalent effect as the infringement identified in the Tribunal's earlier judgments. 14.4p/m^3 is the mean of the three different costs figures described above.

74. We see the sense in Albion's submission that the counterfactual world should assume a common carriage price of 14.4p/m^3, that being the price at which Dŵr Cymru would have arrived if it had undertaken a reasonable assessment of the costs of providing the service to Albion. We find that in the counterfactual world, on the balance of probabilities, Dŵr Cymru would have offered a common carriage price of 14.4p/m^3 to Albion on 2 March 2001.

iii. Would Albion have accepted a common carriage price of 14.4p/m^3 in March 2001?

75. Dŵr Cymru submits that the evidence of the negotiations in the actual world indicates that, even if Dŵr Cymru had offered an access price of 14.4p/m^3 in March 2001, Albion would have rejected that offer. In October 2000, Albion was proposing an access price of 7p/m^3 in its negotiations with Dŵr Cymru, a price that Albion regarded as a fair, cost reflective price for water delivered. There is also evidence that United Utilities was, at least in September 1999, working on the basis that an access charge might be as low as 6p/m^3 and it appears that this was known to Albion. Dŵr Cymru points to evidence that Albion was, according to an internal briefing paper, set on achieving a de-averaged basis for pricing, that is a price based on the costs of the Ashgrove system in isolation rather than an average of the costs of a range of systems.

76. It was Dŵr Cymru's case that, given the low access price of 7p/m^3 that Albion considered was justified, and given also that the 14.4p/m^3 price was based in part on averaged pricing, Albion would have rejected that price and continued to insist on a much lower, de-averaged access price. Dŵr Cymru submits, therefore, that Albion's claim for compensatory loss falls at this first hurdle because there was never a real prospect of Albion moving to common carriage arrangements, even if Dŵr Cymru had proposed a reasonable First Access Price of 14.4p/m^3.

77. We reject this as a plausible outcome in the counterfactual world. Dr Bryan's evidence on this was very clear. He accepted that he was initially considering a figure of around 7p/m^3 as the likely price of common carriage. He had derived this from such information as was available to him at the time from Dŵr Cymru's published regulatory accounts. Although 14.4p/m^3 was substantially higher, it was to be contrasted with what else was on offer, namely a bulk supply price of 26p/m^3 that provided Albion with no margin at all on the supply to Shotton Paper. With a common carriage price of 14.4p/m^3, Albion could expect to supply Shotton Paper at a reasonable margin. Dr Bryan's evidence was that Albion would have accepted a common carriage price, even one substantially above what Albion itself thought was justifiable.

78. We accept that evidence. We find that it would have been commercially nonsensical for Albion to reject a common carriage price of 14.4p/m^3 as a matter of principle. Dr Bryan's approach to negotiations with both Dŵr Cymru and United Utilities was not, on the evidence we have seen, based on die-in-a-ditch principles but on pragmatic business sense. He was well aware that it was open to Albion to enter into a common carriage agreement at that price, while keeping open the option of challenging the price as abusive, once he had been able to review Dŵr Cymru's methodology.

79. Dŵr Cymru further argues that the fact that Albion did not accept the 14.4p/m^3 price when it was offered by Dŵr Cymru in November 2008 (see paragraph 51 above) indicates that Albion would not have accepted it in 2001 either. In our view, that conclusion does not follow. The positions of the protagonists, Dŵr Cymru and Albion, as well as United Utilities, were very different in 2008 after seven years of bitter dispute from what they were in March 2001 when the First Access Price was offered. It is not possible to read

back from how the parties behaved in 2008 to determine how they would have behaved had the abuse never occurred.

80. We therefore find that, on the balance of probabilities, Albion would have agreed to a common carriage price of 14.4p/m^3 and would have been prepared to proceed with a common carriage agreement with Dŵr Cymru at that price.

iv. What indexation provisions would have been agreed for the common carriage price?

81. Dŵr Cymru argues that it would have insisted that the common carriage price be increased year on year in accordance with the Retail Price Index ('RPI'). Albion's case is that the common carriage price would not have been subject to any indexation or, if the parties had ultimately agreed to index the price, that it would have been by reference to the Producer Price Index ('PPI'), not RPI. It is generally accepted that RPI rises at, at least, the same rate as, if not faster than, PPI.

82. We find that Albion's argument that there would have been no price indexation is not realistic. This argument is based on Dr Bryan's analysis of how the costs of running the Ashgrove system in fact developed over the years. This shows, he says, that there was no increase in costs that would have justified indexation. This introduces an unacceptable degree of hindsight into the exercise.

83. Albion also points to Ofwat's final determination of the so-called 'K factor' in 2000[5] as showing that Ofwat expected the costs of supplying non-potable water (including partially-treated non-potable water of the type supplied by Albion to Shotton Paper) to *fall* by 25 per cent over the five years from 2000/01 to 2004/05. On that basis, Albion submitted, both parties would have realised that there was no justification for inserting any inflationary measures into a common carriage agreement in a deflationary world. We do not accept this submission. Although Ofwat had determined that K would be a negative factor for the period 2000-2005 there was nothing to suggest that K would continue to be a negative after that time. Against a backdrop in which the overwhelming majority of Dŵr Cymru's non-

[5] Mr Edwards was closely involved with this process for Dŵr Cymru and explained that the determination of the K factor is a 'regulatory mechanism which can be used to adjust prices in order to recoup unforeseen costs before the next periodic review by Ofwat. "K" is the number determined by Ofwat on a five yearly basis to reflect what each water and sewerage undertaker needs to finance the provision of services.'

potable supply agreements made provision for some form of indexation, we do not agree that this determination of K would have led to Dŵr Cymru entering into a long-term common carriage agreement with no indexation at all.

84. Albion's arguments in favour of a link to PPI, as opposed to RPI, are far more persuasive, and are much more likely, assuming that the parties in the counterfactual world were acting in a commercially reasonable manner, to have won the day. Albion could point to the fact that the Second Bulk Supply Agreement between Dŵr Cymru and itself (which the common carriage arrangements would have replaced) was index-linked to PPI, rather than RPI. So too was the supply contract between Dŵr Cymru and Shotton Paper. Indeed, the evidence indicates that, when Dŵr Cymru and Shotton Paper negotiated that supply agreement between May and August 1997, Dŵr Cymru initially proposed linking the indexation provision to RPI but subsequently accepted an indexation clause that used the lesser of the movement in PPI and the percentage movement in Dŵr Cymru's standard potable charge in any year. The supply agreement concluded between Albion and Shotton Paper in March 1999, at least in relation to indexation, mirrored the terms agreed between Shotton Paper and Dŵr Cymru. Albion would have fought hard against a suggestion that its key input price should go up at a higher rate than the price at which it was selling the water. There is, moreover, no commercial or logical link between the price of common carriage and RPI.

85. Dŵr Cymru's arguments in favour of adopting RPI seem to us weak. Mr Edwards' evidence was that most Dŵr Cymru contracts used RPI rather than PPI. On analysis it seemed that the picture was much more mixed. Looking at the Dŵr Cymru entry on Ofwat's so-called special agreements register, which records special pricing agreements entered into by Dŵr Cymru, most of the *volume* of non-potable water supplied, as opposed to simply *the number of contracts*, is subject to PPI indexation, rather than RPI.

86. We find, on the balance of probabilities that the common carriage agreement that the parties would have reached would have provided for indexation according to PPI. On this basis, the common carriage price of 14.4p/m^3 for the charging year 2000/01, when indexed by PPI in the following years, over the period of Albion's claim would be:

Table 1.

Financial year	Common carriage price of 14.4p/m^3 (in 2000/01) indexed by PPI
2001/2	14.50
2002/3	14.48
2003/4	14.58
2004/5	14.77
2005/6	15.20
2006/7	15.40
2007/8	15.80
2008/9	16.18

B. The cost to Albion of the water supply from United Utilities

87. Perhaps the most hotly contested issue in creating the counterfactual was the price that Albion would have had to pay for the supply of the water by United Utilities from the Heronbridge pumping station. Before explaining our conclusions on this point, it is necessary to set out the background facts.

i. The Heronbridge Agreement and the water supply to the Ashgrove system

88. Under the arrangements in place when Albion applied for common carriage, it was Dŵr Cymru that purchased the raw water from United Utilities under the Heronbridge Agreement (see paragraphs 29 and 30 above). As clauses 1 and 2 of the Heronbridge Agreement record, the Ashgrove system was until 1 July 1986 vested in United Utilities. At that date it was transferred to Dŵr Cymru (then the Welsh Water Authority) and Dŵr Cymru assumed United Utilities' obligations in respect of the outstanding loans associated with the assets of the system (see clause 14 of the Heronbridge Agreement).

89. Under the Heronbridge Agreement, United Utilities was obliged to supply Dŵr Cymru with up to 36Ml/d of raw water. The price which Dŵr Cymru paid to United Utilities under the Heronbridge Agreement was levied on a take-or-pay basis, in other words, a large part of the charge set for Dŵr Cymru was payable regardless of how much water Dŵr Cymru actually took. The charges were calculated as follows.

90. In each financial year, United Utilities determined the actual costs attributable to the Heronbridge Intake Works (where it abstracts the water from the River Dee) in respect of capital financing charges, fixed operational costs and overheads. For so long as Dŵr Cymru's entitlement to water under the Heronbridge Agreement remained at 36Ml/d, Dŵr Cymru was to pay 22 per cent of such costs to United Utilities. That 22 per cent reflected the proportion of water extracted from the Dee at Heronbridge to which Dŵr Cymru was entitled (the other 78 per cent went into United Utilities' pipe network for supply to its own customers).

91. In addition, Dŵr Cymru was obliged to pay 4.5 per cent of the actual costs levied by the Environment Agency for extraction at Heronbridge and 100 per cent of the actual costs of electricity paid by United Utilities but attributable to the supply to Dŵr Cymru. The Heronbridge Agreement made no provision for any inflation-linked indexation of the price payable by Dŵr Cymru since the charge reflected the actual costs incurred year on year.

92. The Heronbridge Agreement also required Dŵr Cymru to contribute to capital expenditures by United Utilities at the Heronbridge pumping station as and when these arose. Clause 9(a) of the Heronbridge Agreement provides that the parties will agree what proportion, if any, of the proposed expenditure will benefit Dŵr Cymru's Ashgrove supply. Clause 11 then provides that United Utilities may adjust or alter the basis of the charges to Dŵr Cymru to reflect those agreed benefits.

93. In these proceedings, the water resource cost payable under the Heronbridge Agreement was referred to, for convenience, as a price of 3p/m^3. That is not entirely accurate since the average price paid by Dŵr Cymru to United Utilities (expressed in p/m^3 by reference to the volume taken, rather than by reference to the entitlement) was: in 2000/01, 3.01p/m^3; in 2001/02, 3.11p/m^3; and in 2002/03, 3.22p/m^3. By 2008/09, the price had reached 5.87p/m^3.[6] Further, although it is convenient to express the cost of the water under the Heronbridge Agreement in terms of a volumetric price (p/m^3), it is important to remember that that is not how it is charged under the Agreement. The majority of the charges payable by Dŵr Cymru were for the *entitlement* to the water; only the charges relating to the electricity consumed in the extraction and pumping processes were linked to the actual off-take by Dŵr Cymru.

[6] The figures are set out in full in Table 2 at paragraph 127 below.

94. It is common ground that Dŵr Cymru has never used its full 36Ml/d entitlement. On average it appears to have taken something in the region of 26Ml/d. Indeed, the apparent rise in the cost of water to Dŵr Cymru between 2000/01 and 2008/09, when that cost is expressed as a p/m^3 figure, is in large part due to the fact that Dŵr Cymru has taken ever-decreasing amounts of water under the Heronbridge Agreement (some 2 million m^3, or 2,000Ml, less in 2008/09 than in 2000/1).

ii. Albion's primary case: supply in accordance with the Heronbridge Agreement

95. Albion's primary case is that the counterfactual should assume, broadly speaking, that Albion would have paid the same price for the raw water that Dŵr Cymru paid to United Utilities over the relevant period in the real world. Its alternative case is that it would have had to pay not more than 9p/m^3. That figure emerges from the negotiations that were started between Albion and United Utilities at the time that Albion applied to Dŵr Cymru for a common carriage price. We therefore have to decide, on the balance of probabilities, what would have happened in the counterfactual world where Albion had accepted, in principle, an offer of common carriage from Dŵr Cymru of 14.4p/m^3.

96. On this point we have heard Dr Bryan's evidence as to the course of the negotiations between Albion and United Utilities. We do not have any evidence as to what the people at United Utilities who were actually taking part in the discussions thought at the time. We have the evidence of Ms White, which we discuss below (see paragraphs 112 to 124), but she was not involved in the negotiations, nor in the internal discussions within United Utilities as to what stance it would adopt. Dŵr Cymru was not, of course, party to the discussions that took place between Albion and United Utilities.

97. We start by looking at the commercial reality of the parties' relative positions and then consider what arguments have been put forward in favour of a different result. United Utilities' bargaining power as against both Dŵr Cymru and Albion was very limited. The product and service that United Utilities was supplying to Dŵr Cymru, and would supply to Albion, was staying exactly the same: broadly, the same amount of water would be abstracted from the river by the same equipment and pumped into the same pipes. There was no obvious reason why United Utilities should get more money for the water than it was earning under the Heronbridge Agreement merely because Albion was moving to a common carriage arrangement with Dŵr Cymru.

98. Could United Utilities have threatened to divert the water for supply to its other customers? The evidence suggests that it could not since there was unused excess capacity at the pumping station over the whole period in any event. Clause 10(b) of the Heronbridge Agreement provides that a further 14Ml/d could be made available to Dŵr Cymru, over and above its already under-utilised 36Ml/d entitlement, without the need for any capacity augmentation or changes to the pumping system at Heronbridge. Despite its apparent dissatisfaction with the price that Dŵr Cymru was paying, there is no suggestion that United Utilities has ever approached Dŵr Cymru asking to free up any of that entitlement to enable United Utilities to meet a more lucrative, unmet demand for this water. It is equally the case that when Albion enquired whether United Utilities would be interested in contributing financially to the development of an alternative water source to Heronbridge, United Utilities indicated that it would place little or no value on the recovery of 36Ml/d of water. As we have said, 36Ml/d is a very substantial quantity of water and so this lack of interest strongly suggests that United Utilities had an excess of supply. In those circumstances, there was nothing else that United Utilities could threaten to do with the water from the Heronbridge pumping station.

99. Notwithstanding United Utilities' dissatisfaction with the revenue it was receiving, the Heronbridge Agreement was not a bad contract. It was a risk free, 'take-or-pay' arrangement which ensured that United Utilities' costs, including a modest contribution to capital, were recovered and that when the time came to upgrade or replace the equipment, the costs would be shared equitably between those benefiting from the water.

100. The United Utilities people negotiating with Albion would have realised that if they tried to insist on a higher price for the water under the pretext of a renegotiation of the Heronbridge Agreement, it was open to Dŵr Cymru to prevent any potential upset of its contract by simply continuing to take the water under the Heronbridge Agreement and selling that water on to Albion itself for the same price as it was paying for it (or perhaps at a marginal profit). Such an arrangement would have significant advantages for Dŵr Cymru in that it avoided any risk of the attractive Heronbridge Agreement unravelling, an important consideration for Dŵr Cymru because it also uses the water from Heronbridge to supply Corus Shotton. Such an arrangement would also enable Dŵr Cymru to retain the entitlement to the water for use in the event that Albion's relationship with Shotton Paper failed for some reason and Shotton Paper wanted to reinstate supply from Dŵr Cymru.

There would, therefore, have been, from United Utilities' perspective, a significant risk that if it pushed the negotiations with Albion too hard, Dŵr Cymru might simply agree to supply the water to Albion on the same terms as it was currently being supplied under the Heronbridge Agreement.

101. United Utilities was tied into the Heronbridge Agreement indefinitely and Dŵr Cymru did not have any appetite for renegotiating its terms. United Utilities could have asked Ofwat to set a new price under section 40A of the Water Industry Act. For the reasons we describe below, United Utilities could not have been optimistic about the chances of such a determination supporting an increase in price. Indeed, as later events show, United Utilities would have had no grounds for any such optimism (see paragraphs 117-119 below).

102. United Utilities was also aware of the possibility (to put it at its lowest) that it would be regarded as a dominant undertaking for the purposes of the Competition Act. It took into account the fact that it was subject to a licence condition, Licence Condition E, which at that time United Utilities believed precluded it from charging different prices to different water-undertaker customers. In January 2002, United Utilities wrote to Ofwat saying that it was contemplating seeking a determination that the price set by the Heronbridge Agreement should be 12p/m^3. The letter said that United Utilities would supply both Dŵr Cymru and Albion at the same price, in order to comply with Licence Condition E and the Competition Act.

103. Looking simply, therefore, at the bargaining position of the parties at the outset of any negotiations, our analysis points to a conclusion that the appropriate price to include in the counterfactual for the price that Albion would pay United Utilities for the water would be the same price as the water was being sold by United Utilities to Dŵr Cymru. We now turn to consider the arguments put forward by Dŵr Cymru in favour of a different result.

iii. The negotiations between Albion and United Utilities in 2000

104. Dŵr Cymru challenges this conclusion by pointing to the fact that United Utilities was very eager to obtain a better price for the water from Albion than it was currently earning under the Heronbridge Agreement. The contemporaneous documents show that prices of 8

or 9p/m^3 were being discussed and that matters had progressed to the stage of draft Heads of Agreement.

105. We have seen an early draft of those Heads of Agreement between Albion and United Utilities, apparently drafted by the latter. That draft provided that, subject to certain exceptions not material for present purposes, United Utilities would supply Albion with an average of 22Ml/d of raw water. The price for that water was set out in clause 9 and took the form of a benefit sharing agreement between the parties. The clause envisaged, in effect, that if the conclusion of the contract between Albion and United Utilities led to a renegotiation of the Heronbridge Agreement enabling United Utilities to increase the price paid by Dŵr Cymru, then the benefit of that higher price paid by Dŵr Cymru would be shared between Albion and United Utilities. Thus, the draft clause 9.1 provided for lump sum payments to be made by United Utilities to Albion when the Heronbridge Agreement was varied and for any monies received by United Utilities from Dŵr Cymru in excess of what United Utilities would have received if the Heronbridge Agreement had remained in force to be split between United Utilities and Albion.

106. In respect of the water supplied pursuant to the draft Heads of Agreement, clause 9.2 stated that Albion would pay to United Utilities a price derived by multiplying the volume of water actually supplied by a unit price expressed in p/m^3. Neither the regularity of the payments nor the unit price is set out in the draft. Clause 9.3 stated that the unit charge to be agreed by the parties for the purposes of clause 9.2 would be based on United Utilities' LRMC and indexed annually by reference to RPI.

107. When asked about clause 9.3 during cross examination, Dr Bryan candidly stated that it was quite clear to him from the start that there was no real intention to base the price for the water on United Utilities' LRMC. Rather both he and those negotiating on behalf of United Utilities regarded LRMC as 'a wonderful construct that could be used to justify prices that were significantly in excess of accounting costs'. He described LRMC as a 'bit of a fig leaf' that could be relied upon to justify to Ofwat whatever price was ultimately agreed between the parties.

108. Dr Bryan's evidence was that United Utilities resented what it saw as the 'excessive profits' made by Dŵr Cymru, that is the difference between the price that Dŵr Cymru paid

United Utilities and the price that Dŵr Cymru charged Shotton Paper. Dr Bryan said that it was Albion's view at the outset of negotiations that it could have compelled United Utilities to offer it a water resource price equivalent to what Dŵr Cymru was paying under the Heronbridge Agreement by using section 40 of the Water Industry Act. However, Albion preferred to try and achieve a commercial, negotiated solution based on a benefit sharing arrangement.

109. It is therefore true that, before the negotiations were suspended, Albion and United Utilities were contemplating an agreement under which United Utilities would get considerably more for the water than was paid under the Heronbridge Agreement. As Dr Bryan emphasised in his evidence, however, those discussions were predicated on the negotiating parties' jointly held belief that a reasonable common carriage price from Dŵr Cymru would be in the region of 6 or 7p/m^3 (see paragraph 75 above). The access price was the all-important factor and until this was known the negotiations with United Utilities could not be concluded. Had Dŵr Cymru offered an access price in the region of 7p/m^3 that would have left sufficient headroom between the price of that input and the likely revenue from Shotton Paper for Albion to contemplate a higher water price, coupled with a benefit sharing arrangement with United Utilities, as well as its benefit sharing arrangement at the other end of the pipe, as it were, with Shotton Paper.

110. The counterfactual we are formulating assumes, however, that Dŵr Cymru would have offered a common carriage price of more than double that: 14.4p/m^3. This would have made Albion less sanguine about giving up to United Utilities a share of a much narrower margin without a good reason to do so. A higher water price coupled with the benefit sharing arrangement envisaged in the draft Heads of Agreement would not have made sense once the parties realised that common carriage was going to cost Albion more than double what it (or United Utilities) had previously thought. Further, the underlying premise of the draft Heads of Agreement would not have survived for very long, because it would soon have become clear that Dŵr Cymru was not going to agree an increase in the Heronbridge Agreement price.

111. The course of the negotiations prior to the offer of the First Access Price and the terms of the draft Heads of Agreement do not, therefore, change our view as to the most likely

bargain that would have been struck between Albion and United Utilities as to the purchase of water from the Heronbridge pumping station.

iv. Ms White's evidence

112. In her evidence to the Tribunal, Ms Janine White put forward a different reason why it is said that United Utilities would have refused to sell the water to Albion at anything less than 9p/m^3. We described her background at paragraph 56 above and also noted that it was her task, in the context of the negotiations with Albion, to calculate an estimate of United Utilities' LRMC attributable to a bulk supply of raw water to Albion. We found Ms White to be an honest witness doing her best to assist the Tribunal, hampered though she was by the absence of any contemporaneous documentation explaining how she had carried out her calculations. It is unfortunate that no records at all of her work on the LRMC appear to have survived but we have no doubt that she believed at the time that the exercise she was engaged in was a legitimate one and that she would have done her work fairly and conscientiously.

113. Ms White explained that she focused on the joint OFT/Ofwat guidance on the application of the Competition Act to the water and sewerage industry, published in February 2000 (and referred to at paragraph 17 above). This stated that water undertakers could breach the Chapter II prohibition if they set predatory prices or if they set prices at excessively high levels. That guidance went on to state that prices set at or above LRMC would not normally raise concerns of predation.

114. The Heronbridge Agreement, as we have seen, priced the water on the basis of recovery of actual costs plus a contribution to capital investment as and when such investment was made and United Utilities appeared to recognise the Agreement as cost-reflective (see paragraph 31 above). In her evidence, however, Ms White stated that the Heronbridge Agreement was not cost-reflective. When asked about this in cross-examination she accepted that she was using an economist's view of costs, being the opportunity cost, rather than accounting cost. In calculating United Utilities' LRMC, what Ms White was trying to calculate seems to have been the opportunity cost of the supply on the basis that pricing at that level would result in the efficient allocation of resources. The question she posed was, in effect, what would be the cost to United Utilities of having to expand by 36Ml/d its water resources in order to keep supplying Dŵr Cymru under the

Heronbridge Agreement if United Utilities was not able to extract the water from the River Dee. That is, in theory, the cost which United Utilities avoided having to incur because it is in fact able to extract the water from the River Dee; hence that is the value of the water to United Utilities; hence the price charged for the water should be equal to that value.

115. We have serious doubts about the validity of the exercise in fact carried out by Ms White. It seems to be based on an assumption that there was a deficit of water in the Integrated Resource Zone operated by United Utilities (that served some 6.9 million people and covered Shotton) so that, in order to find the extra 36Ml/d of water, a new and expensive source would have to be developed and exploited. That assumption is contradicted by United Utilities' own Water Resources Plan covering the relevant period. This suggests that provided that a demand management strategy planned by United Utilities was in fact implemented there was no water deficit foreseen for that region until 2024. Further, that Plan envisages that such deficit as was foreseen could be met, not by opening up new sources of water, but by reducing leakages and rolling out more household metering, work which the regulator required United Utilities to undertake in any event. The Plan also shows that, even if United Utilities had needed to open up new water sources, it could do so at very low cost simply by increasing the abstraction licence amounts at existing sources.

116. The Plan in fact accords with United Utilities' negotiating stance in its discussions with Albion in June 1999 (see paragraph 98 above). Dr Bryan reported to the Albion board that United Utilities told him that it placed no value on freeing up 36Ml/d of water from the River Dee 'because they have sufficient resources in that area for the foreseeable future' (see Dr Bryan's report to the Albion Board for June 1999). A similar comment is made in United Utilities' notes of the meeting with Albion on 7 July 1999 which records that the United Utilities negotiator said that it had no requirement for additional supplies from the River Dee catchment area.

