OFFICE OF FAIR TRADING

Anticipated acquisition by Intercontinental Exchange Inc of a majority stake in the gas, derivatives and biomass operations of APX-ENDEX Holding B.V.

ME/5715/12

The OFT's decision on reference under section 33(1) given on 28 February 2013. Full text of decision published 2 April 2013.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. Intercontinental Exchange, Inc. **('ICE')** is a global operator of regulated futures exchanges and derivatives clearing houses located in the United States (US), Canada, the UK and the Netherlands.[i] ICE's commodity on-exchange platforms in Europe are active in commodity derivatives (including gas and power). ICE also provides trading and clearing services for over-the-counter (OTC) energy and credit derivatives.

2. APX-ENDEX Holding BV **('APX')** is a regulated energy exchange operating spot and futures markets including exchange trading and clearing services for a range of energy spot and derivatives contracts in the UK, Netherlands and Belgium. The APX business that forms the basis of the transaction in this merger comprises APX's natural gas (spot trading and futures), power futures and biomass futures operations ('the Target'). For the year 2012, the target business generated turnover of approximately £[ ].

TRANSACTION

3. By way of a sale and purchase agreement dated 14 September 2012 ('the SPA'), ICE plans to acquire a majority stake in the target with one of APX's current shareholders, N.V. Nederlandse Gasunie ('Gasunie'), retaining a

minority stake (the 'transaction').[1] ICE will pay a consideration of €[ ] for its majority stake in the target business.

4. The parties submitted a satisfactory informal submission to the Office of Fair Trading ('OFT') on 18 October 2012. The OFT's administrative timeline expired on 4 January 2013.

JURISDICTION

5. As a result of this transaction ICE and the Target ('the parties') will cease to be distinct. The parties overlap in the supply of exchange traded derivatives (or ETD); specifically of natural gas futures on the Dutch Transfer Title Facility (TTF) supplied to UK customers. The parties combined share of supply is [70-80] per cent. As a result, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met.

6. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation pursuant to section 23 of the Act.

MARKET DEFINITION

Background: the energy commodities sector

7. The transaction takes place within the overall energy commodities sector. This sector is characterised by the buying and selling of contracts that have differing maturity periods.[2] For example, **spot contracts** typically have a maturity of 'on the day' or 'next day' delivery, **prompt contracts** have a period of 'within month' and **forwards and futures** have a period of 'one month or more'. These maturity periods typically apply whether the contract traded is for natural gas, power or other energy underlying (asset).

[1] The target business will be effected by way of a demerger from the rest of APX's operations to a new company incorporated under the laws of the Netherlands. On completion of the demerger all assets and liabilities relating to the target will be contained in the new company.
[2] The length of time that it is possible to trade is known as a 'curve'. The trading curve contains 'tenors', which refer to how long it will take for the contract to reach maturity before physical delivery has to take place of the commodity.

8. The parties provide trading and clearing[3] services for energy contracts. Trading can take place in several ways. Contracts can be traded either on a regulated exchange platform as an ETD or over the counter (OTC), usually through a broker's electronic platform, by voice or bilaterally negotiated directly by counterparties. Energy contracts can also either be physically settled (physical delivery of the product on expiry of the maturity period) or financially settled[4] (closed out before the maturity period approaches where the seller gets the value of the contract).

9. Clearing services for derivative trades comprise a post trade function designed to mitigate counterparty risk (mainly the risk of contract default). In the provision of clearing services, clearing houses act as central counterparties ('CCPs'), acting as the buyer to every seller and the seller to every buyer and provide security to each transaction for the duration of the position.

10. In relation to energy contracts, regardless of the maturity period of the contract or the underlying asset, contracts traded OTC can either be cleared or uncleared, upon demand of the counterparties,[5] depending on counterparty risks. All ETDs are required to be cleared as part of the bundled package offered by on-exchange suppliers. The OFT understands that this is a commercial practice undertaken by all on-exchange suppliers.