117. Our doubts are supported by the fact that the arguments put forward by Ms White to justify an increase in price under the Heronbridge Agreement were roundly rejected by Ofwat in 2003. Over a year after its letter of January 2002 (see paragraph 102 above), United Utilities made a formal application to Ofwat under section 40A of the Water Industry Act in February 2003 seeking an increase in the price paid by Dŵr Cymru. The

application stated that United Utilities believed that the Heronbridge Agreement as it stood 'fails to secure the efficient use of water resources' and that negotiations with Dŵr Cymru had stalled. The application referred to the low level of charges paid by Dŵr Cymru, stating that the supply at Heronbridge was of potentially high value to United Utilities in avoiding the need for alternative source enhancements. United Utilities proposed a new price of 9p/m^3, although it stated that the then current LRMC would support a substantially higher number.

118. Ofwat dismissed the application under cover of a letter dated 12 August 2003. Ofwat concluded that it was neither necessary nor expedient for the purpose of securing the efficient use of water resources, nor for the purpose of the efficient supply of water, to vary the Heronbridge Agreement. Ofwat stated that the 'effect of a price increase would be to increase the operating costs of Dŵr Cymru, and to increase the revenue base of United Utilities Water.' Moreover, Ofwat continued:

> 'A higher volumetric price appears unlikely to substantially change current supply arrangements. The same water would still be abstracted by United Utilities Water and would still be transported through the same pipes. It would be unlikely to lead to a significant change in the amount of water demanded by Dŵr Cymru as they would still be under an obligation to supply [Albion] and Corus [Shotton], and therefore would not release much capacity to reduce United Utilities Water's requirement to augment water resources in its integrated water resource zone.'

119. The rejection of this application meant that United Utilities was bound to keep supplying water to Dŵr Cymru under the terms of the Heronbridge Agreement. We recognise of course that this occurred after the First Access Price was offered to Albion by Dŵr Cymru. We consider that it is relevant to the construction of the counterfactual, however, because it supports, albeit *ex post*, our conclusion that the enterprise on which Ms White was engaged, in attempting to calculate United Utilities' LRMC of a bulk supply of water from the Heronbridge pumping station, was one of dubious utility and certainly did not justify the prices offered to Albion by United Utilities.

120. As we have said, it was Dr Bryan's evidence that he and the United Utilities people he was talking to all regarded the reference to LRMC as a flexible means of presenting to Ofwat whatever figure they ultimately agreed upon following commercial negotiations. This evidence is confirmed by what happened later. Over the course of negotiations between Albion and United Utilities, the figure of 9p/m^3 had been discussed. In February

2001, however, United Utilities wrote to Albion offering a bulk supply price of 12.1p/m^3. On 7 February 2001, Dr Bryan emailed John Lafon, United Utilities' head of business sales and marketing, demanding clarification of United Utilities' position. Dr Bryan indicated that Albion considered the proposed 12.1p/m^3 to be in breach of competition law and regulatory guidance. Had United Utilities held any sincere belief that 12.1p/m^3 was a genuine estimate of its LRMC of supplying Albion, one might have expected Mr Lafon to reply robustly, maintaining and explaining United Utilities' position.

121. Instead, on 8 February 2001, Mr Lafon emailed Dr Bryan stating that although 12.1p/m^3 was the product of the detailed LRMC calculations and had received Board approval, United Utilities was willing to revert to a bulk supply price of 9p/m^3 subject to two conditions. The first condition was that Albion acknowledge that price as a 'fair and reasonable' one; and, secondly, that the bulk supply agreement between United Utilities and Albion be signed, incorporating that price, prior to any common carriage agreement being entered into between Albion and Dŵr Cymru.

122. Having apparently achieved a 25 per cent price reduction with a single email, Dr Bryan wrote to Mr Lafon again on 20 February 2001 seeking an explanation of how the LRMC figures had been calculated and asking how the reduction from 12.1p/m^3 to 9p/m^3 could be justified. Mr Lafon replied on 1 March 2001 stating, rather elliptically, that the 12.1p/m^3 was an 'LRMC based figure ... built up using components which are regional averages'. The reduction to 9p/m^3 was, said Mr Lafon, due to a review of 'this particular circumstance' taking account of the fact that the supply offered by United Utilities was not a secure one.

123. It was Ms White's evidence that she was the one who calculated the figure of 12.1p/m^3. She described how the reduction in price from 12.1p/m^3 to 9p/m^3 came about. She had been approached by Mr Ken Hickman, a qualified accountant who worked in United Utilities' business sales and marketing department. He was worried that the higher price quoted to Albion would result in United Utilities losing the opportunity to agree the contract because it did not reflect the prices that they had been discussing in the negotiations. She recalled that Mr Hickman was concerned about this 'saying "What are we going to do?"'. She and Mr Hickman explored ways to get the price back down to 9p/m^3. They alighted upon the point that Ms White's calculations had not taken into account the fact that the supply to

Dŵr Cymru was not secure and that there was no back-up supply. She spoke to the managers at Heronbridge to confirm that the supply was 'interruptible'. That justified, in her view, dropping the price back down to 9p/m^3, although she did not claim to have actually worked out whether 3.1p/m^3 was a realistic reflection of long run marginal costs saved as a result the supply not being secure. Ms White also told us that, notwithstanding her compliance role, she had not been consulted by Mr Lafon regarding the two conditions he sought to attach to the 9p/m^3 (see paragraph 121).

124. It is clear to us from what happened here and from the contemporaneous correspondence, as well as from Dr Bryan's evidence, that the United Utilities people involved in the negotiations with Albion did not really regard the calculations provided by Ms White as anything more than support for a bargaining position they were adopting vis-à-vis Albion. We are unable to accept Ms White's assertion that United Utilities would not have agreed to sell the water to Albion at less than 9p/m^3. Ms White has overestimated the influence that her work would have had on the bargain ultimately struck. The backstop to the negotiations between Albion and United Utilities was the existing Heronbridge Agreement; the parties' knowledge that there was no other use for the water extracted under that agreement; United Utilities' apparent recognition that it would be required to supply Dŵr Cymru and Albion on the same terms, and an awareness (later proved to be correct) that United Utilities' arguments in favour of a price increase were weak at best. Ms White produced a price of 12.1p/m^3 apparently based on a detailed LRMC calculation but as we have seen, a single email from Dr Bryan was sufficient for the commercial team to reduce the offered price by 25 per cent. That reduction was subject to two conditions, neither of which appears to have had anything whatsoever to do with United Utilities' LRMC.

125. Our conclusion on this point is, therefore, that for the purposes of the counterfactual, we assume that Albion would have contracted to buy the raw water destined for Shotton Paper for the same price that United Utilities was selling it to Dŵr Cymru. Dŵr Cymru would then have had to decide whether it wanted to renegotiate its own deal under the Heronbridge Agreement to reduce the percentage of the costs it had to pay from 22 per cent to a lower figure which reflected more closely the remaining offtake that it was buying (for the supply to Corus Shotton alone). We do not see how United Utilities could have resisted such a request if Dŵr Cymru had made it, since Dŵr Cymru could have complained to

Ofwat. United Utilities was well aware that it might be considered dominant in the supply of the water and it would be difficult to justify being paid twice for the same water.

126. Given our finding in relation to the agreement between Albion and United Utilities, the question of the inflation-indexing for the cost of the water does not arise. The price for the water would be calculated on the basis of actual costs year-on-year and so automatically reflects any increases in the relevant costs.

127. We therefore find that the price to be incorporated into the counterfactual for the cost to Albion for the water is as set out in the third column of the following table. The second column shows the cost of water expressed in p/m3 for all the water bought under the Heronbridge agreement and the third column shows the same sums expressed in p/m3 for the water acquired under the Heronbridge agreement for supply to Shotton Paper:

Table 2.

Financial year	Average price for all Heronbridge water p/m^3	Average price for Heronbridge water supplied to Shotton Paper p/m^3
2001/2	3.11	3.46
2002/3	3.22	3.20
2003/4	3.59	3.75
2004/5	3.86	4.07
2005/6	4.26	4.49
2006/7	4.63	4.91
2007/8	5.12	5.40
2008/9	5.87	6.03

C. Additional costs for the supply of water

128. Dŵr Cymru argued that the counterfactual should recognise that Albion would have had to incur other costs, in addition to the access price and the purchase of raw water, before it could begin to supply Shotton Paper on the basis of common carriage. The largest item of cost contended for was the cost of augmenting the pumping equipment at United

Utilities' Heronbridge extraction point. Dŵr Cymru also states that Albion would have had to pay for the reservation of a back-up supply of potable water to ensure uninterrupted supply to Shotton Paper. It also raises some one-off additional costs that would have been payable.

i. Augmentation of supply at Heronbridge

129. Dŵr Cymru's Defence asserts that, because Dŵr Cymru would not have been willing to relinquish its rights to the 36Ml/d under the Heronbridge Agreement notwithstanding the loss of Shotton Paper as a customer, Albion would have been required to contribute to the capital cost of augmenting the capacity of the Heronbridge pumping station in order facilitate the abstraction of a further 22Ml/d required to supply Shotton Paper. In his written evidence, Mr Edwards put the cost of this putative capital investment at £3 million in 2000/01 prices. Alternatively, he suggested that Dŵr Cymru might have been willing to allow Albion to buy Dŵr Cymru out of its 36Ml/d entitlement but he also put that cost at a 'similar order of magnitude of low £millions'.

130. We can dispose of this point briefly as we regard this aspect of Dŵr Cymru's case as entirely fanciful. The Ashgrove system is not connected to any other supply network. Water which enters the system has only two possible destinations, Shotton Paper or Corus Shotton. There is currently no possibility of diverting the water to another Dŵr Cymru customer.

131. Dŵr Cymru suggests that it could have found another customer or that it could have built a pipe to take the water to its own potable treatment works at Bretton. Dr Bryan's evidence highlighted a number of problems with that scenario. As we have described, there was already a substantial surplus of water available to Dŵr Cymru at Heronbridge, which it was paying for but not drawing on. If there was any chance of using that additional water, one would have expected evidence of some effort on the company's part to do so. Mr Edwards accepted that, notwithstanding the common carriage application by Albion, Dŵr Cymru had not given any serious consideration to what it might do with the extra 22Ml/d it might find itself with if it no longer had to supply Albion under the Second Bulk Supply Agreement.

132. As to the possibility of using the water at the Bretton works, Dr Bryan explained that there was already additional water there which was not used by Dŵr Cymru. Moreover, the Bretton system was fed by water abstracted from the river by Dŵr Cymru itself and so was not more expensive than the water bought from United Utilities. There could be no economic justification for building a pipe to move the surplus Ashgrove water there.

133. As to the suggestion that Dŵr Cymru could have used its bargaining position to force Albion to pay it a substantial sum of money to refrain from using water for which it had no practical use anyway, we agree with Dr Bryan that the competition rules are there to prevent dominant undertakings like Dŵr Cymru from behaving in such a manner.

134. We have not, therefore, included in our counterfactual any spending on augmenting the water abstraction capacity at Heronbridge.

ii. The reservation of a back-up supply of potable water

135. The Second Bulk Supply Agreement between Albion and Dŵr Cymru provides not only for the supply of non-potable water but also for a supply of potable water. The price of the potable water is 59p/m^3 as compared with the price of 26p/m^3 for the non-potable supply and, like that latter figure, also has its genesis in Ofwat's 1996 minded-to decision (see paragraph 12 above). Clause 2 of the Agreement, headed 'Supply of Potable Water', provides as follows:

> '2.1 [Dŵr Cymru] shall supply such quantity of potable water to [Albion] as it may require during the term of this Agreement up to a maximum quantity of 8Ml/d which maximum quantity [Dŵr Cymru] shall reserve for such supply
>
> 2.2 Subject to the availability of potable water an additional quantity of potable water could be supplied by [Dŵr Cymru] over and above the maximum quantity reserved in Clause 2.1 provided the additional quantity is requested by [Albion]. The availability of the additional quantity of water is not guaranteed and [Dŵr Cymru] will be under no duty to supply it.' (emphasis added)

136. Dr Bryan told us that there were two sources of potable water entering the Shotton Paper factory, one through small pipes which provided water for the canteens, washrooms and so on, and a larger pipe running off the mains which was available for back-up supply in case of an interruption to the non-potable supply. According to Dr Bryan, the latter could supply approximately 50 per cent of the water needed for Shotton Paper's industrial

processes. Both sets of potable pipes are entirely separate from the Ashgrove system and the water provided is abstracted by Dŵr Cymru itself at the Bretton abstraction point.

137. The parties provided us with figures for the amount of potable water supplied as back up to the non-potable supply over the period. This includes water used to substitute for non-potable water when the latter was unavailable for some reason and also 'top-up' water used when the non-potable supply was insufficient for Shotton Paper's needs. If the water was needed because of something Dŵr Cymru had done then Albion only had to pay for the water at the non-potable price. If the water was needed because of something Shotton Paper had done, then the water was paid for at the higher, potable price. As we have said, Shotton Paper took something in the region of 6,800 Ml of non-potable water per annum. By contrast, the amounts of potable water that it used were much smaller:

Table 3.

Financial Year	Supplementary supply charged at potable price (Ml per annum)	Replacement supply charged at non-potable price (Ml per annum)
2000/1	3.2	-
2001/2	23.4	2.7
2002/3	27.9	10.7
2003/4	18.8	7.9
2004/5	5.6	-
2005/6	2.5	-
2006/7	17.1	12.3
2007/8	27.7	-
2008/9	0.01	-

138. In Case 1046, the Tribunal decided that the common carriage service requested by Albion did not include the service of providing a reserved back-up supply. The counterfactual common carriage price of 14.4p/m^3 does not therefore include any cost for reserving a supply of potable water. Dŵr Cymru argued that if Albion had entered into a common carriage arrangement and bought non-potable water directly from United Utilities, Albion would have had to pay someone, most likely Dŵr Cymru, an additional amount to cover the cost of reserving water for a potable back-up supply. Dŵr Cymru estimated the cost of this as 4.4p/m^3 added on to the cost of the non-potable water. This figure came

from a calculation made by Ofwat in the Referred Work (see section 5, and paragraphs 6.95-6.105 and 9.60). In essence, it calculated the cost of reserving potable water for supply to Albion at 10p/m^3. It then multiplied this by the number of m^3 reserved per day pursuant to clause 2.1 of the Second Bulk Supply Agreement (8Ml/d is equivalent to 8,000m^3), giving a per day reservation cost of £800. Across a 365-day year this comes to £292,000. Ofwat then re-expressed that figure by reference to the 18Ml/d of non-potable water supplied to Shotton Paper in 2000/1, arriving at a figure of 4.4p/m^3 as the cost element for the reservation of the potable back-up supply. It is important to note that that is, in effect, a standing charge and is paid irrespective of the amounts of back-up water actually used, such amounts being billed separately by reference to the volumetric charges agreed between the parties.

139. Dr Bryan's evidence was that he would not have been prepared to pay any additional sum for the *reservation* of potable water for a back-up supply to Shotton Paper. Dr Bryan accepted that Dŵr Cymru was, under the Second Bulk Supply Agreement, contractually obliged to reserve to Albion 8Ml/d of potable water and that such a reservation could have cost consequences. However, he denied that there was *in fact* any reservation of water by Dŵr Cymru to meet its obligations under clause 2.1 of the Second Bulk Supply Agreement. If there had truly been a reservation of 8Ml/d of potable water by Dŵr Cymru, then Dr Bryan would have expected this to have appeared in Dŵr Cymru's water resource management plan for that zone because a reservation of such a significant volume of water would have to be factored into the demand projections and resource availability. There was no such entry. Given the small amounts of back-up water likely to be needed and the abundance of water available from the Bretton potable works, Dr Bryan would not have been prepared to pay anything over and above the, already much higher, unit price of 59p/m^3 for any potable water in fact supplied.

140. Moreover, Albion submitted that it would not have agreed to pay anything for potable back-up unless it could pass on the costs to Shotton Paper. Dr Bryan's evidence was that Shotton Paper would not have been willing to pay anything extra in order to *reserve* a potable back-up supply – it would prefer to take the very small risk that potable water was not available in sufficient quantities if and when it was needed.

141. Dŵr Cymru sought to counter this by drawing our attention to an email sent by Shotton Paper to Dŵr Cymru in May 2008, in which Shotton Paper expressed concern at a fax sent by Ms Cross of Dŵr Cymru informing them of the withdrawal with immediate effect of its potable back-up supply. The email referred to 400 jobs being placed directly at risk by this action and to the risk that Shotton Paper's customers, the national British media, may not receive paper on which to print their newspapers. Dŵr Cymru relied on this as evidence of just how important to Shotton Paper the back-up supply was and submitted that Shotton Paper would never have accepted a back-up supply that was not reserved.

142. We are unable to accept this submission. From the text of the email, it appears to deal with an entirely different situation where Dŵr Cymru was threatening to cease supply of potable back-up, whether the water was actually readily available or not, rather than only in circumstances when there was not enough water available. That is not relevant to the question of whether Shotton Paper would have been prepared to pay a substantial extra sum for the benefit of having a *reserved* back-up supply of potable water.

143. On this point we prefer the evidence of Dr Bryan which accords with both commercial and common sense. We do not accept that Albion and Shotton Paper would have been prepared to pay £292,000 a year for the reservation of up to 8Ml/d of potable water. We do not, therefore, include in the counterfactual any costs related to the reservation of a back-up supply of potable water. Of course, Albion would remain liable to pay, and has in fact paid over the years, the charges levied by Dŵr Cymru for any potable water actually taken.

iii. Connection charge

144. Finally as regards any additional costs of Albion's bulk supply to Shotton Paper, Dŵr Cymru argues that Albion would have had to pay a one-off charge of £75,000 to cover a new connection in the pipe work at the Heronbridge pumping station. We do not accept that any such new connection would have been necessary. The changes that would have to occur should Albion progress to a common carriage arrangement with Dŵr Cymru were entirely formal in nature; there is nothing about the physical arrangements that would need to change. We have not, therefore, included this sum in the counterfactual calculation.

D. The revenue to Albion from Shotton Paper

145. Albion did not intend to keep for itself the whole of any cost savings that arose from a move from a bulk supply arrangement with Dŵr Cymru to a common carriage arrangement. Shotton Paper was, to an extent, sponsoring Albion's entry into the market because it wanted to pay less for the water that it consumed. In order to work out what Albion has lost as a result of Dŵr Cymru's abusive conduct, we have to make some assumptions about the price at which Albion would have sold the water to Shotton Paper.

146. As we have said, the supply agreement which Albion and Shotton Paper entered into on 19 March 1999 dealt with what would happen. That agreement provided, first, at clause 5.1 that Shotton Paper would pay the 'Charges' to Albion, provided that those Charges were no higher than those which Dŵr Cymru would have levied under the earlier agreement between Dŵr Cymru and Shotton Paper. The 'Charges' were defined as those specified in Schedule 3 to the agreement. Schedule 3 provided that Shotton Paper would pay 26p/m^3 for non-potable water, such price to be adjusted by the lesser of the annual percentage movement in PPI and the percentage movement in Dŵr Cymru's Scheme of Charges for potable water (there being at that time no generally applicable Dŵr Cymru tariff for large users of non-potable water).

147. The complicating factor, however, is that the agreement also provided for a benefit share between the parties. Clause 7.4 provided, so far as relevant:

> 'Albion Water shall use all reasonable endeavours to provide the Customer [Shotton Paper] with the most cost effective source of water ... and the most cost effective treatment of waste water including the possibilities of effluent water sales. <u>The savings in the cost of supply or services or incremental revenues, net of financing and operating costs, arising from such initiatives as may be agreed between the parties shall be shared between the Customer and Albion Water in the proportion 70:30 respectively</u>. Albion Water will propose and support measures designed to minimise waste and to facilitate the implementation of such initiatives ...' (emphasis added)

148. This, therefore, appears to apply a further adjustment to the price payable by Shotton Paper, over and above the indexation provision referred to above, and incorporates into the calculation of the Albion/Shotton Paper retail price an apportionment of the cost savings that arise from the introduction of Albion into the supply chain.

i. The meaning of clause 7.4

149. No one could claim that clause 7.4 qualified for the Crystal Mark standard awarded by the Plain English Campaign. Dr Bryan did not deal with this in any detail in his witness statement and the questions put to him in cross-examination related to how the benefit sharing arrangement had been dealt with in the schedule of calculations provided by Dr Bryan computing the quantum of Albion's loss according to different variables. We have not heard any evidence from Shotton Paper, the other party to the contract and, of course, Dŵr Cymru, as strangers to the contract, cannot give evidence as to what the parties intended when they devised the clause.

150. In deciding what clause 7.4 means, however, we have been assisted by the fact that on Day 4 of the hearing before us, Mr Pickford took Dr Bryan to part of the transcript of Day 2 (31 May 2006) of the hearing that resulted in the 1046 Main Judgment. Dr Bryan was being asked then about the services that Albion was supplying to Shotton Paper over and above the actual supply of the water. This was relevant in Case 1046 to the question whether Albion was replacing any services that Dŵr Cymru had previously provided and thus whether, as a result of Albion's inset appointment, Dŵr Cymru avoided incurring any costs that it used to incur in supplying Shotton Paper.[7] It is also relevant for our purposes because the discussion of those services led to a discussion of the benefit sharing arrangements which appear to have pre-existed the 1999 agreement and which were then replaced by clause 7.4.

151. In answer to questions from Mr Vajda QC, then acting for Dŵr Cymru, Dr Bryan described how the relationship between Albion and Shotton Paper was intended to work and how it had in fact worked. He said that Albion had a manager who was 'pretty well dedicated to Shotton' and whose task was to understand the plant and processes at Shotton Paper and work out where water might be used more effectively. Dr Bryan said:

> '… those activities in the round have enabled us in partnership with Shotton Paper to reduce their water consumption from 16 m^3 per dry tonne of paper produced back in 1999 – it was actually significantly higher than that when we first became involved – down to a level of 13 m^3 per tonne of paper. We are currently working with them to achieve 12 m^3 per tonne. They, of course, are benchmarked against UPM's international operations. Their

[7] This was, in turn, relevant to the application of the Efficient Component Pricing Rule, although that rule was rejected by the Tribunal as an appropriate method of pricing in the 1046 Main Judgment (see paragraphs 835 and 836).

ambition is to achieve world class which would be 9 m^3 per tonne. We cannot do that for them. They cannot do it without our assistance. It is, in that sense, a genuine partnership.'[8]

152. Dr Bryan went on to say that Albion and Shotton Paper were also in discussion about how to reduce the number of plant shut downs that resulted from the clogging up of the filters that supply water to the paper machines. The value of these services was acknowledged by the Tribunal in the 1046 Main Judgment at paragraphs 876, onwards.

153. A little later in the cross-examination Dr Bryan explained that these efficiency savings might not be sufficiently measureable to be subject to the 70:30 split in the Agreement and were not remunerated separately:

> 'Q How are you remunerated? How do you share in the success of reducing the water consumption of Shotton?
>
> A. That is part of our job. We see it as part of our job. Our payment for that would be in the form of a margin on sales, were we to achieve a cost reflective bulk supply price or common carriage charge. The difficulty in doing what you propose is that within our Customer Service Agreement with Shotton Paper there is an explicit formula that allows for the sharing of benefits. Now, that is fine. When, as I hope, we will be able to come back to Shotton Paper and say, "We have a fairer price for water", those benefits will be (a) readily measured, and (b) clearly attributable to Albion. The difficulty with sharing the benefits of improvements such as I have described – which have happened over a seven year period – is that it is a partnership effort, and for us to claim all the credit is not a very good basis on which to conduct a partnership. So, we view from a practical as well as a commercial point of view ---- we view the ongoing incremental efficiency benefits that we help Shotton Paper to achieve as part of the service, and we do not seek to recover anything additional by way of payment for those – rather, we see it as something which helps cement the relationship, and we hope that we can rely on when we come to re-negotiate that contract in the fullness of time.
>
> PROFESSOR PICKERING: This is the 70:30 formula, is it not?
>
> A. Yes.
>
> Q. Shotton gets 70 and you get 30 percent of the savings ----
>
> A. Of a defined benefit.
>
> Q. Are you saying that you could claim that at the moment but are choosing not to do so, or are you saying that it only kicks in when you have, as you hope, obtained a lower price on which you can deliver generally?
>
> A. We are saying that it only kicks in when we have a defined benefit when we can agree with Shotton what the starting point is. … Our experience over more than 15 years now is that trying to put those sort of incremental gains into a benefit sharing exercise is incredibly difficult and usually leads to bad feeling and therefore in practice if we are going to have a share of benefits we define specific projects, where we can have a start

[8] Hearing in Case 1046 on 31 May 2006, p. 24.

point, we can have an end point, we can have a defined gain and there is no dispute about Albion's contribution.