11. In the UK, the National Balancing Point (NBP) is a Virtual Trading Point (VTP) for the sale and purchase of UK natural gas. The UK NBP is the largest hub for natural gas in Europe, representing approximately [60-70] per cent[6] of all volume of natural gas trades in Europe. Power derivatives are also traded in the UK. In the Netherlands, the TTF is the Dutch

[3] APX provides clearing services for spot contracts only, ICE for futures contracts only.
[4] In the markets where the parties operate, all contracts are physically settled, unless closed out before maturity. Financially and physically settled contracts therefore represent different uses of the same contracts rather than different contracts. In other markets, the OFT understands that financially settled contracts can represent a different type of contract that only permits a financial settlement without the need for traders to close out the contract before maturity. These contracts are not traded in this market.
[5] Third parties told the OFT that the majority but not all OTC contracts are eligible for clearing. Third parties explained that contracts with longer maturities are typically not eligible for clearing. According to one third party, approximately 90 per cent of OTC contracts are eligible for clearing.
[6] APX internal documents. – OFT calculated this figure based on volume data provided by the parties of all hubs in Europe.

equivalent hub for natural gas and power. TTF is operated by a subsidiary of Gasunie, who will retain a minority share in the Target business.

12. The Dutch TTF represents approximately [20-30] per cent[7] volume all trades in natural gas futures in Europe. As such, in Europe, liquidity (trading activity) has tended to aggregate in the UK and the Netherlands and these are two important centres for this type of trading where the parties are both present. The OFT also notes that a number of UK-based trading participants are active in both the UK NBP and the Dutch TTF.

13. The European Markets Infrastructure Regulation (EMIR)[8] which, amongst other things, mandates CCP clearing for eligible OTC derivative contracts may have an impact on the derivatives markets. However, the OFT notes that it is, as yet, unclear what impact EMIR will have on the energy commodity markets.

The Parties' business activities

14. ICE and the Target are both active in the operation of platforms that facilitate the provision of trading and clearing services for natural gas and power contracts in the UK and continental Europe. ICE is also active in the US whereas the target operates mainly in Europe.

United Kingdom

15. In the UK NBP hub ICE is active in **natural gas futures** where it is the only on-exchange platform facilitating the trading of such contracts[9] and is the only supplier of clearing services. Although the parties are both active in UK **power futures** (one month or more), the parties submitted that APX's activities in power futures have [ ]. The parties have informed the OFT that APX's power futures contracts will [ ] upon completion of the transaction.

16. In relation to UK NBP **prompts** (up to a month) APX was active until September 2012 in natural gas and ICE has no presence (as it is only active in **futures**). APX is also active in the provision of services for **natural gas**

[7] APX internal documents. – OFT calculated this figure based on volume data provided by the parties of all hubs in Europe.

[8] Regulation (EU) No 648/2012 of the European parliament and of the Council of 4 July 2012

[9] ICE says its main competitors in this market are the OTC brokers.

and power spot contracts (on-the-day) in the UK where ICE has no presence.

17. In the UK NBP spot market, APX has an institutional role as an independent operator of the UK on-the-day commodity Market ('OCM') licensed by OFGEM. The OCM is an electronic screen trading platform used by the UK's Transmission System Operator (TSO), National Grid, for short term (day-ahead and intra-day) balancing trades (spot trading) to maintain the physical balance of the UK National transmission System (NTS).

The Netherlands

18. On the Dutch TTF hub the parties both facilitate on-exchange trading of natural gas derivatives, more specifically **natural gas futures**.
ICE is a fully integrated exchange with a clearing operation in ICE Clear Europe (ICE Clear). The Target is not vertically integrated and outsources its clearing to ECC (the clearing operation of EEX, a German commodities exchange). APX is also active in the trading of Dutch **natural gas and power spots.** ICE does not offer any natural gas or power spot contracts in the Netherlands.

19. The parties estimate that the total value, in revenue terms, of natural gas futures and forwards (the OTC equivalent to ETD futures) traded on the TTF in 2012 was approximately £ [<50] million. In terms of exchange only revenues this figure was around £ [<10] million and if cleared OTC is included the figure was approximately £ [<10] million, with the remainder uncleared OTC.

Belgium

20. In the Belgian market only APX has any presence offering both natural gas and power spot and futures contracts.

Product scope

21. The parties overlap in the supply of on-exchange platforms that facilitate the provision of trading services of natural gas and power futures.

22. The OFT's starting point in identifying an appropriate frame of reference is generally to consider first if the narrow candidate markets in which the parties overlap can be widened through substitution on the demand-side.[10]

Trading and clearing services

23. The OFT has considered whether or not the provision of trading and clearing services are in separate product markets or one single product market. The OFT notes that, in general, regulated exchanges such as those operated by the parties are linked with the activity of clearing because trades executed on exchanges are always cleared through a designated clearing house (whether vertically integrated or not) as is the commercial practice of all on-exchanges.

24. In relation to previous decisional practice, the OFT, in **London Stock Exchange Group plc and LCH.Clearnet**[11] considered trading and clearing services separately given that the transaction under review involved an independent non-vertically integrated exchange acquiring a majority interest in an independent non-vertically integrated clearing house. The OFT noted in that decision that this was a different type of merger to the proposed acquisition considered by the European Commission (EC) in **Deutsche Borse/NYSE** where both entities involved operated so-called 'vertical silos', that is, an integrated exchange and clearing house. The OFT notes, however, that the EC, whilst accepting that trading and clearing could potentially be provided as separate services, assessed trading and clearing in combination, as a single bundle of services.[12] The EC did state that its approach was without prejudice to whether or not this was the only viable way of derivatives trading and clearing services being provided to users, in particular since alternative models do exist.[13]

25. The OFT considers that it is appropriate to take a cautious approach and to treat exchange and clearing services separately bearing in mind the linkage between the two services in its competitive assessment.

[10] Mergers Assessment Guidelines, OFT 1254, joint publication of the OFT and Competition Commission dated September 2010, section 5.1

[11] ME/5464-12, OFT decision in the anticipated acquisition by LSE of control of LCH.Clearnet Limited 25 January, paragraph 90.

[12] Comp.M/6166 paragraphs 242-243.

[13] Comp.M/6166 paragraph 242 footnote 118.

Trading services

Distinction between trading spots and derivatives (prompts/futures and forwards)

26. As set out above, there are three main types of natural gas and power contracts: spots, prompts and futures/forwards (the latter two types being considered as derivatives). Generally, the distinction between these types of products is dependent on their maturity period; that is the period within which the product has to either be physically or financially settled.

27. The parties overlap in trading of derivatives, specifically futures. The OFT has considered, however, whether a candidate market for trading of futures can be widened to include spot or prompts contracts.

28. The parties submitted that they are not active on the same part of the trading curve. In the UK NBP market, APX operates on the spot market and ICE operates on the future markets only. In the Dutch TTF market, APX operates on spot and derivatives and ICE on derivatives only. As such, the distinction between futures, prompts and spots is important for an overall assessment of the case.

29. In *TenneT/Elia/Gasunie/APX-Endex*,[14] the EC left open whether a distinction should be made between the facilitation of wholesale electricity (power) trading in short term and longer term products.

30. The OFT considers that, those customers, who are trading in prompts or futures for financial settlement and hedging price risks, would be unlikely to respond to a 5 per cent increase (small but significant non-transitory increase in price - SSNIP) in trading fees and/or the overall cost of trading and clearing fees together by switching to trade spot contracts. As such, it is unlikely that spot contracts represent a viable alternative given the very short maturity period, and the fact that spot contracts are almost exclusively physically settled (the buyer takes physical delivery of the natural gas or power within day or next day).

31. The vast majority of third parties indicated that spot contracts are not substitutable with prompts, forwards and futures since customers generally

[14] Case no. Comp/M.5911 paragraph 36-37.

require physical settlement (immediate or close to immediate delivery). This was said to be distinct from futures/forwards and prompts which are often used as a means to hedge price risk and can be financially or physically settled over a longer time period.

32. The OFT has, based on the evidence available, considered spots and derivatives separately. In relation to the distinction between prompts and forwards/futures (both derivatives), the OFT received mixed evidence about the degree of substitution between these. As such, it has adopted a cautious approach and assessed the transaction on the basis of distinct frames of reference for each of prompts and futures/forwards.

Distinction in trading based on commodity underlying

33. The parties submitted that it would not be appropriate to treat each type of energy derivatives as an individual product market, for example, natural gas, power, oil or coal, because the market is driven by large banks and hedge funds who hedge risks across various underlyings and seek to manage their overall exposure to risk.

34. In general, competition agencies reviewing financial services have adopted narrow markets by reference to the specific underlying or products in a series of cases. In the most recent example this approach was taken by the OFT in *LSE/LCH.Clearnet.*[15] Moreover, in *Deutsche Borse/NYSE Euronext* the EC concluded that financial derivatives should be subdivided according to the underlying asset class.[16] The EC also said that*:* **'for a position in one specific asset, a derivatives contract on another asset would not provide a perfect hedge'.**[17]

35. The market investigation supported the general approach that contracts with a different underlying are not substitutable. This was because using different asset classes would not provide a perfect hedge for a position.

[15] ME/5464-12, OFT decision in anticipated acquisition by LSE of control of LCH.Clearnet Limited 25 January, paragraph 84.
[16] Case No. Comp/M6166 (2012) paragraph 444.
[17] Case No. Comp/M6166 paragraph 396.

This would expose traders to 'irrational' risks[18] of offsetting one asset type with another.