Q. Have you had any of those at the moment?

A. Right at the outset – I cannot remember whether it was in Dŵr Cymru or the Authority's skeleton, they pointed out the fact that the original retail price was 27.8p and the determination of the Authority (Director as he was then) was that it should have been 26p. What happened at that point was that Dŵr Cymru immediately reduced their retail price to 26p. That resulted in the defined benefit. That was well before the inset appointment was made and the resultant benefit was shared on a 50:50 basis at that stage over a period of 12 months, and I think from memory resulted in revenues to Albion of some £50,000.'[9] (emphasis added)

154. That answer was not challenged by Mr Vajda. Dr Bryan's evidence was, therefore, that:

(a) the benefit sharing arrangement was not simply a matter of splitting the savings that Albion made by moving from a bulk supply arrangement to a common carriage arrangement with Dŵr Cymru but was also meant to cover other savings that Shotton Paper enjoyed as a result of Albion's inset appointment;

(b) these savings would include efficiencies achieved at the plant as a result of Albion and Shotton Paper working together to reduce the amount of water used per tonne of paper or to prevent wasteful machine stoppages, where the parties agreed that there was a defined benefit that had been achieved through the partnership with Albion;

(c) there had been substantial increases in efficiency as a result of the partnership at the mill but Albion knew from experience that it was counter-productive (so far as maintaining good customer relations was concerned) to claim a share of such savings; but

(d) the occasion when there *had* been a transfer of value to Albion as a result of a benefit share had been before the 1999 Agreement came into operation when Dŵr Cymru's price was reduced as a result of the threat of competition from Albion. This *reduction in the Dŵr Cymru price* was treated by both Albion and Shotton Paper as a defined benefit, attributable to Albion, and justifying a share of the savings being transferred to Albion, albeit in different proportions from those later agreed in clause 7.4.

[9] Hearing in Case 1046 on 31 May 2006, pp. 28 and 29.

155. This is consistent with the evidence of Dr Bryan in the current proceedings where there was the following exchange:

> 'Q. Under your calculations, the vast majority of the benefit that you have ascribed to the pot that you then share, as we saw from the calculations that I carried out, comes from an increase in Dŵr Cymru's retail price, not from a decrease in your buying price, and therefore the price that you could sell on to Shotton?
>
> A. The two factors work together. What we are talking about is: how do we achieve a net gain in the current position? My understanding of competitive markets is that, you know, there are price makers, there are price takers, and there is no question that Dŵr Cymru was at all times the price maker. It is by no means unusual to see a calculation of benefit that reflects what the customer would otherwise be paying absent the entrant, and I don't see anything contradictory in this.'

156. There is nothing commercially surprising in Dr Bryan's evidence as to how clause 7.4 was intended to apply. For a water supplier to devote resources to working with the customer to *reduce* the amount of water sold would not make sense unless part of the customer's savings were shared with the supplier. We would, therefore, expect clause 7.4 to operate to provide that Albion has a share of the savings Shotton Paper makes by buying less water.

157. It is also not surprising that the Dŵr Cymru price was treated as a benchmark so that savings made by Shotton Paper as a result of the inset appointment could be treated as a defined benefit and shared. Albion's *raison d'être* was not only to enhance the services provided to Shotton Paper by its technical and consultancy input but also to provide customers, for the first time, with an alternative source of water to the former monopoly provider. The value to the customer of having an inset appointee is manifested in, amongst other things, the difference in the price that it would have had to pay the monopoly provider absent any competition and the price it pays as a result of the actual or potential competition introduced to the market by the new entrant.

158. Dŵr Cymru argues that this is not the right interpretation of clause 7.4. It argues that such an interpretation means that Albion could increase its water price to Shotton Paper as a result of increases in the Dŵr Cymru retail price, even if no common carriage agreement had ever been entered into and without any water efficiencies or savings having been achieved. We accept that the clause would be difficult to apply in a situation where, after signing the agreement, Albion had abandoned any effort to improve the operation of the paper mill and had simply sat back, increasing its water price to Shotton Paper year-on-year

as the Dŵr Cymru large industrial tariff ('LIT') for intensive users of non-potable water climbed. That is not a situation that could have been in the contemplation of the parties and it is certainly not a situation that has arisen. Such an approach would have been commercially disastrous for Albion, which wanted to use the Shotton Paper arrangement as a spring board for other inset appointments. Albion's origins lay in the ELL company, which was a consultancy business rather than a water provider. It is implausible to suppose that the parties thought clause 7.4 would continue to operate if Albion ceased to provide any such services once the agreement was in operation. The relationship between them would have soured very rapidly if Albion had adopted such a stance and Albion could not have hoped to expand its business. Moreover, the remainder of clause 7, in particular clause 7.5 and 7.7, appears to impose precisely these sort of efficiency-promotion obligations on Albion such that simply sitting back would have been not only disastrous for Albion's working relationship with Shotton Paper, but may well have put Albion in breach of contract.

159. Despite the deficiencies in its drafting, therefore, we find that clause 7.4 was intended to operate in the way Dr Bryan contends. The hypothetical Dŵr Cymru price against which the benefit was to be gauged over the period relevant for the claim was as follows:[10]

Table 4.

Financial year	Dŵr Cymru price	
	Fixed charge in £/year	Volumetric charge in p/m^3
2000/1	-	25.78
2001/2	-	25.98
2002/3	-	26.01
2003/4	81,720	24.26
2004/5	83,955	25.38
2005/6	91,211	28.14

[10] Until 31 March 2003, the prices shown in the table are simply the *de facto* bulk supply prices that were available to Shotton Paper from Dŵr Cymru. With effect from 1 April 2003, however, Dŵr Cymru introduced a standard tariff for large non-potable users, a non-potable LIT, under which a customer was required to pay a fixed charge for the availability of supply and then a volumetric price for the water actually taken. The tariff was broken down into bands according to consumption; the higher a customer's consumption, the higher the fixed charge but the lower the volumetric price. The figures given in Table 4 are taken from the highest consumption band for customers using in excess of 1,000 Ml per annum.

Financial year	Dŵr Cymru price	
2006/7	94,269	29.24
2007/8	100,513	30.78
2008/9	105,519	33.25

ii. Could Albion have enforced the benefit share clause in the real world?

160. Dŵr Cymru points out that the operation of clause 7.4 of the Albion/Shotton Paper supply agreement is not, on its face, conditional on Albion entering into a common carriage agreement with Dŵr Cymru. On the contrary, as drafted, it appears to apply irrespective of how Albion arranges to get the water to Shotton Paper's premises. Dŵr Cymru says that in the real world there was in fact a gross benefit accruing for the purposes of clause 7.4 because the price which Shotton Paper was paying Albion for the water was below the Dŵr Cymru published retail price for large non-potable industrial users. Even in the real world, therefore, Dŵr Cymru argues there was a gross benefit arising from the fact that Albion had entered the supply chain and, under clause 7.4, that gross benefit fell to be split between Albion and Shotton Paper. Dŵr Cymru acknowledges that actually the Albion/Shotton Paper retail price was not adjusted to reflect this because, it says, Albion chose not to enforce its 'entitlement' to 30 per cent of this gross benefit from Shotton Paper. But that, Dŵr Cymru says, is irrelevant – Albion had a contractual entitlement to increase the Albion/Shotton Paper retail price to implement this benefit share and the value of this entitlement should be deducted from Albion's losses (if any) because it is not a loss that derives from Dŵr Cymru's abusive conduct.

161. Dŵr Cymru is correct in its submission that there is nothing in the wording of the Albion/Shotton Paper supply agreement which restricts the operation of clause 7.4 to the situation when Albion had progressed to a common carriage arrangement with Dŵr Cymru. However, Dŵr Cymru's submission on this point ignores the position of Albion and Shotton Paper in the real world. What in fact happened was that clause 7.4 never really came into operation because the prices paid by the parties over the relevant period were determined not by that clause but by the progress of the dispute between Albion and Dŵr Cymru, as well as by the interim relief orders made by the Tribunal in Case 1046. Dr

Bryan's evidence was that Albion simply never considered asserting a right under clause 7.4 given the circumstances of the dispute between it and Dŵr Cymru:

> 'Q. In the real world you didn't seek to rely upon this clause, did you, to extract benefits from Shotton Paper?
>
> A. During the period of the proceedings, no, we did not. They were in abeyance, in effect, because we were engaged in -- and it's not too fanciful -- a fight for our survival.
>
> …
>
> ... the only mechanism that we have for recovering that benefit as a licensed undertaker is through our tariff, and our tariff was in effect set by the Tribunal. Had we tried to vary it, well, the thought never crossed our mind because it would have -- ... we could never have stood up in front of the Tribunal and made a case for interim measures, and we would have ended up having to charge our customer a much higher price than the high price which we already thought was excessive. I don't think that we could ever have contemplated such a move.'

162. It is clear to us that the operation of clause 7.4 was effectively suspended during the course of the proceedings and that it has never in fact operated. This was attributable to the abuse committed by Dŵr Cymru, which necessitated the complaint to Ofwat and the subsequent appeal to this Tribunal. Since the time of the abuse, the parties operated on the basis that Shotton Paper would pay for the water the price that Albion was paying Dŵr Cymru under the Second Bulk Supply Agreement. Albion would, in turn, be kept in business by the interim relief provided by the Tribunal and the *ex gratia* payments from Shotton Paper. These were unusual arrangements that were put in place as a direct result of the abusive conduct.

163. We therefore reject Dŵr Cymru's submission that Albion's failure or inability to enforce clause 7.4 to increase the price paid by Shotton Paper during the course of Case 1046 to reflect the rises in the Dŵr Cymru non-potable LIT was not caused by the abuse.

E. The period for which loss should be recovered

164. The parties are not agreed as to either the start date or the end date of the period for which compensation is payable.

i. The start date

165. Albion's claim is for damages from the date the abusive First Access Price was offered to it by Dŵr Cymru, namely 2 March 2001. The counterfactual we have constructed

assumes that Dŵr Cymru offered a common carriage price of 14.4p/m^3 to Albion on 2 March 2001. Dŵr Cymru submits that, even had it done so, there were a great many issues unresolved at that date, including the question of indexation and the bulk supply agreement with United Utilities. This would have meant that common carriage could not have commenced for some time after 14.4p/m^3 had been accepted as the price. We agree that such matters would have led to some delay in the common carriage arrangements replacing the bulk supply agreement. The question is as to the length of that delay.

166. Dŵr Cymru's case, relying on Mr Edwards' evidence, is that the earliest that the common carriage arrangements could have been put in place was October 2001 and that a more realistic date is April 2002. That of course takes into account the supposed need for capacity augmentation of the Heronbridge pumping station, which we have rejected.

167. Dŵr Cymru also assumes that the negotiations with United Utilities would have been prolonged whereas we have found that in the counterfactual world, once the common carriage arrangements had been agreed in principle, United Utilities would have realised fairly rapidly that it had no real grounds for seeking an increase in price. Dr Bryan's evidence was that Albion already had in place the Second Bulk Supply Agreement with Dŵr Cymru and that this could have been used as the template for the agreement between Albion and United Utilities. He said that if he had had an acceptable access price from Dŵr Cymru, he would have been 'on the ... train up to Warrington and would have been negotiating with United Utilities within 24 hours.'

168. At a meeting between Albion and Dŵr Cymru held on 10 November 2000 there was a discussion about timescales. Albion's note of the meeting records Dŵr Cymru's Mr Holton as indicating that Albion's anticipated common carriage start date of 1 December was unlikely to be met. Dŵr Cymru's note of the meeting goes further and sets out the various steps still to be taken, stating that the parties should target common carriage commencement 'prior to end of December 2000', then some seven weeks away. At that time, however, Dŵr Cymru had not yet calculated the First Access Price and Mr Edwards' evidence was that, without an access price, seven weeks was not a realistic target. Implicit in that evidence, however, is the suggestion that, with an agreed access price, seven weeks was a realistic target. We agree that that is a reasonable estimate.

169. We find, therefore, that in the counterfactual world common carriage would have commenced approximately seven weeks after the offer of a common carriage price of 14.4p/m^3, an offer which we have already found Albion would have accepted. For the purposes of quantifying the compensatory damages to Albion in respect of Shotton Paper, we take Monday, 16 April 2001 as the start date for common carriage.

ii. The end date

170. Albion's pleaded claim for compensation extends to the date of the Unfair Pricing Judgment, 7 November 2008, being the date on which Dŵr Cymru wrote to Albion stating that, if Albion were to renew its request for common carriage, Dŵr Cymru would be prepared to provide that service for the updated equivalent of the 2000/01 price of 14.4p/m^3.

171. Dŵr Cymru argues, however, that the chain of causation was broken on 17 March 2004 and that Albion's claim cannot extend beyond that point. The event said to break the chain of causation was the 'offer' by Dŵr Cymru of the Second Access Price.

172. On 7 January 2004 Ofwat wrote to Dŵr Cymru requesting its access price for the 2003/04 charging year for the treatment and transport of non-potable water to Albion for onward supply to Shotton Paper. This request was prompted by the recognition that, despite Dŵr Cymru having introduced standard partially-treated and raw water tariffs for its customers (a non-potable LIT), the published common carriage access prices for the year 2002/03 still related to potable water only. Moreover, Dŵr Cymru had not published any access prices for the 2003/04 charging year.

173. On 16 January 2004, Dŵr Cymru replied noting its understanding that Ofwat's request related to Albion's complaint to Ofwat about the First Access Price and stating:

> 'As you are aware, Dŵr Cymru introduced new standard partially treated and raw water tariffs for large users in the 2003-04 charging year. This was following detailed discussions and correspondences between Dŵr Cymru and Ofwat regarding the development, framework and methodologies for the new tariffs. The agreed methodology of using Whole Company Average Costs together with the appropriate calculations was supplied to Ofwat as part of the approval process.
>
> Using the derived information from the new large user tariffs, an indicative 2003-04 access price, for the treatment and transport of non-potable water to Albion Water Limited could be:

- Non-Potable Treatment costs – 3.31p/m3
- Non-Potable Transport costs – 14.43p/m3

> Should a similar application be made [to that made in September 2000], the above prices would form the basis of the starting point for any new application and would not include any other administrative and associated costs. As specified, the methodology underpinning these prices has already been supplied to Ofwat.'

174. Ofwat provided a copy of Dŵr Cymru's letter to Albion on or around 17 March 2004 with a short covering letter. At paragraph 141(b) of its Defence, Dŵr Cymru argues that 'had (which is denied) the First Access Price caused it loss, the Claimant should have accepted the Second Access Price and thereby mitigated its loss in whole or in part, but it failed to do so'. This submission presupposes that the Second Access Price was 'offered' to Albion in a manner that was capable of being 'accepted', something that Albion disputes.

175. We consider that where a dominant undertaking offers an unlawfully abusive price, the loss caused by that price may continue until the dominant undertaking withdraws that price and offers a new price directly to the victim of the abuse. It is not sufficient to discuss alternative prices with a third party (such as a regulator), even if the undertaking expects that the third party will pass that price onto the victim or that the victim will find out about the discussions through some other, roundabout route. Dŵr Cymru did not offer a new price directly to Albion at any time before 7 November 2008. We therefore find that Dŵr Cymru did not offer the Second Access Price to Albion in such a manner that Albion's failure – if it can be termed that – to approach Dŵr Cymru in March 2004 could be said to break the chain of causation.

176. Moreover, the terms in which the Second Access Price was described in Dŵr Cymru's letter of 16 January 2004 to Ofwat indicate that the price could still be subject to significant modification if an applicant decided to apply for common carriage on that basis. The letter says that an 'indicative 2003/04 access price ... could be' 17.74p/m^3. Dŵr Cymru goes on to say, somewhat tautologically, that that price would 'form the basis of the starting point for any new application' for common carriage and that the price quoted did not include administrative and associated costs – suggesting that any price ultimately agreed was likely to be higher than 17.74p/m^3. One can contrast this with the terms in which the First Access Price was offered to Albion on 2 March 2001 in a direct letter accompanied with various schedules showing how the price had been derived.

177. We therefore find that, for the purpose of the computation of loss under this head, the effect of Dŵr Cymru's abuse lasted until 7 November 2008.

F. Other matters

i. The effect of the revision of clause 7.4 in the bulk supply agreement between Albion and Shotton Paper

178. Albion has always accepted that in the counterfactual world where Albion entered into a common carriage arrangement with Dŵr Cymru, any savings arising from that would be subject to the original benefit sharing arrangement in clause 7.4 of the agreement entered into between it and Shotton Paper in 1999. Thus all the calculations of quantum presented by Albion have included only 30 per cent of the relevant figure to reflect the fact that 70 per cent of the savings (subject to the deduction of the costs referred to in clause 7.4) would have been passed through to Shotton Paper.

179. We have described earlier the amendment that was made to the benefit sharing clause in the supply agreement between Albion and Shotton Paper on 24 October 2002 (see paragraph 33 above). A question has arisen as to what effect, if any, the revision of the benefit sharing arrangement should have on the Tribunal's computation of damages, given that pursuant to that revision, Albion may be required to pass on 30 per cent of any monies recovered from Dŵr Cymru. Albion argues that there is a risk that it will recover too little if its damages are also reduced in accordance with the original benefit share contained in clause 7.4. In essence, Albion would then get to keep only 70 per cent of 30 per cent rather than either 30 per cent (in accordance with the original agreement) or 70 per cent (in accordance with the revised agreement). Albion, therefore, invited the Tribunal to 'gross up' any damages awarded to it to ensure that the operation of the revised term does not disadvantage Albion in this way.

180. We recognise that there is an element of apparent unfairness in this. However, that is a consequence of the way that the revised term was drafted (in that it does not seem to take account of the fact that the Tribunal would need to apply the original 30:70 split) and of the fact that Shotton Paper has not joined with Albion in pursuing Dŵr Cymru in these proceedings. It would, moreover, be unjust to Dŵr Cymru to increase the amount of damages that it must pay to Albion (by grossing up) as a result of an agreement which Albion chose to enter into with Shotton Paper after the abuse had been committed.

Equally, however, if we were to disapply the original benefit sharing agreement between the parties, we would be awarding to Albion damages in respect of a loss that it has not in fact suffered since, in the counterfactual world where common carriage commenced on 16 April 2001, Albion would have been contractually required to pass on 70 per cent of the savings in the cost of supply to Shotton Paper.

181. Our conclusion on this point is therefore that we must have regard to the original version of clause 7.4 since that is what would have operated in the counterfactual world. How Albion and Shotton Paper decide in light of that to operate the supplementary October 2002 agreement is a matter for them and is not something that this Tribunal can resolve.

ii. Interim relief granted by the Tribunal

182. Albion expressly accepts that, in quantifying the damages to be awarded to it, credit must be given for the amounts paid to it by Dŵr Cymru by way of the interim relief between 1 July 2004 and 9 April 2009 pursuant to the various orders of the Tribunal, since this is, in fact, the margin that Albion has made over the period of the litigation. That is the case even though the period for which loss is claimed runs only to 7 November 2008.

iii. Treatment of the voluntary uplift paid by Shotton Paper

183. As we have said (see paragraph 34 above), Shotton Paper agreed to pay Albion a voluntary uplift to support it during the complaint to Ofwat, and the subsequent appeal to this Tribunal. Between October 2002 and July 2004, Shotton Paper paid Albion an extra 3p/m^3 on top of the price payable under the supply agreement between those parties. Between July 2004 and November 2006 that uplift was halved to an additional 1.5p/m^3 over and above the contract price.

184. It is Albion's case that no account should be taken of these payments when quantifying the damages because, although they are expressed as volumetric payments referable to the amount of water supplied by Albion to Shotton Paper, in reality they were not a price increase. Rather, it is said, the payments were a form of finance, in substance no difference from a bank loan, which Albion is liable to repay. As Dr Bryan put it in his written evidence, which we accept, Shotton Paper made these *ex gratia* payments 'to provide some margin and allow Albion to pursue the fight'. Dŵr Cymru argues that to the extent that Albion was caused any loss, the extent of that loss up to the amount of the voluntary uplifts

was passed on to Shotton Paper. As such, those amounts should be deducted from any damages that Albion is awarded.

185. We prefer Albion's submissions on this point. If Dŵr Cymru were correct, that would mean, in effect, that any claimant in a follow-on damages action that took a loan or some form of financing in order to fund the litigation might be deemed to have passed on its loss to the extent of such financing and would have its damages reduced to the extent of that financing whilst simultaneously remaining liable to repay the sums to the lender. It is true that Shotton Paper is a downstream customer of Albion but we see no reason why the mere identity of the lender should lead to a reduction in Albion's damages. As such, we do not take any account of the voluntary uplift paid by Shotton Paper when calculating Albion's damages.

G. Computation of loss arising from our findings

186. As regards the computation of the quantum of damages resulting from those findings, we asked the parties during the course of the hearing to prepare a model, agreed if possible, which could be used to calculate the final award. The parties were unable to reach agreement and so following the conclusion of the hearing each party supplied its own model. We found the Dŵr Cymru model rather more 'user-friendly' than the Albion model and that the variables incorporated corresponded more closely to our findings. We have therefore based our award on the figures derived from Dŵr Cymru's model. We set out here the entries we have made into that model to arrive at our calculation of the quantum payable by Dŵr Cymru to Albion in respect of the claim for compensatory damages in relation to Shotton Paper. Attached to this Judgment at Appendix 2 is a copy of the 'output page' from the quantum model showing the figures underlying our award.

187. The inputs used by the Tribunal for the Dŵr Cymru model to calculate the award of compensatory damages in respect of the Shotton Paper claim can be described as follows:

(a) a common carriage price of 14.4p/m^3, indexed according to PPI, producing figures for the relevant charging years (2001/02-2008/09) as set out in Table 1 above (following paragraph 86 above);

(b) Albion would purchase the water from United Utilities at the same price that Dŵr Cymru did over the relevant period under the Heronbridge Agreement (see the figures set out in Table 2 above, following paragraph **Error! Reference source not found.**), meaning that no inflation indexation was appropriate;

(c) the period for which Albion was entitled to claim damages in respect of Shotton Paper was from 16 April 2001 (the deemed date of common carriage commencement in the counterfactual) to 7 November 2008 (the date of the Unfair Pricing Judgment and the date on which Dŵr Cymru offered the common carriage price of 14.4p/m^3 to Albion);

(d) since Dŵr Cymru's model does not permit the user to select a particular commencement date in April 2001, we took the net quantum for the 2001/02 year (£328,732) and divided it by 365 to produce a *per diem* rate of £900.64; we then subtracted 15 days' worth of that rate (£13,509.53) from the net 2001/02 figure to allow for the period of 1-15 April 2001 for which we do not consider Albion should recover damages;

(e) there was no need for capacity augmentation, a payment to Dŵr Cymru to relinquish its rights under the Heronbridge Agreement or for a new connection charge and we have not decided whether the Heronbridge Agreement would have been renegotiated;

(f) the appropriate price against which to benchmark the benefit sharing clause of the Albion-Shotton Paper supply agreement was the Dŵr Cymru retail tariff and the relevant figures are set out in Table 4 above (following paragraph 159 above).

(g) we regard the whole of that lost benefit share as caused by the abuse since Albion was not able to enforce the benefit share during the course of Case 1046;

(h) there would not have been any benefit share between United Utilities and Albion in respect of the supply to Shotton Paper;

(i) no account is taken of the voluntary uplift, or *ex gratia*, payments by Shotton Paper to Albion;

(j) there is to be no grossing up of Albion's damages to take account of the variation to the benefit sharing agreement between Albion and Shotton Paper in October 2002; and

(k) finally, we did not make any deductions from the damages in respect of the costs of reserving a back-up potable supply to Shotton Paper.

188. Using the variables set out in the previous paragraph as the inputs to the Dŵr Cymru quantum model provided to the Tribunal, the amount of damages payable by Dŵr Cymru to Albion in respect of the Shotton Paper claim is **£1,694,343.50.**

189. The Tribunal considers it appropriate to award interest on this sum and we set out the periods and rate of interest in paragraphs 225 to 228 below.

IV. THE COMPENSATION CLAIM FOR THE SUPPLY TO CORUS SHOTTON

190. Albion's second head of claim is the loss of the opportunity that it would have had in the counterfactual world to bid for the contract to supply water to Corus Shotton. The steel works operated at Shotton were, as we have said, supplied with non-potable water by Dŵr Cymru via the Ashgrove system, although Corus Shotton's demand was much lower than Shotton Paper's (in the region of 6Ml/d, compared with Shotton Paper's demand of roughly 22Ml/d). Albion says that if it had established itself as the supplier of water to Shotton Paper, it would have been able to respond to an invitation to tender from Corus in 2003. Albion submits that Dŵr Cymru's abusive conduct effectively deprived Albion of that opportunity. The loss claimed by Albion under this heading is for the period 1 April 2004 (when the supply would have begun had Albion secured the contract) to 7 November 2008 (the same end date as for the Shotton Paper claim, when the 14.4p/m^3 price was offered). Dŵr Cymru's defence is, first, that the First Access Price had nothing to do with Albion's decision not to tender for the Corus business and, secondly, that, in any event, there was no real prospect of Albion winning the contract to supply Corus Shotton.