36. The OFT considers that it is appropriate to segment each of the relevant types of contracts: spots, derivatives and prompts/forwards by reference to the individual energy underlying asset class.

Distinction between trading services supplied in different hubs

37. The parties submitted that: 'European natural gas hubs and trading platforms currently face intensified competition from other European natural gas hubs and from trading platforms located elsewhere in Europe as well as in other countries, such as the US. It is acknowledged that power trading may be more national in scope (at least in respect of spot trading, less so in respect of derivatives)'. The parties also highlighted that, in *TenneT/Elia/Gasunie/APX-ENDEX*, the EC found that trading in power contracts is national in scope because contracts are inextricably linked to a particular transmission network and that national power markets in Europe are becoming increasingly interrelated as a result of 'market coupling'.[19,20]

38. The OFT appreciates that some degree of substitutability may exist between trades carried out at different European hubs. In particular, third parties told the OFT that there is high correlation between the price of derivatives (prompt and future/forward) at different hubs in continental Europe. One third party also told the OFT that traders in continental Europe are increasingly trading on the more liquid Dutch TTF hub to hedge price risks related to their national gas contracts.

39. The parties' internal documents also contain an analysis of the development of the European gas market place and speculate that [ ].

[18] A term used by third parties to mean that traders would be exposed to the various risks associated with a particular asset class such as price movements rather than the like for like risk of using the same asset class.
[19] Case no. Comp/M.5911.
[20] The parties submitted these arguments in relation to the geographic scope. The OFT recognises there is an interdependence between the product and geographic scope in relation to the demand-side constraints from different hubs but considers it appropriate to assess this as part of the product scope in this case.

40. The OFT considers that this evidence, though suggestive of the potential for substitution between hubs in continental Europe, is not conclusive as to the degree of substitution between the UK NBP hub and continental Europe hubs. In particular, some third parties explained that, in order for traders to hedge a price risk relative to NBP gas using TTF gas they would also need to hedge the associated foreign exchange (FX) risk. In practice this would require natural gas traders to coordinate with FX traders to hedge the currency risk associated with gas trades. The OFT does not have sufficient evidence on the extent of hedging of natural gas and FX risks across national energy markets. Clearly it is possible but the evidence did not point to it being common practice for many customers.

41. Other customers, however, told the OFT that they would be willing to start trading on TTF, should they experience a SSNIP of five per cent by all venues on the UK NBP.

42. In summary, there is evidence suggestive of a degree of substitution between NBP and TTF hubs. However, this evidence is not sufficiently compelling to conclude, at first phase, that trades on the TTF are constrained by the ability of customers to trade on UK NBP. The OFT has therefore examined this merger on the basis of the UK NBP and the Dutch TTF (and any other affected European hubs) separately.

Distinction between cleared and uncleared products

43. Clearing services arise once a trade has taken place and are conducted by a clearing house which carries out a number of post trade functions, namely:

- it registers and processes the trade

- it may act as a CCP, sitting in the middle of the trade and assuming the counterparty risk involved. A CCP becomes the legal counterparty to every trade, acting as the buyer to every clearing member seller and a seller to every member buyer. It effectively takes on the risk arising from the trade for its clearing members, and

- it may perform netting functions, offsetting a party's trading obligations against the CCP.[21]

44. The process of clearing differs for different types of products. ETDs are generally cleared by a CCP which provides a performance guarantee by legally interposing itself between buyer and seller. In effect the CCP assumes the risk of counterparty default on behalf of the trading parties. Some OTC derivatives are cleared through a CCP in the same way as ETDs, while the majority remain bilaterally traded and clearing is carried out by the parties themselves who usually have collateral posted directly with the counterparties they trade with. There remain a large volume of bilateral contracts in energy markets which are not cleared at all, so called 'uncleared products'.

45. The amount of collateral traders are required to post depends generally on the default risk. Third parties told the OFT that the collateral requirement is a large 'opportunity cost' incurred by traders for clearing. Clearing fees, though an actual cost, constitutes a much smaller proportion of the overall clearing cost.

46. Traders generally tend to prefer clearing all their transactions through one clearing house because of the financial efficiencies generated by cross margining.[22] Traders clearing several transactions through the same clearing house can 'net off' the collateral debits matured in one contract with the collateral credits matured in another contract. This means that the larger the amount of trades cleared by the same clearing house, the lower the overall cost in collateral from one day to another.