191. Both parties accepted that the Tribunal should approach this head of claim as an assessment of the loss of a chance, following the case of *Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602, which was referred to in the Tribunal's

judgment in *Enron Coal* (see, in particular, paragraphs 81 to 83 of the *Enron Coal* judgment). That case emphasises the need to draw a careful distinction between questions of causation and of quantification. In the leading judgment, Stuart-Smith LJ (with whom Hobhouse LJ agreed; Millett LJ also agreed with his analysis of the law but dissented on the outcome) said:

> '… where the plaintiffs' loss depends upon the actions of an independent third party, it is necessary to consider as a matter of law what it is necessary to establish as a matter of causation, and where causation ends and quantification of damage begins.
>
> (1) What has to be proved to establish a causal link between the negligence of the defendants and the loss sustained by the plaintiffs depends in the first instance on whether the negligence consists in some positive act or misfeasance, or an omission or non-feasance. In the former case, the question of causation is one of historical fact. ... Once established on the balance of probability, that fact is taken as true and the plaintiff recovers his damage in full. There is no discount because the judge considers that the balance is only just tipped in favour of the plaintiff; and the plaintiff gets nothing if he fails to establish that it is more likely than not that the accident resulted in the injury.
>
> Questions of quantification of the plaintiff's loss, however, may depend upon future uncertain events. ... It is trite law that these questions are not decided on a balance of probability, but rather on the court's assessment, often expressed in percentage terms, of the risk eventuating or the prospect of promotion, which, it should be noted, depends in part at least on the hypothetical acts of a third party, namely the plaintiff's employer.
>
> …
>
> (3) In many cases the plaintiff's loss depends on the hypothetical action of a third party, either in addition to action by the plaintiff, as in this case, or independently of it. In such a case does the plaintiff have to prove on the balance of probability, as Mr Jackson submits, that the third party would have acted so as to confer the benefit or avoid the risk to the plaintiff, or can the plaintiff succeed provided he shows that he had a substantial chance rather than a speculative one, the evaluation of the substantial chance being a question of quantification of damages?
>
> Although there is not a great deal of authority, and none in the Court of Appeal, relating to solicitors failing to give advice which is directly in point, I have no doubt that Mr Jackson's submission is wrong and the second alternative is correct.'[11]

192. Applying this approach, we must determine the following matters. First, did Dŵr Cymru's act of offering an abusive First Access Price prevent Albion from bidding for the Corus contract? Secondly, if, but for the abusive First Access Price, Albion could have bid for that contract, did it have a substantial, as opposed to merely speculative, chance of winning the tender? Both of these questions go to causation. Finally, assuming Albion surmounts both of those hurdles and we find that it did have a substantial chance of

[11] At 1609H-1611C.

winning the tender, we must evaluate that substantial chance as a question of quantification. The quantum is then the relevant percentage of the total profit that would have been made if Albion had indeed won the business.

A. Did Dŵr Cymru's act of offering an abusive First Access Price prevent Albion from bidding for the Corus contract?

193. It was in fact Corus that approached Albion in July 2003 stating that it wished to switch supply. Dr Bryan met representatives from Corus on 10 July 2003. The following day Corus wrote to Albion saying that it was 'very unhappy with the current situation in the water supply industry and the lack of any real competition in the established regions'. Corus asked Albion to confirm whether it was able to bid for the supply of water to three of Corus' plants, located at Llanwern, Trostre and Shotton[12] with a view to supply starting when the existing agreements expired in Spring 2004.

194. The reason Corus was seeking to switch suppliers was that Dŵr Cymru had informed it that there was about to be a substantial increase in the charge for water. Dŵr Cymru was to move Corus onto its newly-introduced non-potable LIT, which came into effect on 1 April 2003. Since then, Dŵr Cymru has been invoicing Corus Shotton on the basis of the non-potable LIT but Corus, which objects to this price as being too high, has continued to pay in accordance with its previous agreement. There is ongoing litigation between Dŵr Cymru and Corus about this.

195. The table below sets out the prices Corus in fact paid for the non-potable water supplied to its Shotton plant and the relevant prices under the Non-Potable LIT. The figures stated for the 2004/05 and 2005/06 charging years are taken from the top consumption bracket of the Dŵr Cymru Non-Potable LIT (>1000Ml per annum), while those for the subsequent three charging years are from the next consumption bracket down (500-1000Ml per annum).

[12] Corus Shotton is, as we have said, the second site, in addition to Shotton Paper, served by the Ashgrove system and the plants at Llanwern and Trostre are also both supplied by Dŵr Cymru, albeit by different systems.

Table 5.

Financial year	Price paid by Corus Shotton in p/m^3	Dŵr Cymru Non-Potable LIT	
		Fixed charge in £/year	Volumetric charge in p/m^3
2004/5	22.79	83,955	25.38
2005/6	23.43	91,211	28.14
2006/7	23.95	66,681	32.00
2007/8	24.50	70,909	33.74
2008/9	25.60	77,570	36.04

196. Why then did Albion not pursue this potentially lucrative opportunity? It was Dr Bryan's evidence that there were two reasons, one specific and one general, but that both arose as a direct result of Dŵr Cymru's breach of the Chapter II prohibition.

197. The specific reason was that, at the time that Corus made its approach, Albion was going through a turbulent time due to the withdrawal of support by Pennon. As we mentioned earlier (see paragraph 7 above), Albion underwent a corporate reorganisation in 2003/2004. At ELL's May 2002 Board meeting, Pennon announced that it would no longer be providing funding to ELL. On 10 December 2002, Pennon indicated that it would exercise its option to acquire all the shares in ELL, with the intention of withdrawing that company from the competitive market. As noted briefly above, Dr Bryan founded a new company called Waterlevel Limited to continue service to Shotton Paper and to negotiate the transfer to it of Albion. It was agreed on 2 July 2003 that Albion would be transferred entirely to Waterlevel Limited.

198. It was Dr Bryan's evidence that Pennon informed him that this was because Pennon was concerned that the then likely appeal to the Tribunal against Ofwat's pending Decision might harm the outcome of an ongoing price review for Pennon's major subsidiary, South West Water. Pennon viewed the possibility of '[u]psetting Ofwat' as simply too risky. Pennon therefore exercised its option to acquire the outstanding 50 per cent of the shares in Albion's parent, ELL, which necessitated a full corporate re-organisation of Albion. This, in turn, necessitated the involvement of Ofwat to ensure that Albion could continue as an independent licensed undertaking. On 18 July 2003 Pennon wrote to Ofwat stressing the need to conclude this process quickly. At 30 October 2003, however, the process was still

ongoing as Dr Bryan's letter of that date shows. In that letter Dr Bryan stated that he was writing because he was concerned that the process was taking far too long. He continued:

> 'This is no criticism of Ofwat, which I believe has responded promptly. However the delay is damaging the interests of Albion Water and those who wish it to continue its pioneering work in the competitive water market. I attach a letter from Corus, which confirms this demand. Our ability to pursue these as inset appointments has been delayed by over 3 months while we strive to conclude the change of ownership of Albion Water ...'

199. The transfer of Albion was completed on 19 February 2004.

200. Dŵr Cymru accepts this series of events but takes issue with Dr Bryan's evidence as to the reason for Pennon's withdrawal of support for Albion. Dŵr Cymru noted that there was no evidence from Pennon as to its reasons for withdrawing its support for Albion and that the contemporaneous records from the time do not refer to this. Dŵr Cymru further submits that, even if Dr Bryan's evidence was accurate, the independent actions and commercial choices of Pennon cannot be attributed to the abusive level of the First Access Price.

201. We accept Dr Bryan's evidence on this point, however. We have seen no other explanation for Pennon's apparently quite sudden decision to withdraw its support for Albion. We do not find it surprising that neither Pennon's nor Dr Bryan's letters record that Pennon did not want to upset Ofwat. On that basis, we find that Pennon's decision was attributable to Dŵr Cymru's abuse, which necessitated the complaint to Ofwat and then the appeal to this Tribunal.

202. The general reason why Albion could not bid to supply Corus was that, according to Dr Bryan, it had to focus all its very limited resources on the Ofwat investigation into the abusive First Access Price and the subsequent Tribunal proceedings in Case 1046. Albion has always been a small company run by Dr Bryan and a few colleagues. We accept his evidence that Albion simply did not have the resources to devote to pursuing new business opportunities because of the drain imposed by the battle with Dŵr Cymru. Although the financial resources needed to bid for that contract would not have been large, we note that at this time Albion was making zero margin under Second Bulk Supply Agreement with Dŵr Cymru and having to concentrate on the proceedings before Ofwat.

203. On the balance of probabilities, we find that, but for Dŵr Cymru's abusive conduct in offering an unlawful First Access Price, Albion would have been in a position to tender for the Corus Shotton contract.

204. In addition to finding that Dŵr Cymru's abusive conduct was in fact the primary cause of Albion's inability to bid for and win the Corus Shotton business, we have also considered whether it can be said that it was reasonably foreseeable that Dŵr Cymru's conduct would cause this kind of loss. In our judgment, it was entirely foreseeable that, by offering an abusive access price and thereby preventing Albion from pursuing its business under a common carriage arrangement, Albion would be hampered in the development of its business. Indeed, as we discuss in relation to the claim for exemplary damages below, Dŵr Cymru was well aware that the proposed price made Albion's application for common carriage uneconomic. Dŵr Cymru may not have been able to foresee the precise turn of events that led to this kind of loss arising but that is not material for the purpose of finding this kind of loss was foreseeable.

B. Did Albion have a substantial, as opposed to merely speculative, chance of winning the bid for Corus' business?

205. Albion's claim for damages is limited to damages for the loss of the opportunity to supply Corus' plant at Shotton. It does not seek damages in respect of the other plants at Llanwern and Trostre. Dŵr Cymru submits that this shows that Albion was not in contention to supply Corus, since Corus' letter of 11 July 2003 invited Albion to confirm, not that it would tender for Corus Shotton, but that it was:

> 'able to bid for the supply of water to three of our [Corus'] larger plants situated in Wales. Namely, Llanwern, Trostre and Shotton.
>
> The existing agreement for supply of water to these plants expires in the spring of 2004. If you are able to confirm your position with respect to these plants we will take the necessary steps to open formal discussion and negotiation.' (emphasis added)

We observe first that Albion does not in fact state that it would only have bid for the Shotton plant. On the contrary, it was Dr Bryan's evidence that he considered that Albion would have had a strong case for negotiating bulk supply terms to the other two Corus plants at Llanwern and Trostre as well. In light of the greater uncertainties in relation to those two plants, however, Albion has limited its claim for damages in these proceedings to the Corus plant at Shotton, which is served by the same system as Shotton Paper.

206. In any event, we do not read Corus' letter as indicating that it would only have been interested in moving its business to Albion if the latter could supply all three plants. The letter certainly invites a tender for all three plants but it does not state no approaches could be made regarding a single plant. Nor do we see any commercial reason why Corus would so limit the invitation. As Corus indicated both in that letter and in another letter of the same date to Dŵr Cymru, it was dissatisfied with its arrangements with Dŵr Cymru and was actively seeking alternatives. On that basis, even if Albion (Dŵr Cymru's only competitor) had been in a position to bid for a contract to supply Corus' plant at Shotton alone, if that would have resulted in cost savings, Corus was unlikely to have rejected that possibility.

207. Corus' letters also suggest that, like Shotton Paper, it saw advantages to sponsoring market entry. We were told that Corus Shotton and Dŵr Cymru have been locked in litigation for a number of years over the price of water at all three plants, with Corus Shotton refusing to move to the non-potable LIT and declining to pay more than it would have paid for water under the old bulk supply agreement which Dŵr Cymru has purported to terminate. We can see plenty of incentives on Corus' part to avoid the uncertainty and expense that such protracted litigation creates, at least so far as supply at the Shotton plant was concerned.

208. It is true, as Dŵr Cymru pointed out, that Albion has not pursued the opportunity at Corus Shotton since the conclusion of Case 1046 before the Tribunal in 2008. As we noted at paragraph 79 above, however, there have now been more than ten years of acrimonious dispute between Albion and the two companies it would need to contract with in order to supply Corus Shotton, namely Dŵr Cymru and United Utilities. We are, therefore, reluctant to draw inferences from how those companies have behaved in the real world, as to how they would have behaved in a counterfactual world where those disputes had not arisen.

209. It was also Dŵr Cymru's case that, in relation to any common carriage arrangements commencing on or after 1 April 2004, Albion would have required a special exemption from sections 66I and 66J of the Water Industry Act in order to continue with common carriage after 1 December 2005, when those sections entered into force. Applications for exemption could be made under section 66K of the Water Industry Act. We have seen

evidence that the Welsh Assembly Government wrote to Albion on 19 March 2007 indicating that, if an agreement relating to common carriage to Shotton Paper were finalised, the relevant officials would be minded to recommend to the Welsh Ministers that Albion be granted the necessary exemptions.[13] Dŵr Cymru points out, however, that that letter was quite clearly limited to Shotton Paper since it notes that 'Albion Water has been seeking this arrangement since as early as 2000 with any progress having been stalled by pending litigation before the Competition Appeal Tribunal.' That consideration does not, in Dŵr Cymru's submission, apply to Corus. Albion argued, however, that, if the Welsh Assembly Government was, at least in principle, willing to grant an exemption in respect of Shotton Paper, there was no reason to suppose that it would not be similarly willing to grant an exemption for Corus Shotton.

210. We consider that Albion's submission has considerable force. Had common carriage through the Ashgrove system to Shotton Paper commenced in 2001, that would have been a factor the Welsh Ministers would have taken into account in considering whether to grant Albion an exemption for Corus Shotton under section 66K of the Water Industry Act. In this respect, we note that the letter of 19 March 2007 states also that 'due to the specificity of any future common carriage arrangement in relation to supplies at Shotton, both Defra and the Welsh Assembly Government thought it would be best to consider any possible derogation from the prohibitions in the [Water Industry] Act under the provisions for exemptions in section 66K of that Act.' As we note at paragraph 216 below, we have assumed that Albion would have proposed common carriage for Corus Shotton on broadly the same terms as those we found to be applicable to Shotton Paper. In addition, the Ashgrove system serves only two customers: Shotton Paper and Corus Shotton. Were the former already being supplied on the basis of common carriage, it would be a strange decision to refuse an exemption for supply on almost identical terms to the only other customer served by the system, a customer that also took far less water than Shotton Paper. We find on the balance of probabilities that, if Albion had required an exemption from sections 66I and 66J of the Water Industry Act to supply Corus Shotton, this would have been granted.

[13] The Tribunal notes that, in the counterfactual world, the common carriage arrangement in relation to Shotton Paper would have been concluded before the requirement for an exemption came into force.

211. Dŵr Cymru also argued that Albion would not have been able to beat the price at which Corus Shotton was being supplied. As we have said, Corus and Dŵr Cymru are in dispute about the price for the water with litigation concerning the price paid by Corus at its Llanwern plant. The revenues that Dŵr Cymru has in fact received from Corus Shotton and the prices that Dŵr Cymru has been billing over the relevant period, namely those under its non-potable LIT, are set out in the Table 5 following paragraph 195 above. According to Dŵr Cymru, the price that Albion would have had to beat was that actually being paid for the supply of non-potable water to the Shotton plant, since Corus does not believe that an increase in that price was, or indeed is, justified and so it would have been reluctant to switch to a supplier that could not undercut the price being paid to Dŵr Cymru. Albion's case, however, was that the price it had to beat was the price being billed to, though not paid by, Corus, which was based on the non-potable LIT. The prices on which Albion has based its calculation of the damages arising from the loss of the Corus contract would be lower than the Dŵr Cymru tariff charges but higher than the prices in fact being paid by Corus.

212. There is a complication here in that the Corus Shotton site has on it certain 'lagoons' owned by Corus which Dŵr Cymru uses to store temporarily the water pumped through the Ashgrove system in order to balance that system. According to a letter sent by Dŵr Cymru to Ofwat in the context of the Referred Work, Dŵr Cymru considered that:

> 'the full cost of using the lagoons should be attributed to Shotton Paper because of two unusual demand characteristics. First, because of the nature of their processes, their volumetric demand can drop dramatically at any time. Second, unlike the majority of other large potable and non-potable customers they do not have significant on-site storage that could act as the buffer between their processes and the water supply system'.

213. Ofwat agreed with this in the Referred Work. On that basis, Dŵr Cymru gives Corus a discount of 4p/m^3, which it would then recover from the supply to Shotton Paper as part of the common carriage price paid by Albion. Expressed as a volumetric price by reference to the (much larger) volumes of water supplied to Shotton Paper in the 2000/01 charging year, according to Ofwat this added 1.3p/m^3 to the cost of that water.[14] This cost was included in the Referred Work computation of the AAC+ methodology and the LAC methodology, and

[14] See paragraph 9.47 of the Referred Work. In the Unfair Pricing Judgment the Tribunal was content to include a sum for the lagoons in the common carriage price, however it indicated that the sums found by Ofwat (see table at paragraph 49 of Unfair Pricing Judgment) may have been overstated (see paragraph 189 of the Unfair Pricing Judgment).

was not changed in the figures which the Tribunal used in the Unfair Pricing Judgment: see paragraph 195 of that Judgment. This means that the costs of the using the Corus Shotton lagoons is incorporated in the 14.4 p/m^3 price that we have used in the counterfactual for the common carriage price through the Ashgrove system for the supply to Shotton Paper.

214. In our judgment, Corus and Albion would have been able to negotiate a price for the water that was attractive for both of them. We bear in mind the following factors:

(a) a considerable benefit to Corus Shotton in switching to Albion would be the avoidance of the need to litigate with Dŵr Cymru and to incur the costs, and be subject to, the uncertainties that such litigation creates;

(b) Corus would be aware that a contract with Albion was not simply about the price for the supply of the water but about benefiting from the technical consultancy services that, as we have explained, led to a significant reduction of water usage for Shotton Paper: see paragraphs 151 and 152 above; and

(c) Corus' letter of 11 July 2003 shows it was keen to sponsor entry so as not to be entirely dependent on Dŵr Cymru – we have seen that Shotton Paper thought this benefit was sufficient for it to support Albion financially even though there was a risk that it would end up paying more for water than the price of 26p/m^3 on offer from Dŵr Cymru.

215. We therefore find that there was a substantial chance that, but for Dŵr Cymru's abusive behaviour, Albion would have responded enthusiastically to Corus' approach and entered into a bulk supply agreement with it, using common carriage through the Ashgrove system and buying the water from United Utilities under terms similar to those in the Heronbridge Agreement.

216. We have assumed that the terms that Albion would have offered to Corus Shotton would have been the same as those for Shotton Paper, including as to the benefit sharing provision found in clause 7.4 of the Albion-Shotton Paper supply agreement, so that the totality of the loss would be effectively the same, albeit over a shorter period and over lower volumes of water.

217. Of course, in relation to Corus, we do not need to consider the effect of interim relief granted by the Tribunal.

C. How is Albion's substantial chance to be quantified?

218. We then come to the final question under this head of claim: the question of what percentage chance we consider Albion had of winning the Corus Shotton business on the basis of the foregoing. As Stuart-Smith LJ said in *Allied Maples* at 1614D:

> '[T]he plaintiff must prove as a matter of causation that he has a real or substantial chance as opposed to a speculative one. If he succeeds in doing so, the evaluation of the chance is part of the assessment of the quantum of damage, the range lying somewhere between something that just qualifies as real or substantial on the one hand and near certainty on the other.'

219. Unless we are of the view that it was a 'near certainty', to adopt Stuart-Smith LJ's phrase, that Corus would have agreed a supply agreement with Albion on the terms outlined above, we must make some discount to the damages to reflect our uncertainty. This approach is also reflected in the judgment of Neuberger LJ, as he then was, in *Maden v Clifford Coppock & Carter (a firm)* [2004] EWCA Civ 1037, where he said that 'unless the judge was certain, or very close to certain, that ... [the third party would have settled a claim on the terms proposed], he should have discounted the award of damages to take into account the uncertainty'.[15]

220. Given Corus Shotton's apparent level of dissatisfaction with Dŵr Cymru, we consider it would have been highly likely that Corus would have awarded a contract to supply its Shotton plant to Albion. This cannot be put as high as being a certainty or a near certainty. We have borne in mind that no formal negotiations were ever opened between Corus and Albion. We do not know how Corus would have viewed the terms outlined above, namely those that we found would have been applicable to Shotton Paper, and we do not know whether Dŵr Cymru would have made Corus some counter-offer in an attempt to keep its customer (although in the light of what we know about the litigation between them this seems unlikely). We consider it appropriate to reduce Albion's damages for its lost opportunity by one third or 33 per cent.

---

[15] The *Maden* case was not cited to us but we consider that this brief statement from Neuberger LJ assists in applying this stage of the test set out in *Allied Maples*.

221. As with the award in respect of Shotton Paper, and for the same reasons (see paragraph 186 above), we have calculated the award for the loss of opportunity in respect of Corus Shotton using the quantum model provided to the Tribunal by Dŵr Cymru. As with the Shotton Paper award, Appendix 2 has the 'output page' from the model in respect of the Corus Shotton claim.

222. As we have said, the inputs to the Corus Shotton calculation will be broadly the same as for the Shotton Paper claim:

(a) A common carriage price of 14.4p/m^3, indexed according to PPI, producing figures for the relevant years (2004/05-2008/09) as set out in Table 1 above (following paragraph 86);

(b) Albion would purchase the water from United Utilities at the same price that Dŵr Cymru did over the relevant period under the Heronbridge Agreement, meaning that, as with Shotton Paper, no indexation was appropriate and that the price expressed in p/m^3 for the water acquired for supply to Corus would have been:

Table 6.

Financial year	**Average price for all Heronbridge water p/m^3**	**Average price for Heronbridge water supplied to Corus Shotton p/m^3**
2004/5	3.86	4.07
2005/6	4.26	4.49
2006/7	4.63	4.91
2007/8	5.12	5.40
2008/9	5.87	6.03

(c) The period for which Albion was entitled to claim damages in respect of Corus Shotton was 1 April 2004 to 7 November 2008; and

(d) The price for Albion to beat (which on our findings it would have been able to beat) in order to secure the opportunity to supply Corus Shotton was the Dŵr Cymru Non-Potable LIT, the figures for which are set out at Table 5 above (following paragraph 159).

223. That gives rise to a total award of £242,651. For the reasons set out in paragraph 220 above, that award must be reduced by 33 per cent, giving rise to a total figure for the Corus Shotton claim of **£160,149.66.**

224. As with the award to Shotton Paper, the Tribunal considers it appropriate to award interest on this sum and we turn now to address this matter.

V. INTEREST ON THE SUMS AWARDED

225. Albion seeks an award of interest in respect of those sums awarded to it pursuant to Rule 56(2) of the Tribunal's Rules. It seeks either simple interest at 8 per cent per annum, being the rate prescribed by Order made by the Lord Chancellor under Section 44 of the Administration of Judgments Act 1970[16] or compound interest at 1 per cent above LIBOR. Albion claims interest from the date of the infringement of the 1998 Act until the date of this judgment. Dŵr Cymru accepts that Albion is entitled to interest on any sums awarded to it under these heads but argues that the appropriate rate is simple interest at 1 per cent over the Bank of England base rate. Dŵr Cymru submits that this is the rate commonly applied in commercial litigation and is wholly sufficient. In the event that the Tribunal is minded to order interest at a higher rate, then Dŵr Cymru submits that we should follow the approach of the Tribunal in *2 Travel*, which awarded interest at 2 per cent over the base rate (see paragraph 415 of that judgment).

226. We do not consider that this is a case where it is appropriate to award compound interest. We will adopt the approach of the Tribunal in *2 Travel* and award simple interest at the rate of 2 per cent per annum over the base rate for the relevant period.

---

[16] See Judgment Debts (Rate of Interest) Order 1993, SI 1993/564, amending section 17 of the Judgments Act 1838, pursuant to section 44 of the Administration of Judgments Act 1970 with effect from 1 April 1993.

227. As to what that relevant period is, the loss was not suffered on one day but over the period when Albion would have earned the increased revenues from supplying Shotton Paper pursuant to common carriage arrangements. Interest should, therefore, run from the mid-point of the period for which damages are awarded, namely from 26 January 2005 until the date of payment. In respect of the sum awarded for the Corus Shotton claim, it should also run from the mid-point of the period for which damages are being awarded, namely 20 July 2006 and at the rate of 2 per cent above the base rate per annum until the date of payment.

228. We leave the precise calculation of the amount of interest due on both principal amounts to the parties on this basis.