47. The choice of clearing a certain transaction depends on the extent of the counterparty risk faced when trading OTC (whereas all exchange trades are mandatorily cleared). Set against this, traders consider the cost of clearing, the large part of which is made of collateral requirement and the associated opportunity cost, and the residual part consists of clearing fees. If the cost of clearing exceeds the perceived counterparty risk, traders will decide not

[21] Netting refers to the offsetting of buy and sell positions over a given period of time in a given product thereby reducing the number of open positions that need to be cleared and settled.
[22] Cross-margining involves calculating the amount of collateral required from a counterparty to cover the risk presented by that counterparty's portfolio. Cross-margining applies to products which display a degree of risk correlation.

to clear the transaction; conversely, if the counterparty risk is perceived as exceeding the cost of clearing, then traders will clear the trade.

48. Given the relative importance of the (opportunity) cost of collateral, in comparison to clearing fees, in determining the balance between counterparty risks and clearing costs, third party customers contacted by the OFT confirmed that they would not modify their choice of whether or not to clear a transaction in response to a five per cent SSNIP in clearing fees.

49. The OFT therefore considers, on a cautious basis, that cleared and uncleared products form distinct and separate product markets.

Distinction between trading ETD and OTC (cleared)

50. The parties submit that OTC trading forms part of the same relevant market as ETD. The parties submitted that in commodity markets most traders have access to both OTC and ETD platforms. This dual platform use is to improve the ability to hedge and manage the exposure to movements in natural gas and power prices, the assumption of risk by financial counterparties and arbitrage between similar and related instruments.

51. The OFT considers that there are a number of important distinctions between ETDs and cleared OTCs. The mechanisms by which an ETD and cleared OTC is traded is not the same. An ETD provides an element of security and transparency to traders which OTC trading does not. For example, third parties confirmed that ETDs guarantee price transparency and anonymity and that these factors were important when choosing to trade ETDs. As ETDs are traded on regulated markets, third parties also noted the importance of regulatory oversight in reducing the risk of market manipulation. These factors make trading OTCs and ETDs quite different from a customer perspective.

52. The OFT's market investigation therefore generally supported the findings of the EC in relation to the mode of execution in *Deutsche Borse/NYSE*. In that case, the EC considered that ETD and OTC derivatives have fundamentally different characteristics mainly in terms of market participants, trading strategies, clearing arrangements, costs and legal

risks.[23] Furthermore ETD and OTC derivatives are subject to different rules in that ETD derivatives are governed by the trading rules of the exchange that designed the contract whereas OTC derivatives are subject to bilateral contracts negotiated between the parties.[24] It should also be noted that in *LSE/LCH.Clearnet*[25] the OFT did not find any evidence to depart from the EC's position on this point.

53. Set against the different characteristics between ETD and OTCs, the OFT recognises that it received some evidence from its third party market testing that some customers would switch between ETD and cleared OTC in response to a SSNIP. This points towards some substitution between ETD and cleared OTC, however, the OFT has not been able to test a sufficient number of third parties on this question in order to conclude that ETD and cleared OTC are in a single market.

54. As a result, taking a cautious approach and conscious of previous decisional practice in this area and the fact that its competitive assessment does not differ however the product scope is determined, the OFT has left the precise product scope open in this case.

Clearing services

55. As noted above, clearing services can be provided to ETDs or OTCs. Generally, clearing of ETDs is carried out as part of a bundled service: the customer trades on a vertically integrated or non-integrated platform (where the exchange will nominate the clearing house) and clears the transaction accordingly. In respect of OTCs, the customer faces a different choice. It faces a choice as to whether or not to use clearing services and which clearing house to use.

56. The OFT understands that certain clearing houses tend to aggregate liquidity by focusing on certain asset classes. For example, a clearing house focusing in financial derivatives is unlikely to offer clearing services in energy commodities in the same pool of contracts as this would expose the clearing house to certain risks of price increases of different products.

[23] Comp. M/6166 paragraph 321
[24] Comp.M/6166 paragraph 326
[25] ME/5464-12, OFT decision in the anticipated acquisition by LSE of control of LCH.Clearnet Limited 25 January, paragraph 86.

Moreover, the OFT's investigation has found that clearing of natural gas and power contracts will be offered by the same clearing house but that this does not typically extend to clearing services for all energy commodities, for example a combination of oil, coal, natural gas and power.

57. The process of clearing can differ between asset class and instruments and within asset classes between different maturity periods. For example, clearing spot contracts is not the same as clearing prompts, forwards or futures since the operational requirements or risk profiling differ. In comparison, clearing derivatives, which have longer maturities than spots involves complex long term risk management procedures that require a different skill set than spot clearing. Consistent with this is the fact that currently, in the Netherlands, APX clears spot trades executed on its proprietary platform but outsources clearing of its futures trades to ECC as its nominated clearing house.