VI. THE EXEMPLARY DAMAGES CLAIM

229. The authorities on exemplary damages and their application in the case of a breach of the Chapter II prohibition are matters that have recently been considered by this Tribunal in *2 Travel*: see paragraph 448 onwards of that judgment. In this case the claim is limited to the second category for which the law permits an award of exemplary damages as described by Lord Devlin in *Rookes v Barnard* [1964] 1 AC 1129, 1226 and 1227, that is:

> 'Cases in the second category are those in which the defendant's conduct has been calculated by him to make a profit for himself which may well exceed the compensation payable to the plaintiff. … Where a defendant with a cynical disregard for the plaintiff's rights has calculated that the money to be made out of his wrongdoing will probably exceed the damages at risk, it is necessary for the law to show that it cannot be broken with impunity. This category is not confined to moneymaking in the strict sense. … Exemplary damages can properly be awarded whenever it is necessary to teach a wrongdoer that tort does not pay.'

230. Subsequent cases have discussed the different elements required. We will consider here the first element, namely the 'cynical disregard' for the claimant's rights and later consider the second element, namely the calculation of likely profit against the risk of having to pay damages.

A. The first limb of *Rookes v Barnard*: cynical disregard

231. As regards the requirement for 'cynical disregard' referred to by Lord Devlin, this was described by Lord Diplock in *Broome v Cassell & Co Ltd* [1972] AC 1027, at 1130, as being satisfied where:

> 'the defendant, at the time he committed the tortious act, knew that it was unlawful or, suspecting it be unlawful deliberately refrained from taking obvious steps which, if taken, would have turned suspicion into certainty.'

Lord Hailsham in the same case (at page 1077) described the necessary mental state as 'knowledge that what is proposed to be done is against the law or a reckless disregard of whether what is proposed to be done is illegal or legal'.

232. In *Kuddus v Chief Constable of Leicestershire Constabulary* [2002] AC 122 Lord Nicholls expressed the test in the following terms (at paragraph 63):

> 'On occasion conscious wrongdoing by a defendant is so outrageous, his disregard of the plaintiff's rights so contumelious, that something more [than compensatory damages] is needed to show that the law will not tolerate such behaviour.'

233. The Tribunal in *2 Travel* emphasised that, outside the context of egregious cartels, it will often be difficult in the competition law sphere to distinguish between conduct which is sufficiently outrageous to fall within Lord Devlin's second category and conduct which, though *ex hypothesi* amounting to an abuse of a dominant position, does not indicate that the company has taken an 'unacceptable' risk that its conduct would turn out to be unlawful (see paragraphs 480 to 483 of the *2 Travel* judgment). The Tribunal concluded that it was only where an undertaking is aware that its proposed conduct 'is either probably unlawful or clearly unlawful that a risk can be classed as "unacceptable".' Whether a risk is in fact unacceptable will depend on various factors including the undertaking's motive and the degree and seriousness of any anti-competitive effects.

234. The risk that Dŵr Cymru took here was that it would be found to be in a dominant position and that the First Access Price would constitute an abuse of that dominant position. We have to consider whether Dŵr Cymru either knew that the First Access Price was abusive or that it offered that price, reckless as to whether it was abusive or not. We do this against the background that the coming into effect of the Competition Act and the likely emergence of common carriage as a new business model were matters which were

well known in the water industry in 1999 and 2000. Ofwat in its MD and RD letters (see paragraphs 17 to 24 above) emphasised to senior executives of the water undertakers the importance of the proper calculation of access charges as a means of opening up parts of this market to competition for the first time.

235. Every price is arrived at by a series of decisions as to what elements to include or exclude in terms of the costs to be recovered in the price and as to the level of profit to be earned. In a simple case of excessive pricing it may be possible to show, for example, that the undertaking, having calculated its costs of producing a particular widget, then charged an exorbitant price entirely unrelated to the underlying costs of supply. If there was no possible justification for such a high profit margin, one could say that the undertaking issued that price knowing, or at least being reckless as to, the abusive nature of that price because it was maximising its profit in an environment of market power. In another case it might be possible to show that the undertaking included a substantial element in the price to cover a cost that was not actually incurred in the production of the widget and so was not properly recoverable in the price charged for the widget. Again, in that case one could identify that particular step as the step taken, which the undertaking knew would lead to the price being unlawfully high or was reckless as to whether that would be the result.

236. We must, therefore, examine the way Dŵr Cymru went about the task of devising the common carriage price, the mechanisms that it put in place to ensure that the price proposed complied with the relevant competition rules and the Ofwat guidance, and the decisions that it took about how the price should be calculated. These questions arise both at the level of principles where one would expect to see the senior management discussing the issues raised by this novel task facing the company and at the level of the more detailed calculation. This will indicate whether Dŵr Cymru's approach to calculating the common carriage price was one that it thought was defensible at the time as a matter of principle and whether the errors we now know it made in its calculations demonstrate that it must have been aware at the time that there was no objective justification for its price, or that it was reckless as to that fact.

i. The evidence presented by Dŵr Cymru

237. At the time we are concerned with, that is mid-1999 to March 2001, Dŵr Cymru underwent a corporate reorganisation. It was owned by Hyder plc which also owned the electricity supplier SWALEC. It was divided into Hyder Utilities (the company which owned Dŵr Cymru and SWALEC) and Hyder Consulting (a consultancy business, formerly called Acer). There was also a smaller company within the group, called LiCo, which owned the licences operated by Dŵr Cymru. For our purposes, the decisions on the First Access Price were taken by the Dŵr Cymru board headed by the Managing Director, Dr Michael Brooker. There was also the LCE, the composition of which included some of the executive directors of Dŵr Cymru (including Dr Brooker and Mr Williams) and which was also concerned with regulatory matters.

a. Mr Williams' evidence: absence of 'malicious motive'

238. The main witness tendered by Dŵr Cymru to explain what had happened at a senior level as regards the First Access Price was Mr Jeff Williams. He was described in the contemporaneous documents as the 'sponsor' of the project for devising a common carriage price. His title was Customer Policy and Income Director, a role which he took on at Dr Brooker's request in early 1999. Mr Williams was both a member of the Dŵr Cymru main board and also of the LCE. In Mr Williams' team were Mr David Holton (Commercial/Key Customer and Competition Manager), Dr Jackie Boarer (Head of Income and Tariffs), Mr Paul Henderson (a tariffs manager) and Mr Edwards (a financial analyst in Dŵr Cymru's Economic Regulation Department, working on financial modelling).

239. Mr Williams provided a witness statement to the Tribunal covering his involvement in the First Access Price calculation. He states that he was aware during 2000 of 'Ofwat's ongoing competition initiative' and that Albion's request for common carriage fell within the remit of his team. Mr Williams says that he was the 'project sponsor' which meant that he was ultimately responsible for informing and updating the Board, and the LCE, as the matter progressed. The main thrust of his witness statement was that since he was the sponsor of the project, he would have been aware of 'any malicious motive or otherwise improper thinking' underlying the calculation of the First Access Price or the indicative price. He did not recall any such motive or thinking either at the supervisory level of the

LCE or Board meetings or at the operational level within the team doing the calculation. He went on to say:

> '… Indeed I am unable to recall the specifics of the Board and LCE meetings that took place between November 2000 and February 2001, although I attended the Board meetings and believe that I also attended the LCE meetings in my role as Project Sponsor. This indicates to me that nothing untoward occurred in relation to Albion's application and that the surrounding issues were considered professionally and objectively by the Board and the LCE as an agenda item just like any other'.

240. There were some caveats in Mr Williams' statement as to the scope of his recollection of events. He said that:

> 'Given the considerable period of time that has elapsed since the events in question, my recollection of the precise sequence of events by which the LCE and Board considered Albion's request (and the indicative price to be offered) is limited.'

241. He also said, referring to various Board minutes and reports prepared for the LCE that:

> '14. Mr Edwards and Mr Holton were primarily responsible for the preparation of these reports. I had a good understanding of the broad issues surrounding their work, and would have made myself familiar with the contents of the reports before introducing them for discussion at the LCE. I did not follow the intricacies of the price modelling exercise but, as I understood it, the indicative price of January 2001 and the First Access Price of February 2001 were the result of a series of calculations based on approved methodologies and following a process of dialogue with Ofwat in relation to the development of the access principles, in the hope that this approach would be regarded as acceptable by Ofwat.'

242. Despite those caveats, the Tribunal was being invited to infer from the fact that he did not recall any malicious intention being expressed by his colleagues that no such malicious intention had existed at either the supervisory or operational level. In the light of his witness statement, we expected, as did Albion, that he would be the person to answer questions about the discussions at senior level as to how the company should go about devising the price in the light of the Ofwat guidance and how he had supervised and checked the detailed work done by Mr Edwards and Mr Henderson.

243. In fact, Mr Williams was not able to give any such evidence. To almost every question he was asked by Mr Sharpe QC, appearing for Albion, he replied either that he did not remember or that he did not have the level of detailed knowledge needed to be able to answer. He had no recollection of any Board or LCE meeting that he had attended. He had no recollection of having seen most of the documents that he was shown from the trial

bundles, whether he was the author of the document, its sponsor, a recipient or otherwise. He could not really remember the content of any discussion with any person about the approach to the formulation of the First Access Price.

244. What also became clear to us was that Mr Williams was not simply saying that he had had no recollection or understanding of the matters now. Rather he told us that he had very little understanding of the way the common carriage price was being devised at the time. He was candid that his previous work for Dŵr Cymru had been in human resources. He had no background in issues relating to the commercial aspects of the business, he had no understanding of economics or how prices are built up, nor did he show any understanding of the competition law issues that might arise in this context. He did not understand the concept of long run marginal costing. He used the term 'regional average pricing' frequently in the course of his evidence but, when he was asked how the general principle had been applied in this case, he was unable to explain how it was all put together. Mr Williams was asked whether he was ever party to any discussions as to what it was appropriate to include or exclude from the regional average price calculation for an access price for Albion. He said he did not recall 'being involved in that sort of detail' and that given his level of knowledge he probably would not have been. He said he would have relied on 'the team of experts' that Dŵr Cymru had to do that for him and to do it properly. Despite being the Customer Policy and Income Director, Mr Williams did not know that Dŵr Cymru operated its scheme of charges based on the financial, rather than the calendar year.

245. The following exchange between Mr Sharpe and Mr Williams can serve as an illustration of many similar tranches of his evidence. It occurred early on in his cross-examination when Mr Sharpe tried to ask him some preliminary questions about Dŵr Cymru's pricing structure for industrial users generally:

> 'Q. Yes. Okay. I want to ask you some questions about Welsh Water's pricing structure in 2000/2001. You didn't simply charge all of your customers the same price for water, did you?
>
> A. I don't believe so.
>
> Q. No. But in relation to potable water, you had a standard tariff for your potable business, didn't you?

A. At this point in time, distanced from it in the way I am, I really cannot remember. I'm not sure how much detail I was involved with at the time. So I really cannot answer the question.

Q. All right. Would it surprise you there was a standard tariff for small retail customers and a lower tariff for customers taking large volumes of potable water?

A. Again I can't comment because I don't know.

Q. And the large volume purchasers would probably be industrial customers. Is that reasonable?

A. It can be reasonable but I don't know. I wasn't involved in that level of detail. My background, which I have already covered, is mainly HR. As far as work within my directorate was concerned, I had people who knew all these issues and all I needed to do was manage it. I didn't need to know the fine detail and I didn't.

Q. Is it 'fine detail' to know that there is a standard potable charge based upon volume?

A. I don't know. I don't know what the definition is. I just cannot answer the question. I don't have that level of knowledge.

Q. But this would have been well within your area of responsibility, wouldn't it: in fact, right at the centre of, I would have thought?

A. Yes, it would have been actually and that's why I had probably people who knew all the detail, who were experts in those areas and they did the necessary work.

Q. You didn't feel the need to understand what they were doing?

A. I couldn't possibly get involved in the detail of everybody who worked for me. It would have been quite impossible.'

246. We therefore fail to see how Dŵr Cymru could have thought it appropriate to invite the Tribunal to draw any inference about what happened from the fact that Mr Williams does not now remember it. The fact that Mr Williams does not remember any 'malicious intention' being expressed in his presence does not help us decide what was going on in the corporate mind of Dŵr Cymru. Mr Williams was not the person directing this project, whatever title he was given.

b. Mr Williams' evidence: compliance with Ofwat guidance

247. Similarly as regards responsibility for compliance with the Competition Act and the Ofwat guidance, it does not appear that Mr Williams would have been in a position at the time to perform any useful role. He did not, so far as we were told, have any training in competition issues either before or after taking up this key post within the company. He was asked in the witness box whether it was his job to look at the guidance notes issued by

Ofwat and to make sure that the company's approach to common carriage complied with that. Mr Williams' response was that he would not 'have gone into the detail of it'. He said that he would have expected Mr Holton 'to be covering these bases':

> 'MR LANDERS: These MD letters came to the MD. He then passed them on to you. What did he say to you that he wanted you to do with them?
>
> A. First of all, to understand them and then derive the policies that we needed to derive to be consistent with them. I wouldn't have got involved in the detail of it, I confess, because it wasn't an area where I had any expertise. And hence it would go on to the team and if they needed to discuss points of principle with me, they would come and do it. But I don't remember going through a great dialogue with them on it.
>
> MR LANDERS: Did you go through a dialogue with the MD?
>
> A. No.
>
> MR SHARPE: Well, but --
>
> THE CHAIRMAN: Sorry, so David Holton was a member of your team?
>
> A. Hm-mm.
>
> THE CHAIRMAN: Is this fair: you left it to him to come up with a way of pricing common carriage that he thought was consistent with this guidance that was coming from Ofwat?
>
> A. Yes, it wouldn't have just been Mr Holton, also Dr Boarer would have been involved in the discussion and I believe Mr Edwards as well.
>
> THE CHAIRMAN: Right. But you were their boss?
>
> A. Yes, but I wouldn't have got involved in the detail of it.
>
> THE CHAIRMAN: But were you answerable to the Board for making sure that the way that common carriage was priced complied with these --
>
> A. Clearly.
>
> THE CHAIRMAN: You say 'clearly' - it may be clear to you, but it's not clear to us at the moment.
>
> A. I would have been responsible clearly as the sponsor. So, yes, they would have expected me to be happy that we were complying. …'

248. Certainly if, as Mr Williams suggested, the Board had been relying on him as project sponsor to ensure compliance, they must have realised that he was not fulfilling that role.

249. As regards the other members of the team who Mr Williams thought would be able to understand what would make a price lawful or unlawful in competition law terms, we were

told that Mr Edwards had an MSc in Economic Regulation and Competition from City University for which he had studied between 1997 and 1999. This involved studying economics, financial modelling and competition law. He did not receive any training on competition matters from Dŵr Cymru. He did, however, produce a 'checklist' at the end of January 2000 in which he set out what he had gleaned from several of the MD letters about how Ofwat would approach investigations under the Competition Act into excessive pricing, refusal to supply and conduct relating to non-price terms. This was produced, Mr Edwards told us, in response to a request from Mr Holton and it would have been shared with Mr Holton and Dr Boarer, and perhaps with Mr Williams. Mr Edwards was asked to explain, later in his evidence, why, when the checklist recorded that Ofwat would examine allegations of excessive pricing by reference to standalone costs, no comparison of the standalone costs of the company's non-potable assets had been prepared:

> 'Q. … There hadn't been any form of stand-alone non-potable comparison carried out, had there, by that point?
>
> A. I don't believe there had.
>
> Q. Despite the fact that was part of the compliance checklist that you had prepared?
>
> A. That's correct.
>
> Q. Whose decision was it to produce this without carrying out that comparison?
>
> A. I am not sure it was a decision. I think the checklist that we saw yesterday I produced in order to guide my development of the statement of principles and the network access code, and I don't remember seeing -- using it for this work. I believe what would happen is I would have filed it with the network access code filings and when I came back to this work, I wouldn't have picked it up again. Therefore, I wasn't using the checklist.'

250. It therefore seems that no one senior to Mr Edwards in the company considered that the Competition Act checklist that he had produced was a useful document to have in mind when computing the common carriage price. Indeed, from the above statements, it appears that even Mr Edwards himself paid the checklist no heed after the Network Access Code was prepared.

c. Other sources of evidence about decision making at a senior level in Dŵr Cymru

251. In the absence of any evidence from Mr Williams, we looked to the contemporaneous records of discussions of the matters at the Dŵr Cymru Board and to papers prepared in

advance of the LCE meetings[17] to understand how Dŵr Cymru had approached the task of devising a common carriage price following Albion's application. However, very little material from the Dŵr Cymru Board or LCE papers was disclosed by Dŵr Cymru. The few documents that were disclosed prior to the hearing were supplemented by some additional documents that were disclosed by Dŵr Cymru between the end of the main hearing and the dates set for closing submissions. These were discovered as a result of further searches conducted by Dŵr Cymru following the very belated disclosure of the Hyder Report discussed later in this judgment. The following picture emerges.

252. On 12 December 1999 Dr Boarer and Mr Holton (both members of Mr Williams' team) put a paper to the Dŵr Cymru Board about competition in the water industry. Mr Williams is named as the sponsor of the paper. This referred to the fact that Dŵr Cymru had lost one customer via an inset appointment (that is Shotton Paper had been lost to Albion). It also says that over recent months there had 'been a significant amount of activity both from possible competitors such as [Albion] but also an increased awareness, by industrial customers, of the opportunities to reduce costs by "switching" suppliers.' Under the heading 'Where Do We Need To Focus Attention?' the paper said that Dŵr Cymru needed to consider potential scenarios for the development of competition in the water industry and to undertake detailed work on allocation of costs. This would enable them to understand better their current cost structures and the risks of losing various customer types. The paper suggested that the company needed to review the basis for average costings:

> 'If the industry develops – at least for the largest customers – deaveraged pricing, we need to be prepared to respond and also consider challenging competitors to protect/increase our customer base.
>
> …
>
> 'We will also need to review all our sources and possible sources in the region to see where there is risk of "insets" or "switching" of supply. These areas of greatest risk then need to be "protected" as far as possible.'

253. This paper covered a subject of critical commercial importance to the company. We would have expected to see it receive serious consideration by the Board and for there to be some record of the decisions they made and clear directions from the Board to the

[17] No records at all of discussions at the LCE have been produced. It is not clear whether these have been lost or whether no records of LCE meetings were in fact kept.

team charged with implementing those decisions. In fact, we have not seen any documents or heard any evidence about the response of the Board to this paper.

254. The next document disclosed is a Board paper produced in April 2000, again citing Mr Williams as the sponsor. The paper identifies 'Large User Water Customers and Income at risk' totalling £23.4 million. It notes that income will still be received in respect of these supplies if water is sold to the inset appointee under a bulk supply arrangement or if common carriage is used. Having considered the possible outcomes if competition does or does not develop in the way the Government intends, the paper concludes that the more likely outcome is that more large customers will seek opportunities to change supplier and stimulate more water companies to become active in the market. Again, we have not seen any documents or heard any evidence about the response of the Board to this paper.

255. There is then a lengthy gap in the record until an extract from Dŵr Cymru Board minutes relating to a meeting on 6 November 2000 at which Dr Brooker and Mr Williams were present. This contains a 'competition update' in the following terms so far as relevant:

> '4.4.1 All arrangements necessary to implement common carriage are now in place.
> …
>
> 4.4.2 Application has been made by Envirologic [Albion] for common carriage of water acquired from North West Water [United Utilities] to its customer at Shotton Paper. This will have a relatively neutral cost effect for Dŵr Cymru for so long as average cost distribution can be applied to such arrangements.
>
> 4.4.3 Under common carriage the consequences of a burst of a supply main remain with Dŵr Cymru as the distributor.' (emphasis added)

256. We have no evidence as to what was discussed at that Board meeting beyond that uninformative record. The statement at paragraph 4.4.1 appears to have painted a rather rosier picture than was justified, given that at November 2000 (some two months after Albion Water's common carriage application) the work on calculating a price for common carriage was only just beginning, as we describe below, and no firm access price would be offered to Albion for another four months.

257. When this extract from the November 2000 Board minutes was put to him, Mr Williams was unable to recall if there had been a Board paper to support this topic at the meeting and he was not able to help as to the information on which the statements had been based. He could not say what discussion had led to the conclusion, recorded in the minute, about how use of the average costs of distribution would lead to a relatively neutral effect. He thought it was more likely to be based on things that Dr Brooker had said rather than on anything he himself had said. He was pressed by Mr Sharpe as to whether the discussion at the Board meeting had focused on the need to include all the distribution costs of potable, rather than non-potable, water in the common carriage price in order to achieve a result that would protect Dŵr Cymru's revenue but he said he did not know. As regards the statement in the minute, he said: 'I don't know what it was intended to impart because it is so cryptic.'

258. Finally there was a minute of a Board meeting of 15 January 2001. This states under the heading 'Business Matters':

> '6.1 **Common Carriage Application – Ashgrove, Deeside (DCC/01/020):** The content of the progress report was noted. The issue of de-averaging of costs of supply remains a complex issue.' (emphasis in original)

259. Mr Williams again accepted that this was 'quite cryptic' but was unable to describe (although he was recorded as present at the meeting and was named as the sponsor of the paper) anything that had occurred at the meeting or to confirm whether the 'progress report' referred to there was the LCE paper, marked 'LCE/01/001' that was among the disclosed documents. It was, we were told, at this meeting that the Board agreed to release a draft, or indicative, common carriage price of 19.94p/m^3 to Albion but there is no reference to any discussion or decision about this in the minutes that we have seen.

260. Beyond those two brief comments we have no evidence of the discussions which occurred in the Dŵr Cymru Board. There appears to have been a Board meeting in February 2001 at which the First Access Price was approved but there are no papers relating to that. Mr Williams had no recollection of whether there had been such a meeting or of anything that had been said at that time and was at a loss to explain the complete absence of any papers.

261. We find it surprising that the Dŵr Cymru Board could have regarded those passages in the minutes as an adequate record of the discussions that must have taken place at meetings of the Board or of the LCE about the company's approach to common carriage. The company was fully aware that this was a decision of the utmost importance both as regards its obligations towards Ofwat and common carriage applicants, and for its ability to hold on to its largest customers.

262. As regards any Board papers, Dŵr Cymru told us that there are no email records held for Dr Brooker, Dr Boarer or Mr Holton as they left Dŵr Cymru 'prior to the 2007 migration of Dŵr Cymru's IT systems'. It is certainly unfortunate that, even though Dŵr Cymru was in the midst of an investigation into conduct in which those three people were key participants, some subsequent IT migration exercise was allowed to destroy all their email records. This is not a case where the spotlight unexpectedly shines on an incident or discussion that occurred many years before when no one could have appreciated its significance at the time. Dŵr Cymru knew how important this was at the time and that any price offered was likely to be subject to scrutiny. The investigation into the price started almost immediately after the First Access Price was offered, a few months after any relevant Board meeting was held.

263. So far as Board minutes are concerned, Dŵr Cymru has said that the absence of such minutes may be attributable to the changes of company secretary that took place during the first part of 2001. Again, it is most unusual for changes in the holder of the office of company secretary in a substantial, regulated company to result in the accidental destruction or loss of Board minutes and papers. One of the primary functions of the Company Secretary is to draw up and retain such documents.

264. After Mr Williams gave evidence we heard at length from Mr Edwards. We consider below his evidence about the detail of the calculations but we consider here his evidence as regards the involvement of senior management in the calculation of the First Access Price. Mr Edwards described in his witness statement his earlier work from 1992 onwards with Denis Taylor who was then the Head of Economic Regulation at Dŵr Cymru. This work included the development of Dŵr Cymru's LITs for potable users. Mr Edwards says that, although the company's approach to pricing:

> 'became more sophisticated over time, the same principle underpinned these projects: namely we adopted a "top down" regional average approach, looking at what services these large users did not take and deducting them from the overall cost.'

265. During 2000, Mr Edwards worked on the development of the Dŵr Cymru Statement of Principles and its Network Access Code (see paragraphs 18(a) and 21 above), which the company was required by Ofwat to produce for potential common carriage customers. Until the end of 2000, however, it was Mr Henderson, rather than Mr Edwards, who was primarily responsible for the development of the pricing methodology and price modelling for Albion's request. This was because Mr Edwards was working intensively on a different project. Mr Edwards said:

> 'I understood from discussions with [Mr Henderson] at the time that he had taken an approach based on regional average pricing because this was similar to the methodology that had been used in the development of Dŵr Cymru's LITs, and had been included in past submissions to Ofwat. Mr Henderson and I both considered that, since Ofwat was already familiar with such an approach in these contexts, it would be comfortable with a similar methodology being used in the context of access pricing. In addition, it was one of the three main approaches to access prices that had been outlined in "MD163".'