58. Finally, the OFT understands that clearing houses tend to focus on the provision of clearing services to trades executed on specific hubs. This means that traders operating on the TTF or NBP hubs are unlikely to clear their transactions through clearing houses that do not operate in those hubs.

59. On the basis of available evidence, therefore, the OFT considers the precise product scope can be left open given that no competition concerns arise on any reasonable alternative basis. However, the OFT has nevertheless analysed this transaction against the supply/provision of clearing services for natural gas and/or power derivatives traded in specific hubs (UK NBP, Dutch TTF) separately.

Geographic scope

60. The focus of OFT's analysis is on the trading and clearing of natural gas derivatives, specifically futures. The parties submit that the relevant geographic market is at least EEA-wide, if not global. The Parties submit that traders in Europe can access trading and clearing platforms from any location worldwide.

61. Third parties have confirmed that the natural gas futures market is at least EEA-wide. Contracts in natural gas and other energy commodities are

traded and cleared by a number of counterparties within and outside Europe.

62. The OFT notes, in respect of financial services markets, that the EC and the OFT in previous cases[26] have found the geographic market to be at least EEA-wide in relation to a range of asset classes including equities and derivatives. The OFT further notes that, in relation to the trading and clearing of energy commodities (for example, the trading of natural gas and power derivative in the UK or Dutch TFF) that the same conditions apply to traders, no matter where they operate in Europe. For example, trading and clearing fees are the same for all traders operating on a given platform in Europe.

63. On the basis of evidence considered, the OFT assesses the transaction on an EEA-wide basis.

CONCLUSION ON RELEVANT FRAME OF REFERENCE

64. The OFT has assessed the proposed transaction against the following relevant frames of reference:

   a) Supply of on-exchange trading services in, at least, the EEA separated by:

      i. type of contract (gas futures/forwards, prompts, spots)

      ii. length of contract (different maturity dates)

      iii. type of underlying (natural gas, power)

      iv. whether the contract is cleared or uncleared

      v. specific hub (UK NBP, Dutch TTF, other European hubs).

   b) Supply of clearing services in, at least, the EEA with the same distinctions as for trading services.

[26] Deutsch Borse/NYSE and LSE/LCH.Clearnet.

COMPETITIVE ASSESSMENT

65. The OFT considered its competitive assessment in natural gas futures in the Dutch TTF hub. The OFT assessed the following theories of harm:

    i. horizontal unilateral effects in the supply of trading services for UK NBP power futures

    ii. horizontal unilateral effects in the loss of APX and ICE as a potential competitor in the supply of trading services for UK NBP spot and natural gas futures

    iii. horizontal unilateral effects in the supply of trading services for Dutch TTF natural gas futures, and

    iv. non-horizontal effects arising from foreclosure of cleared OTC brokers.

Corporate governance and regulatory framework

66. The parties argued that the Government of the Netherlands (Dutch State) will have an interest in ensuring the competitive behaviour of the merged entity. This is because the merged entity will incorporate Gasunie, a company wholly owned by the Dutch State, as a minority shareholder with certain veto rights. The parties submit that given the nature of the shareholding agreement, the merged entity could not and would not engage in any of the theories of harm above.

67. Specifically, ICE intends to purchase 79.12 per cent of the share capital in the merged entity with Gasunie retaining 20.88 per cent of the share capital. The parties described Gasunie's shareholding as a **'…substantial controlling minority stake'**. The parties submitted the transaction forms part of the Dutch State's industrial gas policy. In effect, the Dutch State is seeking to ensure that sufficient liquidity is maintained on the TTF in order to promote and safeguard the position of the TTF and the Netherlands' gas strategy.

68. In pursuit of this aim, the parties explained that the merged entity, through the public and legal obligations placed on Gasunie would not be allowed by the Dutch State and the Dutch competition authority (NMa), which also has

a regulatory role in this market, to engage in any anti-competitive behaviour since this would go against the aims of the Dutch State to ensure a certain level of trading on the TTF.