266. Mr Edwards moved at the end of January 2001 to working full time on the access pricing project. He was the most junior member of Mr Williams' team working on this project. He said in his witness statement:

> 'I was not given any formal or informal instructions as to the approach to take, but simply continued to base my approach on the regional average methodology that had been adopted by Mr Henderson up until that point, and that we had previously discussed'.

267. The explanation for this apparent lack of any involvement in the process on the part of the Dŵr Cymru senior management thus appeared to be that the company *assumed* that it would approach this pricing issue in the same way as it approached all other pricing issues, namely by working top-down from the total company price and arriving at a price for common carriage by adjusting that total company price to reflect the service(s) that the

would-be customer seeking the price actually required. Mr Williams said that as he understood it, they were 'just applying their normal methodology'. Mr Williams did say later in his cross-examination that he had been aware of people within Dŵr Cymru 'kicking around ideas' and that there had been an 'ongoing debate about various approaches'. He said that he would not have been involved in such discussions in any detail and he did not recall discussing this with anyone more senior in the company such as Dr Brooker.

268. Mr Edwards' evidence was that rather than considering whether MD 163 (as to which see paragraphs 22 to 24 above) *permitted* average pricing methodologies, the question Dŵr Cymru would have asked itself was, did MD 163 *prevent* the company from adopting that approach. He was firmly of the view that MD 163 'did not preclude average pricing'. Mr Edwards also said that he based his work on whole company pricing because that is what Dŵr Cymru had said it intended to do in the Statement of Principles and Network Access Code, issued in February and August 2000, respectively.

269. When he was pressed by the Tribunal about how the decision to price on the basis of whole company averages was taken within Dŵr Cymru, Mr Edwards said that he was not sure who would have made that decision:

> 'THE CHAIRMAN: So you were never present at any discussions along the lines of, "How are we going to approach this new task that we have of finding a common carriage price?"
>
> A. I think there were discussions around what options were available with the ECPR,[18] long run marginal cost, was it long run incremental cost approach. So we were aware of the different approaches we could take, and therefore at that time there were discussions around which ones should we do, but I think there was never a decision made not to do what we had always done. So I think the questions that the introduction of the Competition Act was posing on the company were being discussed. I think there was never a decision that we would go to another type of costing. Therefore, the old methodology would continue through. So I don't think there was a conscious decision to keep through with it; it's just a part of the DNA.'

270. Albion argued that this explanation for the lack of debate within Dŵr Cymru as to the appropriate response to Albion's application was implausible. It submitted that it was not true that Dŵr Cymru always priced on the basis of whole company costs because the evidence showed that the Dŵr Cymru contracts with large industrial users of non-potable water were not calculated that way. Albion relied on Ofwat's published 'special

[18] That is the 'Efficient Component Pricing Rule', a method rejected by the Tribunal in the 1046 Main Judgment: see paragraphs 835 and 836.

agreements register', the Dŵr Cymru entry on which sets out the prices paid by large industrial users of raw and partially treated water. This shows wide variations in price such that, for example, Shotton Paper was paying 26p/m^3 for its water while Corus Shotton was paying about 14p/m^3. Albion argued that the range of prices showed that Dŵr Cymru must have been charging these users on the basis of the costs of the assets actually used to supply them rather than on the basis of whole company average costs of a broader class of assets.

271. Mr Edwards' explanation for the range of prices was that the different prices on the special agreements register were largely historical. Several of the agreements were entered into in the 1950s and 1960s when there were local council water companies which would offer long-term, low-priced water rates to companies to attract their business to the area. We accept his evidence that, although large industrial non-potable user prices may not be based on average pricing and may reflect the individual circumstances of the customer when the agreement was entered into, they are certainly not based on de-averaged pricing in the sense of having worked out the cost of the particular assets used by the customer and pricing to recover those costs.

272. Albion argued that evidence showing the different sizes of non-potable pipes and the prices paid by customers primarily using a particular size of pipe indicated that Dŵr Cymru was charging lower prices to customers who used larger size pipes. Again, we agree with Mr Edwards' evidence that this breakdown of pipe usage did not demonstrate that but showed only that there was no significant difference in pipe usage between large and small non-potable users.

273. There is plenty of evidence to show, however, that Dŵr Cymru did *not* simply assume unthinkingly that whole company average pricing would be used for the computation of the common carriage price for Albion. On the contrary, it is clear that Dŵr Cymru embarked on a substantial exercise to work out the value of the assets used for, and the costs of, non-potable supply.

274. The hearing bundle contained an undated draft document outlining an invitation to tender in which Dŵr Cymru states that, in response to the introduction of the Competition Act and the production of its Network Access Code, Dŵr Cymru 'would like to calculate

local costs in order to be ready to respond to competitive threats'. This document was put to Mr Williams who said in response:

> '… I certainly don't have any recollection. I don't recall the tender going out. I don't recall any work being done and a report coming back. So I'm at a loss to be able to give you any explanation, being perfectly frank'.

Mr Edwards said that he had never seen a response to this and assumed that it was a draft.

275. There was also a document, undated but likely to have been produced by Mr Edwards in early 2000, where the company was attempting to derive both a top-down price and a bottom-up price. After the heading '<u>Bottom Up Price</u>', the paper stated: 'Question: To what extent do current cost centres, objective codes allow this split [among services that could be requested] to be achieved? To what extent can this split be achieved on a geographic basis: by resources zones, north Wales/south Wales or regional costs only?'. Mr Edwards was asked why he was exploring 'bottom up' prices if, as he claimed, Dŵr Cymru was set on using whole company average pricing. He said that the way that cost centres work in the water industry is that actual direct costs would not be the total costs of the service because a large proportion of the costs are shared. In this document he was trying to see whether they could allocate sufficient of the direct costs 'to make it meaningful' and then attribute the common costs and shared costs across each of the areas. He said that he visited the management accountants and decided that 'there is so much smearing of common costs and shared costs that it doesn't add that much to go down to a very local level'. That is why, he said, the company started from a regional average basis i.e. whole company costs.

276. Matters took an unexpected turn in the course of Mr Edwards' evidence, however. During his cross-examination on Day 9 of the hearing, Mr Edwards referred to a study that Paul Henderson had engaged consultants to carry out in early- to mid-2000. The study, Mr Edwards recalled, was to look at assets particular to all of Dŵr Cymru's non-potable networks. Another employee of Dŵr Cymru, Lynette Cross, who had been sitting in court during the hearing, then contacted Mr Henderson. Mr Henderson confirmed that there had been a report prepared by Hyder Consulting Ltd who had been commissioned in 2000 by him to carry out a study to support his work on calculating a non-potable LIT. Hyder, we recall, was the parent company of Dŵr Cymru and the electricity supplier SWALEC (see

paragraph 237 above). On the evening before the final day of the main hearing, a copy of the report was found on Ms Cross's e-filing system. She thought she had scanned and stored it in 2005.

277. The report found in Ms Cross's email account ('the Hyder Report') states that Hyder Consulting was commissioned by Hyder Utilities to collate information concerning the supply of non-potable water within Wales. For the purposes of the report, the customers had been divided into three regions, North, South East and South West, and supply systems, of which there were ten. One of those ten was, of course, the Ashgrove system, which was in fact the only system included in the North region. The Hyder Report contained a detailed breakdown identifying all the Dŵr Cymru assets involved in producing non-potable water. As regards the Ashgrove system the Hyder Report placed a value of £12.3 million on the pipes used. There was no valuation of the treatment systems used in non-potable supply. That was work that was still to be done at the time that the Hyder Consulting work was brought to an end. Mr Edwards acknowledged that the Hyder Report was being prepared with an eye to Albion's application for common carriage.

278. What we do not know is why the Hyder Consulting work was stopped before it was completed and why the work that had been done appears to have played no part at all in the computation of the common carriage price by Mr Henderson or Mr Edwards. Mr Beard in his closing submissions for Dŵr Cymru was prepared to say only that 'There might be all sorts of reasons why further work wasn't pursued'.

279. We conclude from this that it is not true that Dŵr Cymru unthinkingly adopted a habitual stance of basing pricing decisions for common carriage on whole company potable costs, or on potable and non-potable prices/costs because it was 'in the DNA', as Mr Edwards claimed, or because it never gave any serious thought to doing anything else. A considerable amount of effort was put into precisely the kind of work one would have expected to see, namely working out the values of the assets involved in the different non-potable treatment and distribution systems to put the company in a position to produce a price based on those costs. We therefore reject this as an explanation for the absence of evidence of any involvement of senior management in the decisions on the computation of the First Access Price.

280. We make one final comment as regards the Hyder Report. Dŵr Cymru was pressed during the course of the hearing before us as to why the Hyder Report has never previously been disclosed to Ofwat and why the fact that this work had been carried out was not disclosed in any of the evidence presented by Dŵr Cymru at the earlier stages of this decade-long dispute. Ofwat, in exercise of its statutory information gathering powers under section 26 of the Competition Act, asked Dŵr Cymru in June 2001 for 'a breakdown of the actual costs incurred by Dŵr Cymru in providing the services requested by Albion Water'. In Dŵr Cymru's response there was no mention of the Hyder Report. Instead the company sent a one page calculation carried out by Mr Taylor in 1996 and stated that there was no reason to think that the breakdown would not still be reasonably accurate as at 2000. When pressed, Mr Edwards was also unable to say why none of the information in the Hyder Report or the other work done to identify the stand alone costs of the Ashgrove system were provided.

281. Mr Beard said in his closing submissions that Dŵr Cymru does not accept that it had been wrong to withhold these documents from Ofwat and the Tribunal, and that, in any event, he was instructed that 'on review in fact the Hyder work is considered to be deeply flawed'. Whilst we note this submission by Mr Beard, we struggle to understand how Dŵr Cymru could have considered the Hyder Report should not be included in its response to the information request from Ofwat. It was not for Dŵr Cymru to determine what it was and was not appropriate to disclose to Ofwat: if a document fell within the category of information requested, as the Hyder Report plainly did, it should have been provided to Ofwat.

ii. Drawing an inference of 'cynical disregard' in Dŵr Cymru's decision making process

282. At the conclusion of the hearing before us, Albion submitted with some force that, in light of the evidence, and indeed the absence of evidence, the Tribunal would be justified in drawing an inference that Dŵr Cymru deliberately set out to charge an abusive price in order to exclude Albion from the market and protect its own revenue. Albion pointed to the very limited number of Board papers and minutes that have been disclosed and the extremely brief records of discussions contained in those minutes that we have seen. Albion submits that we should infer that the cryptic Board minute statement about the continued complexity surrounding the issue of de-averaging costs masks a discussion in which the Board concluded that that price being proposed at that stage (19.94p/m^3) was

unsatisfactory because it would have allowed Albion to enter the market profitably and, therefore, did not ensure revenue neutrality so far as Dŵr Cymru was concerned.

283. Albion points to the failure of Dŵr Cymru to tender any evidence from people who must have been considering the issue and taking the decisions at a senior level. It is well established in civil cases, see for example *Bentham v Kythira Investments Ltd* [2003] EWCA Civ 1794, paragraphs 25 and 26,[19] that a court is entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action, if there is no good reason for that witness not being called to give evidence. In this case, Albion said, there is no suggestion that Dŵr Cymru had any good reason not to call Dr Brooker, Mr Holton or Dr Boarer. They were the people more senior to Mr Henderson and Mr Edwards who it appears were actually in charge of the project. Dr Brooker, Dŵr Cymru's Managing Director, seems to have been the senior manager who had the best grip on the common carriage project according to the evidence of both Mr Williams and Mr Edwards. Mr Williams' evidence was that it was Dr Brooker who would have taken the lead on explaining matters relating to Albion and common carriage at Board meetings. It was Dr Brooker, rather than Mr Williams, who responded on Dŵr Cymru's behalf to Ofwat's guidance in MD 154. There has been no indication from Dŵr Cymru in the course of these proceedings that Dr Brooker or the other senior people, such as Mr Holton, were unavailable to give evidence.

284. Finally, Albion points to evidence belatedly disclosed by Dŵr Cymru, following the discovery of the Hyder Report, which certainly casts doubt on the professed helpful and cooperative attitude that both Mr Williams and Mr Edwards said in their witness statements that the company had adopted in its negotiations with Albion. In particular, there was an internal email from Mr Henderson to Mr Holton dated 7 November 2000 providing briefing notes for a meeting with Albion (presumably the meeting which took place on 10 November 2000). Mr Henderson describes the proposed responses to be given to Albion as 'slippery answers', confirming, Albion says, that the intention going into this meeting was for Dŵr Cymru to provide information which was designed not to assist Albion.

285. According to Dŵr Cymru, there was no senior involvement in the preparation of the First Access Price. In his closing submissions Mr Beard said this:

[19] See also *Wisniewski v Central Manchester Health Authority* [1998] P.I.Q.R. 324 (CA) at 340.

'MR BEARD: …. To be clear, Dŵr Cymru's case is that the FAP was put together by Mr Williams' team. The question was what was their state of mind. There was no cynical disregard for Albion's rights on their part. Indeed, they were concerned not to act unlawfully and were keen to ensure that Ofwat accepted their approach.

THE CHAIRMAN: So you're saying there was no instruction as to how to go about this given to Mr Williams or his team by anyone more senior than Mr Williams?

MR BEARD: We're not aware of any such instruction and certainly no such instruction that this should be pursued with cynical disregard, or the effect of cynical disregard, obviously not in those words, but with that moment. No.

THE CHAIRMAN: What do you mean when you say, "We're not aware of any such instruction"?

MR BEARD: Well, the evidence is that no such instruction was given and that the basis on which Mr Williams was proceeding and the basis on which Mr Edwards was proceeding was that using the regional average cost pricing methodology was entirely appropriate, it had been the methodology that had been used previously, and then Mr Edwards took the calculations that Mr Henderson had been developing and took them forward in order to create the FAP. In that regard, the need for the FAP to be produced was clear, given the requests of Albion and the demands of Ofwat, which were being communicated in correspondence. But there was no instruction that somehow the way in which that was to be developed was to Albion's detriment or that there was an assessment of the profit that would be made by using the regional average cost.

THE CHAIRMAN: Putting those two things on one side for the moment, what are you saying as regards any instruction at all to Mr Williams or his team as to how to go about this task?

MR BEARD: Well, instructions from whom? Mr Williams was a board director --

THE CHAIRMAN: Well, I'm asking you.

MR BEARD: There is no indication that anyone else gave instructions to the team to get on with the FAP. The team knew that the FAP had to be produced, Albion had asked for it. Ofwat had indicated that a price needed to be produced, and indeed, had chased it up. Mr Williams gave evidence that he was concerned to ensure that a price was produced. That is what happened, using Mr Edwards' calculations.'

286. We have considered carefully the evidence that we had before us. Certainly, the picture Dŵr Cymru itself presents of what happened casts it in a very poor light. If Mr Williams and Mr Edwards are to be believed, two junior members of the team were left to calculate the common carriage price – the first of its kind in England and Wales – apparently without any guidance, instruction or competent supervision from senior management. The person appointed to be sponsor of the project was someone who, on his own evidence, did not understand what was going on and did not have the expertise to fulfil the role to which he was appointed. Further, Dŵr Cymru seems to have failed to record

discussions at a senior level about the common carriage price beyond the most cursory, cryptic statements. It has allowed any documents containing a proper record of decisions to be destroyed or mislaid through IT and management changeovers. Despite the salience of this, the first common carriage application in England and Wales, the Board did not institute any effective mechanism for ensuring compliance with the law or independent quality control of the price calculations being made. We find that this constituted a conspicuous and reprehensible failure of corporate governance. The consequences of this failure are apparent in the conduct of the negotiations with Albion and in the errors that were made in the computation of the price.

287. If Dŵr Cymru's version of events is true – if it simply failed to engage in any meaningful way at a senior level with the question of how to work out a common carriage price, despite the importance of this question to the company and to the industry – is that failure of itself enough to meet the very stringent *Rookes v Barnard* test? We have concluded, with some hesitation, that it is not. We recognise that the Board would have regarded the First Access Price as a highly desirable outcome for Dŵr Cymru. They knew that the level of the First Access Price would make common carriage economically unviable for Albion and that it had the best chance of maintaining revenue neutrality for Dŵr Cymru. But the key point for our purposes is that there is no evidence here that there was an instruction from the Board either to Mr Williams or to members of his team that they must come up with a common carriage price that made Albion's inset appointment uneconomic *even if* that could only be done by offering a price that was so high as to be abusive. We bear in mind that in *Broome v Cassell* Lord Reid described exemplary damages as an "undesirable anomaly" and that an award should be made only in exceptional circumstances.

288. In our judgment, the *Rookes v Barnard* test requires some evidence that the company knew that the way the price was in fact calculated was unlawfully excessive or that it did not care whether it was excessive or not. In so far as 'the company' for this purpose is Mr Edwards, it is clear that he devised the price knowing that the methodology would come under scrutiny by Ofwat as soon as the price was issued. We find, as we describe below, that he genuinely but mistakenly thought that the method he used was defensible. In so far as 'the company' was Mr Williams, it is clear that Mr Williams was not competent to come to any view as to the legality or illegality of the First Access Price. In so far as 'the

company' is any other member of Mr Williams' team, or Dr Brooker or any other Board members, we simply do not know what they thought. We do not know how many of them made it their business to understand how the prices presented to the Board meetings had been calculated, whether they expressed any doubts about the legitimacy of what Mr Edwards was doing or what they were told if they did express any such doubts.

iii. Drawing an inference of 'cynical disregard' from the way the First Access Price was in fact calculated

289. In the absence of any direct evidence that someone in Dŵr Cymru knew or suspected that the price was illegal, it would be open to us to infer the necessary 'cynical disregard' if there was something about the way the First Access Price had been calculated that was clearly wrong. We therefore now turn to our findings as regards how the First Access Price was calculated in order to consider whether it was so obvious that it was an indefensible price that we would be justified in finding that Dŵr Cymru must have been aware of this.

290. First, we consider two issues of principle, namely: (i) the use of 'top-down' regional average pricing; and (ii) the failure to cross-check the result against a 'bottom-up' calculation. We then consider issues arising from the more detailed calculation of the price, namely: (iii) the apparent 'target' of 26p/m^3 as the price for the non-potable LIT; (iv) the changes made to the price between January and March 2001; (v) the deduction of average treatment costs from a potable tariff starting point; (vi) the failure to make an adjustment to reflect the lower costs of non-potable as compared with potable pipes; and (vii) the adjustment to derive non-potable treatment costs from potable treatment costs.

iv. The principles used in computing the First Access Price

a. The decision to adopt the principle of whole company average pricing

291. The approach adopted by Dŵr Cymru in deriving a price for common carriage has been described as a 'regional average' or 'whole company average' pricing approach. It is important to understand what is meant by 'regional average pricing' or 'whole company average pricing'[20] here because it does in fact cover a wide range of options. What it means at base is that, instead of identifying precisely which assets a customer would be

[20] So far as Dŵr Cymru is concerned, because almost all its business is in the single region of Wales, the industry term 'regional average pricing' is effectively the same as 'whole company averaging' when considering Dŵr Cymru's pricing policy (compare, for example, paragraph 308 of the Interim Judgment with paragraph 265 of the 1046 Main Judgment).

using and working out the costs involved in supplying the customer using those particular assets, a wider range of assets is used as the base for the costs and the price worked out as an average of those. This is an approach to pricing that is conventionally adopted in relation to utilities where the monopoly supplier must provide a service to everyone who wants that service; where the costs of providing that service to different customers varies enormously; but where, for social policy reasons, it is not appropriate that prices to customers should vary enormously. Thus, in the water industry, some households live close to a mains water supply or draw their water from a clean source that needs little treatment. Others live many miles from a water supply and draw their water from a reservoir that needs much more treatment to make it potable. The price that domestic households pay does not, however, vary according to those parameters because the water companies are permitted to average out the costs.

292. The main area of dispute between Albion and Dŵr Cymru has, throughout the Ofwat investigation and throughout Case 1046, focused on the appropriateness of regional average pricing for calculating the common carriage price for the use of the Ashgrove system. It is clear that the First Access Price was not based on the costs of providing the particular assets that Albion needed to use, namely the Ashgrove system, comprising the pipes and treatment works. Rather the price was derived using as a starting point the company's average price of providing particular services, namely the cost of providing the whole pipe network and the cost of providing all treatment work for potable water.

293. Albion's initial stance in the negotiations with Dŵr Cymru in 2000/2001 was that the common carriage price should be 'deaveraged',[21] that is, that it should be based on the cost of specific assets employed in providing common carriage to Shotton Paper, not on whole company costs. Dŵr Cymru always resisted that and had the support of Ofwat in that resistance, both when Ofwat decided in its 2004 Decision that the First Access Price was not abusive and during the course of Case 1046. Later in the proceedings, Albion accepted that complete deaveraging of costs would not be reasonable in an industry where so many costs incurred by the provider are shared or common costs. From that point, Albion's stance was that there is nothing inherently wrong with top-down pricing provided that the correct adjustments are made to the whole company price to pare away elements that do not apply to the service under consideration.

[21] Sometimes also referred to as 'bottom-up' pricing, as contrasted with 'top-down' pricing.

294. In the 2004 Decision, Ofwat broadly accepted Dŵr Cymru's method of arriving at a common carriage price although, as we discuss further below, it made some adjustments to Mr Edwards' calculations. Before the Tribunal in Case 1046, Ofwat consistently argued not only that a top-down approach was permissible but that it was, in effect, *mandatory*. As the Tribunal records in paragraphs 405 onwards of the 1046 Main Judgment, Ofwat submitted that 'it was neither necessary nor appropriate to consider local costs because that would involve "de-averaging" and would be contrary to the fundamental principle of regionally averaged prices in the water industry'.

295. The Tribunal's conclusion at paragraph 470 of the 1046 Main Judgment was that:

> '… there is nothing intrinsically inappropriate in a "top-down" approach to establishing average accounting costs, assuming reliable information and proper accounting procedures. But any such "top-down" approach needs to be subject to appropriate verification.' (emphasis added)

296. It is true, of course, that the Tribunal's comments were made in ignorance of the Hyder Report because it was not disclosed. Ofwat indeed is recorded as having submitted to the Tribunal that:

> 'The practical problems with any "bottom-up" calculation in the water industry are illustrated by the present case: neither Albion nor Dŵr Cymru have been able, for the purposes of this appeal, to prepare a "bottom-up" cost calculation that the Authority considers is correct' (see paragraph 410 of the 1046 Main Judgment).

297. Ofwat's staunch support of the whole company average pricing approach was, however, based on principle rather than just practicality. The Tribunal was clear that that top-down calculation was generally a permissible methodology as long as it was sufficiently 'granular' in identifying what services were actually used by the common carriage customer and excluding the costs of those which were not used.

298. The Referred Work carried out by Ofwat that formed the basis of the Tribunal's Unfair Pricing Judgment used, as we have described, three methodologies. The 'AAC+' methodology in the Referred Work started with whole company costs and then broke them down to a greater degree of 'granularity' than had been attempted by Mr Edwards or Ofwat. Thus, the figure for 'distribution' was split into a number of different sub-functions: pumping, storage, mains and customer interface: see paragraph 45 of the Unfair Pricing Judgment. Ofwat looked at each of the ten discrete non-potable systems in Wales

and worked out what services each of them supplied to the relevant customer. Ofwat also based some of the calculation on tariff modelling that had been done by Dŵr Cymru in the context of providing a new tariff for approval in 2006. For the purposes of the Referred Work, Dŵr Cymru had effectively backdated that new model with 2000/2001 figures: see paragraph 7.5 of the Referred Work. The LAC method was more based on local costs, where that information was available, but still drew on estimates and the AAC+ method where local cost information was not available. The capital cost estimates in the LAC calculation were informed by a report from engineering consultants.[22]

299. In the light of this, it is not possible to say that simply by adopting a policy of basing its price on a whole company average cost methodology Dŵr Cymru must have realised that the resulting price would be unlawfully high. It all depends on how the calculation was done. Further, the complexity of the Referred Work (in which, it must be recalled, Ofwat concluded again that the First Access Price was not unlawful) and the figures on which it was based indicates that it would not have been easy for Dŵr Cymru in 2000/01 to replicate the work that was done later by Ofwat and relied on, and further refined, by the Tribunal in the Unfair Pricing Judgment.

b. The decision not to cross-check the First Access Price against de-averaged pricing

300. Albion also makes a different point, which is that Dŵr Cymru failed to use local costing as a 'cross check' as to the reasonableness of the First Access Price. In paragraph 470 of the 1046 Main Judgment, after finding that there was nothing intrinsically wrong in using a 'top-down' approach, the Tribunal went on to say that the approach is acceptable only if the allocations made can be properly verified:

> 'The obvious cross-check in such a context is a "bottom-up" calculation which starts with the activity in question and then identifies the costs properly attributable to that activity. As the Tribunal again said in the interim judgment at paragraph 311, a "top-down" and a "bottom-up" calculation properly done should meet in the middle provided that there is a sufficient link between the product and the services in each calculation. However, in this case such "bottom-up" information as there is before the Tribunal does not verify the "top-down" calculation to be found in the Decision.'

[22] The last methodology, LRIC, was held to be inappropriate by the Tribunal (see Unfair Pricing Judgment, paragraphs 104-106).

301. Albion argued that the work being carried out by Hyder Consulting was clearly one means by which Dŵr Cymru could have carried out this cross-check. It suspects that the reason why the work was stopped before it came to a final result was because Dŵr Cymru realised that it was going to generate an 'inconvenient' result which would show that the proposed First Access Price was excessive.

302. Albion also pointed to the fact that Mr Edwards was aware that Ofwat guidance stated that any investigation into excessive pricing would involve looking at stand alone costs. This is apparent from the document referred to as the 'compliance checklist' that he drew up at the end of January 2000. This checklist shows that Mr Edwards analysed MD 154 and 158, and the joint Ofwat/OFT guidance (see paragraphs 17 to 21 above) summarising its effect. The checklist records that excessive prices would be investigated in relation to 'stand alone costs'. This ought to have prompted Dŵr Cymru to complete the exercise of finding out what those stand alone costs were. As we have already described (see paragraph 249 above), the checklist seems to have been ignored after the Statement of Principles and the Network Access Code were issued.

303. We note, however, that although the Tribunal described the need to cross-check as 'obvious', Ofwat was firmly of the view that any investigation of local costs was illegitimate as a matter of principle. Thus, in paragraph 306 of the Interim Judgment, the Tribunal recorded Ofwat's response to an attempt by Albion to rely on evidence of local costs:

> '306. [Ofwat's] essential response to these arguments is twofold: (i) local costs are "irrelevant", and the only practical and principled way of assessing costs is by reference to regional average costs; and (ii) the various figures relied on by Albion are insufficiently robust to enable any conclusions to be drawn. …
>
> 309… One of [Ofwat's] principal concerns in this case, among others, is that in [its] view there would be a potentially adverse effect on tariff setting if the principle of "regional average" costs was departed from.'

304. The Tribunal's conclusion on this point in Case 1046 was expressed in the following terms in the Interim Judgment:

> '316. In these circumstances we find it difficult to say that figures for the costs of the Ashgrove system are potentially "irrelevant" as [Ofwat] submits, assuming that such figures can be appropriately verified. One particular potential relevance of such figures in our view is as a cross-check against [Ofwat's] "top down" calculations. Indeed, since the [Regulatory Accounting Guidelines] appear to require the costs of non-potable supplies to

> be separately identified, we are not at present clear why it would be difficult to establish the average cost of non-potable supplies on a bottom-up basis.…'

305. In the 1046 Main Judgment, the Tribunal expressed itself in more definite terms saying that 'the practice of "regional averaging" cannot be invoked as a reason for not undertaking any more detailed inquiry as to what are the actual underlying components of the distribution costs attributable to non-potable users': see paragraph 613.

306. The Tribunal required Ofwat, as part of the Referred Work, to look at costs of non-potable specific systems saying that each system has its own cost structure and is dedicated to particular customers. It could be said that the LAC method adopted in the Referred Work is reasonably equivalent to the task given to Hyder Consultancy. Ofwat's LAC calculation, of course, arrived at a much lower figure for common carriage (14.1p/m^3 excluding the cost of a back-up supply; which the Tribunal adjusted further to 13.8p/m^3). In describing the LAC methodology in the Referred Work, Ofwat made clear its doubts about the value of the exercise saying it was 'not a methodology that the Authority employs in a regulatory context as it traditionally regulates prices and tariffs on a regionally averaged basis': paragraph 9.2 of the Referred Work. Further, the way Ofwat has described the work done indicates that it is not possible to say that there is only one correct way to do this. Particularly when it comes to the correct allocation of common costs, the Referred Work records that Ofwat considered it had made a fair allocation of common costs in the LAC methodology in this case, 'acknowledging that there are no prescriptive rules in competition law on how such an allocation should be made': see paragraph 9.59 of the Referred Work.

307. We do not know what the Hyder Report would have said about local costs, either of the Ashgrove system in particular or the non-potable supply generally, if it had been completed. It is not clear to us how much work remained to be done. On the one hand, Mr Henderson wrote to Mr Edwards on 6 Sept 2000:

> '... results from the Non-pot asset exercise done by [Hyder Consulting]. This should give us the information to derive costs individual schemes and perhaps derive a [non-potable] LIT ... It looks like there is now a surfit [*sic*] of information to work with!'

308. On the other hand, there is evidence that there were still substantial gaps to be filled before the work could be used. Mr Henderson said in a later email dated 27 November 2000 to a Mr Brotherton (who was also working on producing the data):

> 'We are now moving forward to derive the network access price for Ashgrove and other Nonpotable [*sic*] supplies using the data that Ivan put together for us. However, it seems that the values for above ground assets are still missing on these – can you help fill in the blanks please.'

It was also Mr Edwards' evidence that it would not have been possible to derive a common carriage price from the Hyder Report alone, since all it showed was the capital value of the pipes. It did not include operating, maintenance or management-on costs.

309. Although, as the Tribunal said in the Interim and 1046 Main Judgments, it would have been sensible, even necessary, to carry out a bottom-up check on the top-down methodology, we cannot conclude that the failure to do so evidences either a decision taken in cynical disregard of Albion's rights designed to ensure that any resulting common carriage price would be unlawful or that Dŵr Cymru closed its eyes, reckless to the risk that the common carriage price might be unlawful.

v. The detail of the calculation of the First Access Price

310. We turn then from the principle of regional average pricing to the detailed calculation of the First Access Price. Are there any elements there which were so obviously wrong that we can infer that Dŵr Cymru must have intended to infringe, or been reckless as to whether it infringed, Albion's rights when it included or excluded that particular element?

311. The primary evidence on the calculations was given by Mr Edwards. As we have described, he worked on the Dŵr Cymru Statement of Principles and Network Access Code which were produced in February and August 2000, respectively. He then became more intensively involved in computing the Albion common carriage price in January 2001 when he took over the work that had already been started by Mr Henderson.

312. There are a few matters to set out by way of preliminaries. The first is that the context of the work carried out by Mr Henderson and Mr Edwards was that at the time, Dŵr Cymru did not have a tariff for large users of non-potable water (since the non-potable LIT was

only introduced in 2003). There was the standard tariff for small users of *potable* water and there was a LIT for users of *potable* water. There was also a tariff for small users of *non-potable* water set at 49 p/m^3. This 49 p/m^3 tariff was applied to only a negligible volume of water. What Dŵr Cymru did not have was a tariff price for large non-potable customers. The discussions about the common carriage price, therefore, focused on the calculation of a non-potable LIT price. This could then be used, by deducting the cost of the raw water, to produce a rate for non-potable common carriage.

313. Secondly, the task that Mr Henderson and Mr Edwards undertook was not to produce a specific price for Albion's common carriage application but a price that would be charged to any applicant for non-potable common carriage anywhere on the Dŵr Cymru network. Thus, paragraph 5.4 of the LCE paper of February 2001 noted that '[a]s the constituent prices are based on whole company averages they are not particular to the Ashgrove application therefore they are, effectively, Dŵr Cymru's Common Carriage prices'.

314. Finally, by way of preliminary remarks, we note that both Mr Henderson's and Mr Edwards' methods worked on the principle not only of using average costs but of finding the cost of bulk distribution (a key element in the composition of any common carriage price) by arriving at a residual figure having deducted other categories of cost from a starting point figure. In other words, they did not attempt to build up the whole company average cost of bulk distribution by looking at Dŵr Cymru's assets used in bulk distribution (as was done in the Referred Work). Rather, they deducted various other costs from the figure that was treated as a proxy for the total cost stack and regarded the remainder, once all other services had been deducted, as the cost of bulk distribution. We discuss the differences between their methods further below.

a. The first stage: Mr Henderson's initial calculation.

315. The first attempt at the calculation of a non-potable LIT (and hence a non-potable common carriage price) that we have seen was set out in an email dated 29 November 2000 from Mr Henderson to Mr Holton and Mr Edwards. This attempted to arrive at a price by working back from the standard non-potable tariff for small users of 49p/m^3. In the case of *potable* water, the difference in price between the standard tariff and the lower-priced LIT was justified by the fact that standard tariff consumers use much more of the smaller pipe network than the large industrial users. The potable LIT was computed by removing from

the standard tariff a sum reflecting the costs of the smaller pipes. Mr Henderson was exploring whether the same could be done to calculate a non-potable LIT from the non-potable standard tariff. His conclusion spelled out in the email is that, having looked at what pipes the standard non-potable tariff users use, this does not make sense since they are only in fact using large pipes. The large industrial users are using almost as much of the pipe network as the standard users.

316. Mr Henderson, therefore, suggests another way of trying to remove a 'local distribution' element from the standard potable tariff to arrive at a non-potable LIT. He identifies the local distribution element in the potable tariff by deducting the highest potable LIT price (44p/m^3) from the standard potable tariff price (83p/m^3). This, amounting to 39p/m^3, can be regarded as the price for the local distribution of potable water. The second step is to look at the activity based costing tables that Dŵr Cymru supplies to Ofwat for regulatory purposes. These indicate that distribution as a whole amounts to 67 per cent of the standard potable tariff (that is 56p/m^3), the other 33 per cent (or 27p/m^3) comprising resources (i.e. the raw water) and treatment costs. If the activity based costing tables indicate that total distribution element within the standard potable tariff is 56p/m^3, and the local distribution element can be regarded as 39p/m^3, then this indicates that the bulk distribution element is 17p/m^3. A maximum non-potable tariff for large industrial users would then be 27p/m^3 (for resource and treatment) plus 17p/m^3 for bulk distribution namely 44p/m^3.

b. The second stage: the 19.94p/m^3 price in the LCE paper

317. Mr Henderson had not, in his 29 November 2000 email, attempted to split out the cost of water resources and water treatment. He did further work and produced an undated paper headed Network Access Prices. Mr Edwards' evidence was that when he examined the work that Mr Henderson had done he found a number of errors. His corrections were marked in manuscript on the Network Access Prices document. One error had been the use of the total modern equivalent asset value in the calculation of the split of costs between resources and treatment, whereas the correct approach was to include only the return on capital of the modern equivalent asset. Another error had been to use as a starting point the standard potable volumetric rate, which did not include the costs that standard tariff customers paid in the fixed standing charge payable under the LIT. Mr Edwards therefore made some corrections to Mr Henderson's work.

318. Mr Edwards' re-working of Mr Henderson's calculation was set out in the LCE paper produced in December 2000. The figure he arrived at was the figure of 19.94p/m^3, which was ultimately presented to the Board at the Board meeting on 15 January 2001. Despite the Board, at that meeting, apparently rounding that figure up to 20p/m^3 and approving it for issue to Albion as an 'indicative' price, the minute records merely that the Board considered that: 'The issue of de-averaging of costs of supply remains a complex issue'. During the course of these proceedings this price was referred to as 'the Indicative Price' although Albion' case was that it had not been presented to the Board as anything other than the final calculation – which was then revisited only because the Board thought it was too low. We will refer to it as the Indicative Price without prejudice to Albion's contention on that score.

319. The Indicative Price, based on Mr Henderson's methodology as corrected by Mr Edwards, was derived as follows:

(a) the starting point used was the top band of the Dŵr Cymru potable LIT, namely 83.74p/m^3;

(b) Mr Edwards then calculated the water resource costs at 4.02p/m^3, which he derived from the activity-based costing tables that were submitted by Dŵr Cymru to Ofwat for regulatory purposes;

(c) he also calculated the whole company potable treatment cost at 29.48p/m^3. This he derived by deducting the water resources cost (4.02p/m^3) from the percentage of the starting point that he considered represented resources and treatment (that was 40 per cent of 83.74 = 33.50 less 4.02 = 29.48p/m^3);

(d) he then split out the local distribution element by calculating the difference between the standard potable tariff and the highest band of the potable LIT (that is 83.74 less 44.64 = 39.10p/m^3);

(e) he deducted the figure for local distribution (39.10p/m^3) from the figure for total distribution within the potable price (that was 60 per cent of 83.74 = 50.24p/m^3) to

arrive at a residual figure he recorded as 11.10p/m^3, which he regarded as the cost of bulk distribution;

(f) he then added back in 30 per cent of the potable treatment costs of 8.84p/m^3 (that is 30 per cent of 29.48p/m^3); and

(g) this gave a non-potable common carriage price of 19.94p/m^3 (that is 11.10 plus 8.84p/m^3).

vi. The final computation of the First Access Price

320. The final computation of the First Access Price was set out by Mr Edwards in a number of schedules to a Board paper that were then sent to Ofwat under cover of Mr Edwards' letter of 20 February 2001.

321. The First Access Price was computed in the following way:

(a) the starting point used was not the top band of the potable LIT but rather the average price paid by customers in the top band of the large potable users tariff (derived from dividing the total income from the top band of the potable LIT by the total volume of water supplied to those customers). This gave a starting figure of 43.9p/m^3. Mr Edwards then had to split this into resources, treatment and bulk distribution (local distribution was of course already excluded from the potable LIT figure);

(b) to calculate the water resource figure, he worked from figures in the June Return 2000, an annual document provided by Dŵr Cymru to Ofwat for regulatory purposes. Here he took what was described as the whole company average price of water at 2000/01 values as being 73.3p/m^3;

(c) to work out how much of that 73.3p/m^3 reflected the costs of water and treatment, he first split that figure into resources and treatment on the one hand and distribution on the other hand. Taking the figure for resources and treatment, he then split that figure into an amount for resources on the one hand and treatment on the other hand. The appropriate percentages were, again, derived from the June Return figures and

were as follows: resources: 5.32% = 3.9p/m^3; treatment: 32.68% = 24.0p/m^3; and distribution: 62% = 45.4p/m^3;

(d) to work out how much of that distribution cost of 45.4p/m^3 reflected bulk distribution he deducted the cost of treatment and resources (3.9 plus 24.0 = 27.9p/m^3) from the starting point figure (that was the average price paid by the top band potable LIT customers = 43.9p/m^3) to arrive at 16.0p/m^3;

(e) to that figure he then added 30 per cent of the potable treatment costs to arrive at a price for non-potable treatment costs of 7.2p/m^3 (being 30 per cent of 24.0p/m^3); and

(f) this gave a common carriage figure of 23.2p/m^3 (being 16.0 plus 7.2p/m^3).

322. Albion criticises a number of aspects of this calculation. It submits that:

(a) the evidence shows that both Mr Henderson and Mr Edwards had in mind the figure of 26p/m^3 as the non-potable LIT and were trying to derive a methodology and price for common carriage that would (once the cost of the raw water was added) add up to 26p/m^3. Albion asserted that the whole exercise, in particular the changes made to move from the Indicative Price to the First Access Price, show that the figures were being manipulated to get the 'right' result from Dŵr Cymru's point of view;

(b) Mr Edwards' method was flawed because it deducted an average treatment cost for potable and non-potable water (that is 27.9p/m^3) from an average price of potable water (that is 43.9p/m^3) to arrive at the residual figure for bulk distribution, thus mixing up two strands of costs;

(c) both methods were flawed because they assume that bulk distribution costs were the same for potable and non-potable water rather than charging just a proportion of bulk distribution costs. In other words, Albion submits that just as an adjustment was made by regarding non-potable treatment costs as only 30 per cent of potable treatment costs, so a similar adjustment should have been made to reflect the fact that bulk distribution for non-potable water is cheaper than bulk distribution of potable water; and

(d) the reduction for non-potable treatment in both methods should have been greater than the reduction in fact made; instead of applying a multiplier of 30 per cent, Dŵr Cymru should have used a multiplier of 15.2 per cent.

vii. The 'target' of 26p/m^3 and reasons for the shift from Mr Henderson's method to Mr Edwards' method

323. We find that Mr Henderson and Mr Edwards both had in mind the figure of 26p/m^3 as representing the average Dŵr Cymru price in fact being charged for non-potable water to large industrial users. Mr Edwards was cross-examined about where this figure of 26p/m^3 came from. It was put to him that this was the price of the supply to Albion and Shotton Paper under the Second Bulk Supply Agreement of 1996; this was, therefore, the 'target' price for any common carriage proposal because it would result in common carriage being uneconomic for Albion. Mr Edwards denied that. His evidence was that he understood that Mr Henderson believed that was the 'correct price' for the non-potable LIT because that was the price that Denis Taylor had come up with several years earlier. He said that it was a bench mark figure that had been established over a number of periods as the partially-treated, non-potable price for special agreements. It also appears that Mr Edwards knew that the 26p/m^3 price had been 'approved' by Ofwat in 1996 (see paragraph 12 above) as the price that Ofwat would be minded to set as for the bulk supply to Albion. We accept his evidence that he was aiming to get to a figure of 26 p/m^3 for non-potable LIT because that was a figure that had been produced by his previous boss and which was at that time being paid by Albion.

324. In fact, we now know from the documents disclosed after the main hearing in this claim had finished that certainly Mr Henderson and Mr Holton realised that there was no firm basis for the 26p/m^3 figure. In the document attached to Mr Henderson's email of 7 November 2000 he notes that there is no evidence that the standard non-potable rate (that is the 49p/m^3) is cost reflective and further that:

> 'There is a nominal large user tariff for non-potable water in the range 26-30p/m^3. This has been set based on the Albion Water price derived by [Denis Taylor] and uses assumptions of cost allocation for which there is no supporting evidence'.

325. But it is not clear that Mr Edwards knew about these conclusions or the lack of robustness of the 26p/m^3 figure. The 7 November 2000 email was produced by Dŵr

Cymru only after Mr Edwards had given his evidence so that Albion did not have an opportunity to put it to him.

326. So far as the changes made between the computation of the Indicative Price and the First Access Price are concerned, we have not seen any evidence, either in the contemporaneous documents or from Mr Williams, as to what discussions took place at the January Board meeting when the 19.94p/m^3 price was considered. Mr Edwards says that that figure was never intended by him to be the final quoted price because he knew that there were problems with the method on which it was based. Albion suspects that the Board recognised that a price of 19.94p/m^3 would not achieve a revenue neutral position for Dŵr Cymru and therefore instructed Mr Williams' team to redo the sums to come up with a higher figure.

327. Mr Edwards denied that there was any manipulation of the figures because the 19.94p/m^3 figure was inconvenient:

> 'Q. The reality is, Mr Edwards, that the reason why you were suddenly getting involved in recalculating the price was because the Board hadn't been satisfied with a figure that was going to lead to a massive drop in income and make common carriage viable going forward, wasn't it?
>
> A. That's totally incorrect. The reason I was involved was to ensure that any price that we revealed to the customer and to Ofwat was robust and suitable for challenge. I think our concern was a lot more around the regulatory and customer challenge to the way the price was calculated, rather than the quantum of the price.'

328. We have considered whether we should accept Mr Edwards' evidence on this point. We note that we have already rejected the parts of his statement that deal with capacity augmentation at Heronbridge (see paragraphs 129 to 134 above). On balance, we are not prepared to find that Mr Edwards, as a junior employee devising the common carriage price, took it upon himself to revise the 19.94p/m^3 price in a way which he knew or strongly suspected would be unlawful and would expose Dŵr Cymru to potential sanction by Ofwat in order to get to what he thought was the answer that the Board wanted to hear. We accept that there were aspects of the work that Mr Henderson had carried out that were problematic so far as Mr Edwards was concerned and which needed to be revisited. Mr Edwards also stressed in his evidence the time pressure that he was under to produce a figure for the January Board meeting and to quote to Albion, as well as to Ofwat, as a

possible price. It is not surprising, therefore, that further work needed to be done after January 2001.

329. We do not therefore regard the mere fact that the 19.94p/m^3 price was rejected as evidence of the intention of the Board to increase the common carriage price to an excessive level regardless of whether this could be achieved lawfully or not. We do not find that Mr Edwards was either instructed to increase the price for that purpose or that he did so of his own accord, knowing or being reckless as to whether the revised price would be unlawful.

viii. The deduction of average treatment costs from a potable tariff starting point

330. Mr Cook, cross examining Mr Edwards on behalf of Albion, described the changes that Mr Edwards had made to the calculation as 'a bit of accounting trickery'. He said that the key change was the move to using whole company average treatment costs, rather than potable water treatment costs, as the starting point for calculating the cost of treatment to be included in the common carriage price. Because a significant proportion of water sold by Dŵr Cymru is raw, spreading any treatment costs incurred over all the water sold, whether raw or treated, necessarily brought down the proportion of the average price reflecting treatment costs down considerably.

331. There were two aspects to this. The first was simply the mixing of a potable figure (that is the average potable LIT price paid of 43.9p/m^3) with a whole-company, all-water figure (that is the whole company resource and treatment cost of 27.9p/m^3). The mischief of this comes, according to Albion, when the lower treatment and resource figure of 27.9p/m^3 was deducted from the average price of water and *the residual amount* of 16.0p/m^3 was treated as the bulk distribution cost. As the treatment costs were reduced, that residual amount was higher. In fact, it had moved from 11.1p/m^3 in the figures generated by Mr Henderson to the 16p/m^3 used by Mr Edwards.

332. As to the point about the mixing of potable figures and all water figures, Ofwat was unconvinced about this part of the calculation. It noted (see paragraph 284 of the 2004 Decision) that the LIT figure related to potable users only, whereas the treatment cost being deducted was a treatment cost for both potable and non-potable water. Ofwat said that it

was ‘disappointed to have found apparent inconsistencies in the methodology used by Dŵr Cymru in Step 4’: see paragraph 287.

333. However, having done its own calculation to remove this inconsistency, Ofwat found that the right figure for bulk distribution costs was in fact either 15.8p/m^3 (based on the Dŵr Cymru cost justifications for the new non-potable LIT, which had been produced by the time of the 2004 Decision) or 16p/m^3 (using the appropriate percentage of the whole company average price used at step 1). Given that these figures were close, Ofwat concluded that it was not appropriate to make any adjustment to the bulk distribution figure.

334. It does not appear to be this step, therefore, that led to the price being excessively high.

335. The second aspect of the sum that Albion complains about is the fact that although the treatment cost is presented by Mr Edwards as a treatment cost for *all water* supplied by Dŵr Cymru, this was not in fact the case. He had excluded significant amounts of water sold by Dŵr Cymru from the calculation, namely the water sold to other water undertakers rather than to water user customers. This resulted in the exclusion of two significant volumes of water. One was the Dŵr Cymru supply contract for what has been referred to as Elan Valley water. This amounted to a supply of 122,896 Ml in 2001/2002 at a price of approximately 3.3 p/m^3. It also excluded the water sold under the Second Bulk Supply Agreement to Albion itself (approximately 6,800 Ml per annum).

336. In so far as Mr Edwards had excluded the Elan Valley water, that step was accepted as legitimate by Ofwat. In paragraph 265 of the 2004 Decision, Ofwat concluded that ‘in view of the special circumstances in which the assets relating to the Elan Valley supply were financed, the history of that supply and the highly unusual volumes of water supplied, it does not appear unreasonable to exclude figures relating to the Elan Valley Bulk Supply Agreement …’. In so far as he excluded the Albion and other bulk supply water, that was corrected by Ofwat: see paragraph 262 of the 2004 Decision. Ofwat decided that there was no reason to exclude that supply from the calculation.

337. Albion submitted that the exclusion of bulk supply, particularly the Elan Valley volumes had been deliberate. It pointed out that the inclusion of that large volume of water

would have resulted in the treatment costs expressed in p/m^3 being clearly too low, because it would have averaged potable treatment costs over a huge volume of raw water. This would have resulted in the residual amount representing bulk distribution being a much higher figure (because only a very small p/m^3 amount for treatment costs would have been deducted from the 43.9p/m^3 figure, being the average price paid by the large potable users). That would, in turn, have shown that the step of spreading treatment costs over the entire potable and non-potable water volume and then deducting that from a potable large users price was flawed.

338. The exclusion of *all* the bulk supply volumes and income from the figures was something that Mr Edwards accepted in hindsight was a mistake. Mr Edwards could not recall that anyone in the company had asked him why he had excluded bulk supply. He said '[i]t's something that is quite obviously wrong when you look at it like this. Therefore I can't imagine someone had ever looked at that'. We do not consider that Mr Edwards was guilty of deliberate 'accounting trickery' on this point. It was a mistake he made that went uncorrected because there was no one competent supervising his work or capable of testing and challenging the way he went about calculating the price.

339. Although we regard it as reprehensible that Dŵr Cymru put forward the First Access Price that was defective in this way, this appears to have been the result of incompetence and inexperience, rather than of a cynical disregard for the legality of the resulting price.

ix. The assumption that bulk distribution costs are the same for non-potable and potable distribution

340. Albion criticised both Mr Henderson's and Mr Edwards' methodology on the basis that Dŵr Cymru should have known that pipes used in the distribution of potable and non-potable water were different, and that non-potable distribution was cheaper not just because it uses bigger pipes but because the cost of operating those pipes is lower.