69. In support of this argument, the parties noted that Gasunie will be [ ] with veto rights and can block any action/decision it deems harmful to the general operation of the TTF market. The role of the [ ] is to oversee the policy of the Management Board and the general course of affairs of the company.[27]

70. Furthermore, Gasunie is the sole appointed operator of the natural gas grid and operates the TTF. Gasunie's activities are therefore heavily regulated and directly overseen by the Dutch State and/or the NMa. Part of these regulatory obligations also extends to Gasunie. In addition, the parties submitted that the regulations stipulate that Gasunie in its exercise of its tasks must make sure that its activities are performed in a non-discriminatory way. The regulations also allow the Dutch State to adopt additional rules in order to promote transparency and liquidity but may also include the manner in which or the conditions under which, producers, traders, suppliers and grid operators supply information in relation to the demand and supply of natural gas.

71. The OFT notes that the corporate governance provisions do not specifically restrict or prevent price increases to trading fees and clearing costs. In fact, there is nothing in the corporate governance provisions that would suggest that any price changes would be put before the [ ].[28]

72. Furthermore, the OFT notes that the shareholders' agreement provides ICE with a [ ] on Gasunie's shareholding, in effect providing it a right to buy the Gasunie shares. In addition the shareholders' agreement also provides Gasunie with a [ ], providing Gasunie the right to sell its shares to ICE. The [ ] may be exercised by ICE within a period of [ ] following the expiry of [ ] from the closing date ([ ] exercise period).[29]

[27] [ ]

[28] Part B, Schedule 6 of the Shareholders Agreement details the [ ] Matters' which need the [ ] approval. There is nothing in the [ ] requiring the approval of the [ ] in relation to any price changes.

[29] The [ ] may also be exercised in respect of all (and not some) the [ ] shares by ICE. The [ ], if exercised, will not be less than €[ ] and more than €[ ].

73. The OFT notes that, as with any merger control agency, it cannot place complete reliance on the intervention of state agencies to prevent breaches of competition rules. Merger control is an ex ante review process intended to ensure that ex post breaches of competition law do not take place through ex ante control.

74. Set against that general policy provision, the OFT does note that discussions with the Dutch State did confirm that they would have oversight of certain aspects of the conduct of the merged entity but the OFT considers that these related to systemic risk and ensuring the continued growth and security of the TTF rather than curtailing any significant price rises or degradation of quality or innovation.

75. In any event, given ICE's [ ] on Gasunies' shares and conversely Gasunies' [ ]; it is not inconceivable that such checks and balances by the Dutch State could be terminated within a [ ] period by the exercise of the [ ] or [ ]. Therefore, notwithstanding the involvement of a Dutch State owned company in the merger in protecting and developing the TTF, the OFT does not rely on the specific corporate governance or regulatory provisions to mitigate any competition concerns.

HORIZONTAL ISSUES

Horizontal unilateral effects in trading services for UK power futures

Shares of supply

76. ICE and APX overlap in the supply of UK power futures contracts. In particular, ICE is the largest exchange operating in power futures with a market share of [80-90] per cent,[30] followed by N2EX with [10-20] per cent. APX, though present in this market, has no market share as its contracts are currently not traded. Since its launch in 2009 there have been only [ ] trades in total, the most recent in [ ].

77. Since there is no current increment between the parties respective power futures trading, the OFT focused its analysis on potential competition.

[30] Based on 2011 trading volume data excluding OTC trades.

Potential competition

78. The OFT notes that APX launched its UK power futures market in October 2009 after losing a tender process to Nasdaq OMX/NordPool. The tender process was run by the Power Trading Forum (PTF) under the umbrella of the Futures and Options Association (FOA) following OFGEM's intervention to try and increase liquidity and transparency in the power futures market.

79. The OFT examined a number of APX's internal documents. These do indicate that in 2010 APX may have attempted to generate interest from market participants in its power futures product in an effort to push for liquidity. However, the OFT notes that the last power futures trade was undertaken in [ ] indicating that this attempted entry failed. Moreover, there was no evidence that APX had any intention of re-entry into the power futures market. The parties informed the OFT that it is APX's intention to [ ].

80. The OFT therefore concludes that, on the basis of evidence available, there is not a realistic prospect of a significant lessening of competition (SLC) in the UK power futures market as a result of this merger.

Horizontal unilateral effects arising from the loss of potential competition in the UK NBP natural gas market

81. Although the parties do not overlap in the supply of trading services on the UK natural gas market, the OFT also examined whether APX might be the best placed potential entrant in this market and conversely whether ICE might be the best placed potential competitor to enter the market for the facilitation of spot natural gas trading.

APX position as potential entrant in NBP natural gas futures market

82. APX's internal documents show that APX attempted an entry into the natural gas prompt market on several occasions but failed to gain enough liquidity to hold its position. In particular, one internal document stated that APX-ENDEX launched the NBP market in 1999. Following this date, the market and product offering had been adjusted and re-launched on several occasions with the most recent changes occurring in 2007 and 2008.