341. In his evidence, Mr Edwards rejected the suggestion that there was any such assumption underlying his calculation. Rather he said that part of the whole company averaging approach is to treat the distribution network as a single asset and charge everyone an element of that cost regardless of whether they are using the potable or non-potable distribution network. Thus, the calculation does not assume that potable and non-

potable distribution costs are the same but rather regards any such difference as irrelevant because all customers have to pay a share of the overall costs of both systems. He said that a lot of customers take their water through a particular discrete network but they are not charged on the basis of the costs of that particular network. They pay a share of the costs of the whole network, including those parts that their water does not travel through.

342. This stance was supported by Ofwat during Case 1046. Ofwat argued before the Tribunal that treating distribution costs as a single item without distinguishing between potable and non-potable distribution was widely accepted in the industry. Ofwat also argued that there is no material difference in the cost drivers for potable and non-potable distribution: see the 1046 Main Judgment, paragraph 366.

343. The Tribunal's conclusion (in paragraphs 448 onwards and then 477 onwards of the 1046 Main Judgment) was that, looking at regional average costs, there was insufficient information about this topic. The Tribunal did not say, despite all the evidence provided to it, that it was obvious that non-potable bulk distribution was cheaper than potable. At the summary in paragraph 631 of the 1046 Main Judgment the Tribunal said:

> 'In our judgment, the evidence we have referred to above, taken as a whole, shows on the balance of probabilities that it was not reasonable for Dŵr Cymru to assume that the costs of "distribution" of non-potable and potable water were the same at 16p/m^3. The essential error, in our view, was to rely on the approach that "a pipe is a pipe" (paragraphs 299 to 301 of the Decision) without considering more widely the different characteristics and cost components attributable to non-potable as distinct from potable supply systems.'

344. In the Referred Work, Ofwat concluded that bulk *potable* mains ≥600mm were the best comparator for bulk non-potable mains of the same size, although pipes 300-600mm diameter were also relevant (see paragraph 7.83). Ofwat, therefore, applied a nominal estimated weighting factor of 10 per cent (rather than 100 per cent) to the capital costs associated with 300-600mm pipes. This had the effect of including only those 300-600mm potable pipes that truly fulfil a 'bulk distribution' function (where bulk distribution involves transporting large quantities of water to single large users (or groups of large users) or to whole residential areas). So far as bulk non-potable distribution mains (>600mm) were concerned, a weighting factor of 50 per cent of for bulk (>600mm) potable mains would be appropriate. Ofwat also noted (at paragraph 7.103) that this weighting factor reduction implied that the bulk mains repair and maintenance, and associated bulk mains operation and control costs for non-potable distribution were also assumed to be 50

per cent of bulk potable distribution costs. However, this was satisfactory since, as Albion had submitted, a number of these operational activities are either not required (for example, sampling water quality) or at least not required to the same extent as on potable systems.

345. There is no doubt that this was one of the factors that led to the three methodologies used in the Referred Work coming to a lower price than the First Access Price. However, the manner in which the cost relationship between bulk potable and non-potable distribution was considered by Ofwat and the Tribunal in the course of the earlier proceedings does not indicate that the mistake that Mr Edwards made in simply equating the two kinds of supply was such an obvious mistake that Dŵr Cymru must have known that it would lead to the First Access Price being excessive.

x. The 30 per cent adjustment to derive non-potable treatment costs from potable treatment costs

346. The other error that Albion identifies is the use of the 30 per cent multiplier to arrive at the non-potable treatment costs. Mr Edwards took the whole company costs of treating water to a potable standard and then applied a percentage reduction to get to the costs of partial treatment. The percentage he applied was 30 per cent, that is he assumed that the cost of partial treatment was 30 per cent of the treatment cost of potable water.

347. Albion criticised the use of this figure on the basis that, during the course of the investigation leading up to the 2004 Decision, Dŵr Cymru accepted that a more accurate figure was 15.2 per cent.

348. At the time when the LCE paper was prepared at the end of December 2000 or early January 2001, the figure of 30 per cent was qualified with the comment:

> 'The 30% multiplier was calculated from talking to operational managers and asset managers at the time the initial Shotton Paper/Albion Water agreement (c.1996) was being negotiated. Work is currently being carried out to produce a robust asset value based price for the non potable portion of the treatment price.'

Mr Edwards also said in an email dated 5 February 2001 to Mr Holton and Mr Henderson that the only challenge to the methodology he was at that time contemplating for calculating the First Access Price was to this 30 per cent figure.

349. Mr Edwards' evidence was that the 30 per cent figure came from work done by Mr Taylor (his former boss) which would have been more thorough than simply asking operational managers. However, he accepted that it was five years out of date at the time he calculated the First Access Price and should have been investigated further. When he was asked why he had continued to use the 30 per cent figure for the First Access Price even though he knew it was not robust, Mr Edwards said that there was no other figure at the time that he and Mr Henderson could use. He also accepted that when the work was later carried out by Dŵr Cymru, the company came to a figure of 15.2 per cent. He could not explain why Dŵr Cymru did not carry out that work earlier.

350. Mr Edwards was asked why the caveat about the 30 per cent figure included in the December 2000 LCE paper was not repeated in the calculation schedules that went to the LCE in February 2001 nor in the schedules that went to Ofwat. He denied that this was an attempt to conceal the problems with the 30 per cent figure. First, he said that, since the Board had seen the December paper, it would have been aware of the caveat. Secondly, Mr Edwards said that he knew that Ofwat would be investigating the calculations closely and would quickly find out where the 30 per cent figure came from. He expected that this would be discussed with them once the price had been issued and Dŵr Cymru had to justify it. He was also, he said, fully aware that Albion would challenge the figures and he accepted that that was why Dŵr Cymru provided the figures to Ofwat before releasing the First Access Price to Albion.

351. Ofwat recorded in the 2004 Decision that Albion accepted that the treatment cost to be included in the common carriage price was not the treatment costs at Ashgrove itself but an averaged non-potable treatment cost. Ofwat further recorded that during the course of the investigation Dŵr Cymru had – rather to Ofwat's surprise – come up with the revised figure of 15.2 per cent rather than 30 per cent as the correct proportion of total treatment costs to be treated as the cost of partial treatment. A multiplier of 15.2 per cent results in a treatment cost of 3.2 p/m^3 (rather than the 7.2 p/m^3 included in the First Access Price).

352. In paragraph 295 of the 2004 Decision, Ofwat said:

> '295. This figure [of 15.2 per cent] broadly matches Albion Water's assessment of the direct costs of treatment at the Ashgrove Treatment Works, and is below Albion Water's

> estimate of maximum possible treatment costs. Ultimately it is this adjustment to Step 5 of the calculation which most significantly affects the First Access Price.
>
> 296. There is, however, no evidence that Dŵr Cymru had deliberately overestimated the non-potable treatment costs as Albion Water alleges. In fact, it was Dŵr Cymru itself that highlighted the case for a lower percentage in Step 5 following its further work in the context of the New Tariff".

353. Ultimately, in the Referred Work, which was considered in the Tribunal's Unfair Pricing Judgment, Ofwat arrived at slightly higher figures for water treatment. The cost of water treatment included in the Referred Work under the different methodologies was: 5.3p/m^3 (including sludge management) using the AAC+ methodology; 7.4p/m^3 (excluding sludge management) using the LRIC methodology; and 3.0p/m^3 (excluding sludge management) using the LAC methodology.

354. In the light of that, we cannot conclude that Dŵr Cymru's inclusion of a figure of 7.2p/m^3 for treatment costs in the First Access Price was so obviously wrong and unreasonable that by including it, Dŵr Cymru must have intended that, or been reckless as to whether, the First Access Price was unlawfully high.

xi. Conclusion on the first limb of Rookes v Barnard

355. Although, therefore, Dŵr Cymru failed to cross-check its average pricing methodology and there were undoubtedly errors in the calculations, the evidence does not establish that that failure followed a deliberate decision by the company to close its eyes to the likely result of such an exercise. Nor does it seem to us that those errors were deliberate, or so obvious that Dŵr Cymru must have realised or have been reckless as to whether it had produced an unfairly excessive access price. To express the matter in the terms of the test in *2 Travel* to which we referred earlier, there is insufficient evidence here to show that Dŵr Cymru, whether at a senior or junior level, was aware that the First Access Price was either clearly or probably unlawful.

B. The second limb of *Rookes v Barnard*: calculating gains against risks

356. We turn, finally, to the second element in the *Rookes v Barnard* test (Lord Devlin's speech at page 1227):

> 'Where a defendant with a cynical disregard for a plaintiff's rights has calculated that the money to be made out of his wrongdoing will probably exceed the damages at risk...' (emphasis added.)

357. Lord Diplock in *Broome v Cassell* also said that:

> 'While, of course, it is not necessary to prove that the defendant made an arithmetical calculation of the pecuniary profit he would make from the tortious act..., it must be a reasonable inference from the evidence that he did direct his mind to the material advantages to be gained by committing the tort and came to the conclusion that they were worth the risk of having to compensate the plaintiff if he should bring an action.' (emphasis added)

358. In *John v MGN* [1997] 1 QB 586, at 616, the Court of Appeal endorsed the following academic passage as an accurate statement of the law:

> 'a) Exemplary damages can only be awarded if the plaintiff proves that the defendant when he made the publication knew that he was committing a tort or was reckless whether his action was tortious or not, and decided to publish because the prospects of material advantage outweighed the prospects of material loss. "What is necessary is that the tortious act must be done with guilty knowledge for the motive that the chances of economic advantage outweigh the chances of economic, or perhaps physical, penalty".
>
> b) The mere fact that a libel is committed in the course of a business carried on for profit, for example the business of a newspaper publisher, is not by itself sufficient to justify an award of exemplary damages.' (emphasis added)

359. Later on in his judgment in *John v MGN*, Bingham LJ giving the judgment of the Court said that the second element required that:

> '… the publisher must have acted in the hope or expectation of material gain. It is well established that a publisher need not be shown to have made any precise or arithmetical calculation. But his unlawful conduct must have been motivated by mercenary considerations, the belief that he would be better off financially if he violated the plaintiff's rights than if he did not, and mere publication of a newspaper for profit is not enough.'

360. In this case, there is certainly evidence that the Dŵr Cymru Board was aware of the potential adverse effect of the introduction of common carriage on its existing business. Even before Albion applied for common carriage, Dŵr Cymru had suffered a substantial reduction in the revenue it earned on the supply of water to Shotton Paper from the price of 27.47p/m^3 that it had been charging to the 26p/m^3 it was paid under the Second Bulk Supply Agreement with Albion: see paragraph 14 above. This amounted to a loss of revenue of about £100,000 per year. Senior management at Dŵr Cymru could not have

been unaware of the loss of this income, the cause of that loss and the warning signal this gave them as to possible effect of the introduction of competition on their business.

361. The sparse Board papers and minutes that we have seen show that:

(a) the Board was told in April 2000 that £23.4 million of revenue was 'at risk' from the introduction of competition into the industry and a recognition that large customers were likely to seek opportunities to change supplier and stimulate more water companies to become active in the water market;

(b) according to the November 2000 Board minute, the Board discussed the application by Albion for common carriage for the supply of water to Shotton Paper and had concluded that a 'relatively neutral cost effect' could be achieved 'so long as' Dŵr Cymru used an average pricing methodology for pricing the arrangements; and

(c) that the Board had been expressly told in the February 2001 LCE paper that an access price of 23.2p/m^3 made Albion's common carriage application 'uneconomic'.

362. Dŵr Cymru had well in mind the economic advantages that could be gained by insisting on a whole company average basis for calculating common carriage and it recognised that if it could justify such an approach, that was likely to protect its existing revenue from Albion and other inset appointees. The LCE paper shows that senior management went into some detail as to how much money was at risk and how the market might develop in ways that increased or mitigated the risk of the revenue being lost.

363. However, the case law cited above shows that it is necessary for there to be some additional evidence not only that the defendant was motivated by the desire to make a profit or avoid a loss of revenue but that there had been some weighing up or balancing of the likely gain against the likely loss in terms of having to pay compensation to the claimant. In *John v MGN* the Court of Appeal did not have to decide whether the prominence given to the headline of the article containing the defamatory material was enough of itself to evidence the requisite calculation because there was other evidence of calculation to put before the jury. This was a letter from which it emerged that the

publishers had made an assessment that the claimant was very unlikely to sue for defamation because of his earlier admissions of substance abuse.

364. In the present case there is no evidence before us that the Dŵr Cymru Board or anyone else in Dŵr Cymru weighed the risks of going ahead with the First Access Price against the likely downside in terms of future compensation payments to Albion. Mr Edwards' evidence was that to his knowledge there was no discussion or consideration of any kind within Dŵr Cymru as to whether the First Access Price might allow Dŵr Cymru to achieve an elevated level of profit:

> 'I also confirm that neither I, nor to the best of my knowledge and belief, any other person in Dŵr Cymru had any intention to obtain supra-competitive profits.'

365. We recognise the point made by Albion that, if Dŵr Cymru had turned its mind to the question of whether any benefit would outweigh compensation, it would have realised that the maximum compensation payable to Albion would be a sub-set of the money they made in the interim from continuing supplying under the Bulk Supply Agreement at 26p/m^3. However, we do not regard that as an adequate substitute for evidence that Dŵr Cymru, either at a senior or junior level, actually thought about it.

C. Conclusion on exemplary damages

366. We have already indicated our misgivings about the way Dŵr Cymru conducted this part of the case before the Tribunal with the very belated disclosure of relevant documents; the absence of the kind of evidence one would expect to see from witnesses and contemporaneous documents, and the implausible explanations as to why that evidence was not forthcoming. But we have concluded that Albion's claim for exemplary damages must fail on two grounds:

(a) it is not possible to conclude on the basis of the evidence before the Tribunal or by drawing an inference from the way that the case has been conducted that Dŵr Cymru must have intended to issue an unlawfully excessive price or that it was reckless as to whether the price was so excessive. Further, the factors that led to the First Access Price being found to be abusive were not so obviously wrong and unlawful that we can infer that Dŵr Cymru must have realised that the price was indefensible; and

(b) there is no evidence that Dŵr Cymru deliberately closed its eyes to the excessive nature of the price because it had calculated, in however broad a fashion, that the money it was likely to make from issuing the First Access Price was likely to exceed any damages that it would be liable to pay to Albion in the event of a successful claim.

VIII. THE OVERALL RESULT OF THE CASE

367. For the reasons given above, the Tribunal's unanimous decision is that:

(a) Dŵr Cymru is liable to pay Albion £1,694,343.50 in respect of Albion's claim for loss arising in relation to the supply of water to Shotton Paper;

(b) interest is payable by Dŵr Cymru on the sum of £1,694,343.50 at an annual rate of 2 per cent above the base rate from 26 January 2005 until payment;

(c) Dŵr Cymru is liable to pay Albion £160,149.66 in respect of Albion's claim for loss arising from the lost opportunity to supply water to Corus Shotton;

(d) interest in payable by Dŵr Cymru on the sum of £160,149.66 at an annual rate of 2 per cent above the base rate from 20 July 2006 until payment; and

(e) the claim for exemplary damages is dismissed.

Vivien Rose Tim Cowen Brian Landers

Charles Dhanowa OBE,
QC (*Hon*)
Registrar Date: [●] March 2013

APPENDIX I: GLOSSARY OF DEFINED TERMS

The Parties	
Albion	The Claimant, Albion Water Limited
Dŵr Cymru	The Respondent, Dŵr Cymru Cyfyngedig
The Tribunal's judgments in the infringement proceedings: Case 1046/2/4/04	
The Interim Relief Order	Order of the Tribunal made 2 June 2004 granting Albion's application for interim relief; varied by rulings [2005] CAT 19 (11 May 2005) and [2006] CAT 33; and brought to an end by the Remedies Judgment
The Interim Judgment	*Albion Water Ltd v Water Services Regulation Authority* [2005] CAT 40 (22 December 2005)
The 1046 Main Judgment	*Albion Water Ltd v Water Services Regulation Authority* [2006] CAT 23 (6 October 2006)
The Margin Squeeze Judgment	*Albion Water Ltd v Water Services Regulation Authority* [2006] CAT 36 (18 December 2006)
The Unfair Pricing Judgment	*Albion Water Ltd v Water Services Regulation Authority* [2008] CAT 31 (7 November 2008)
The Remedies Judgment	*Albion Water Ltd v Water Services Regulation Authority* [2009] CAT 12 (9 April 2009)
Defined terms	
2 Travel	The Tribunal's Judgment in Case 1178/5/7/11 *2 Travel Group Plc (In Liquidation) v Cardiff City Transport Services Limited* [2012] CAT 19
2004 Decision	Ofwat's decision of 26 May 2004, CA98101/2004: 'Complaint by Albion Water against Dŵr Cymru

	relating to common carriage for the supply of water to Shotton paper mill', in which it found no infringement of the Chapter II prohibition by Dŵr Cymru
AAC+	Average accounting costs plus
Ashgrove system	The system of pipes owned and operated by Dŵr Cymru through which water is supplied to Shotton Paper and Corus Shotton
Case 1046	The appeal brought in the Tribunal by Albion against the 2004 Decision in Case No. 1046/2/4/04
Competition Act	Competition Act 1998
Chapter II prohibition	The prohibition of the abuse of a dominant position contained in section 18(1) of the Competition Act
Corus Shotton	A steel producer supplied with non-potable water via the Ashgrove system
ECPR	Efficient component pricing rule
ELL	Enviro-Logic Limited; former parent company of Albion
Enron Coal	The Tribunal's judgment in Case 1106/5/7/08 *Enron Coal Services Limited (In Liquidation) v English Welsh & Scottish Railway Limited* [2009] CAT 36
First Access Price	The price of 23.2p/m^3 offered by Dŵr Cymru to Albion for common carriage on 2 March 2001 and found to constitute and infringement of the Chapter II prohibition in Case 1046
Heronbridge Agreement	Agreement entered into by Dŵr Cymru and United Utilities on 10 May 1994 (deemed to have commenced on 1 July 1986) for the supply of raw water from United Utilities' Heronbridge pumping

	station to the Ashgrove system
Hyder Report	The Report prepared by Hyder Consulting Limited for Dŵr Cymru, collating information concerning the supply of non-potable water by Dŵr Cymru within Wales, dated August 2000
Indicative Price	The indicative price of 20p/m^3 (rounded up from 19.94p/m^3) for common carriage communicated by Dŵr Cymru to Albion on 16 January 2001
LAC	Local accounting costs
LCE	License Company Executive; a management committee of the LiCo with responsibility for the regulatory and operational aspects of Dŵr Cymru's water business, and comprising a number of the Dŵr Cymru executive directors
LiCo	License Company which owned the operating licences for Dŵr Cymru and Swalec
LIT	Large industrial tariff; standard retail tariff for intensive users of water; separate LITs existed for potable or non-potable water
LRIC	Long-run incremental cost
LRMC	Long-run marginal cost
m^3	Cubic metre; 1 cubic metre is equivalent to 1,000 litres
Ml	Megalitre; 1 megalitre is equivalent to 1,000 m^3
Ml/d	Megalitres per day
Ofwat	The Water Services Regulation Authority
p/m^3	Pence per cubic metre

PPI	Producer Price Index
Referred Work	Report of Ofwat dated 18 June 2007 to the Tribunal, provided pursuant to the Margin Squeeze Judgment and Rule 19(2)(j) of the Tribunal's Rules
RPI	Retail Price Index
Second Access Price	An "indicative" access price of 17.74 p/m^3 in 2003/4 prices, notified to Ofwat by Dŵr Cymru on 16 January 2004; communicated to Albion by Ofwat on or around 17 March 2004
Second Bulk Supply Agreement	The agreement entered into between Albion and Dŵr Cymru on 10 March 1999 for the supply of non-potable water via the Ashgrove system to Shotton Paper
Shotton Paper	A paper-making plant situated on Deeside supplied with non-potable water via the Ashgrove system
Tribunal's Rules	The Competition Appeal Tribunal Rules 2003 (SI 2003 No. 1372)
United Utilities	A water undertaker and supplier of non-potable water from the River Dee at Heronbridge to Dŵr Cymru
Water Industry Act	Water Industry Act 1991, as amended

Shotton Paper - Summary of Compensatory Award Calculations

	Stage 1 - Simple Comparison of Costs										Stage 2 - Result of the Application of Albion/SP Benefit Share			
Period	Volume	Buying price (bulk supply)	Net buying costs (real world)	Common carriage price	Average UU selling price to Albion	Average UU selling price to DC (for information)	UUBenefit share	Other costs (back-up, etc)	Net costs (counter-factual world)	Difference in costs	Effective Albion tariff to Shotton Paper	Margin over costs achieved (counter-factural world)	Margin over costs achieved/available in the real world	Net quantum
	m^3	p/m^3	£	p/m^3	p/m^3	p/m^3	£	£	£	£	p/m^3	£	£	£
1 March 2001 - 31 March 2001	-	-	-	-	-	-	-	-	-	-	-	-	-	-
1 April 2001 - 31 March 2002	6,715,157	25.98	1,744,598	14.50	3.46	9.61	-	-	1,205,676	538,921	22.44	324,123	-4,609	328,732
1 April 2002 - 31 March 2003	6,807,657	26.01	1,770,672	14.48	3.20	11.65	-	-	1,204,053	566,619	22.50	326,493	-711	327,203
1 April 2003 - 31 March 2004	6,551,380	26.35	1,726,289	14.58	3.75	12.41	-	-	1,201,407	524,881	22.84	305,600	-7,390	312,990
1 April 2004 - 31 March 2005	7,209,034	24.98	1,800,647	14.77	4.07	16.69	-	-	1,358,310	442,337	23.30	336,168	114,521	221,647
1 April 2005 - 31 March 2006	6,556,990	24.98	1,637,801	15.20	4.49	19.32	-	-	1,290,614	347,186	25.08	368,908	146,877	222,031
1 April 2006 - 31 March 2007	6,864,329	24.90	1,709,238	15.40	4.91	22.36	-	-	1,394,046	315,192	25.75	392,871	188,380	204,490
1 April 2007 - 31 March 2008	6,545,087	24.37	1,594,929	15.80	5.40	24.81	-	-	1,387,695	207,234	27.12	405,942	234,984	170,958
1 April 2008 - 7 November 2008	4,152,876	24.82	1,030,903	16.18	6.03	32.58	-	-	922,447	108,456	28.26	257,858	148,769	109,089

2001 - 2007 overcharge on bulk supply already reimbursed by DC		-94,699	-94,699
Sub-total		2,956,129	1,802,442
Allowance for Value of Shotton uplift payments made in 2002-2006 (if applicable)		-	-
Residual interim relief		-94,590	-94,590
Net quantum		2,861,539	1,707,853
Grossing up (if chosen by user)		-	-
Final quantum		2,861,539	1,707,853
Interest	calculated at 2% above base rate	580,834	346,659
Final quantum after interest		3,442,373	2,054,512

The above results are based on the following user choices

DC Common carriage price to Albion Water	14.4 p/m^3			Indexed on the basis of PPI	Back-up potable:	Back-up supply not selected
UU bulk supply price to Albion Water	As per DC			Not indexed	Capacity augmentation	No cost is included
Period for compensation	01/04/2001	to	7/11/2008		No fee is paid to DC for relinquishing water rights	
Benchmark price for benefit share	DC Retail Tariff					

The stage 2 calculation assumes that the benefit share could not have operated in the real world

Corus - Summary of Compensatory Award Calculations

	Real World			Counter-factual world					
Year	Volume m^3	Price paid p/m^3	DC retail tariff p/m^3	Relevant Volumes m^3	DC retail tariff p/m^3	Albion Tariff to Corus p/m^3	Albion's buying cost p/m^3	Margin achieved p/m^3	Award £
2004/05	1,309,326	22.79	31.79	1,309,326	31.79	23.30	18.84	4.45	58,320
2005/06	1,062,455	23.43	36.72	1,062,455	36.72	25.08	19.68	5.40	57,380
2006/07	885,654	23.95	39.53	885,654	39.53	25.75	20.31	5.44	48,213
2007/08	893,128	24.50	41.68	893,128	41.68	27.12	21.20	5.92	52,873
2008/09	706,581	25.60	47.02	427,820	47.02	28.26	22.21	6.05	25,864
Total									242,651
Interest calculated at 2% above base rate									40,145
Total after Interest									282,796

Results are based on the following user input choice: The DC retail tariff is chosen as the Price to Beat in 2004/05

As a consequence of that choice, and the calculation of the Albion tariff to Shotton Paper: Albion is able to offer a competitive price