83. It is clear from APX's internal document that its strategic rationale for continuing to push and develop its NBP offering, having established the OCM spot market, was to **'…offer the full curve of exchange traded gas products…'**. The APX internal document suggests that it was using the gas prompt market as a step towards entering the natural gas futures market and despite numerous attempts, APX was unable to gain any traction in the prompts market.

84. The OFT considered that there is no evidence to suggest a further strategy in the future nor whether any such strategy of APX would be more successful than previous attempts. The parties have further informed the OFT that APX's prompts business was subsequently delisted in September 2012. Furthermore, the OFT considers that even if APX successfully entered the prompt market, it would represent only a limited competitive constraint on ICE's natural gas futures operation because of the limited substitutability between prompts and futures contracts.[31]

85. Therefore, subject to the evidence available, the OFT finds that there is not a realistic prospect of an SLC in the NBP natural gas futures market as a result of the elimination of APX as a potential entrant.

ICE position as potential entrant in NBP natural gas spot market

86. The OFT notes that APX operates in a particular segment of the spot market. APX has an institutional role as independent operator of the UK OCM, the trading platform for within-day spot trading used by the National Grid to maintain the physical balance of the UK national transmission system. This role is regulated by OFGEM and APX operates as a monopolist. The potential entry of ICE would therefore be in a different role, as a traditional (that is non-OCM) market place to facilitate trading of day-ahead (as opposed to within day) spot trades.

87. The evidence suggests that ICE could not offer the OCM spot unless National Grid terminates its contract with APX and awards it to ICE. On this basis the merger does not represent a loss of potential competition by ICE given the institutional role that APX has on the OCM.

[31] The OFT considers it can leave the precise product definition open but it has nevertheless assessed, on a cautious basis, prompts and futures as a separate frame of reference. See paragraph 31 above.

88. Therefore, subject to the evidence available, the OFT finds that there is not a realistic prospect of an SLC in the NBP natural gas spot market as a result of the elimination of a potential entrant.

Horizontal unilateral effects in the trading services for TTF natural gas futures

89. The parties overlap in the supply of trading services for natural gas futures trades in the Dutch TTF market. The parties earn revenue streams from UK customers[32] trading and clearing natural gas futures in the TTF. The parties estimate the value of trades and clearing carried out by UK customers on the Dutch TTF in 2012 as £ [<3] million on a UK customer location basis and £ [<3] million on a UK customer invoicing basis.

90. ICE is a fully integrated exchange with its clearing operation ICE Clear. The Target is not vertically integrated and outsources its TTF natural gas futures clearing to ECC (the clearing operation of EEX, a German commodities exchange). There is therefore no overlap in the provision of clearing services for natural gas futures and the OFT has therefore concentrated its assessment on the supply of exchange traded services.

Shares of supply

91. The parties' combined share of supply of exchange-traded volumes was [90-100] per cent (increment [0-10] per cent).[33] The parties' estimated combined share of supply for trading services for all cleared products (that is, ETD and OTC cleared) on TTF was around [70-80] per cent (ICE, [15-25] per cent and APX, [45-55] per cent).[34] Post merger the parties' combined share of supply will therefore be significant whether or not cleared OTC is considered as a strong competitive constraint. This share of supply is sufficient to raise **prima facie** competition concerns and therefore the OFT has considered the closeness of competition between the parties activities for UK customers on the TTF.

Closeness of competition

[32] The OFT's definition of UK customers is consistent with its definition in Mergers – Jurisdictional and procedural guidance paragraph 3.59

[33] Based on 2011 volume of trades. However, the parties remained the only exchanges in 2012 and therefore their [90-100] per cent market share would be unlikely to change in 2012.

[34] Based on 2012 volume of trades.

92. The parties submitted that most trades take place bilaterally (off exchange). OTC bilateral trades (uncleared) account for around 90 per cent of volume. The parties submitted that they face several constraints (in addition to APX). First, they point to the constraint from brokers supplying trading services for cleared OTC natural gas futures. Second, they point to OTCs which are traded bilaterally, that is, off-exchange and are typically uncleared. The OFT considered uncleared products to be in a separate market to cleared products. In relation to cleared OTCs, the estimated share of the broker channel for cleared OTC natural gas futures on the TTF was around 27 per cent. Data for individual brokers was not available[35].

93. Third parties informed the OFT that cleared OTC natural gas futures contracts are interchangeable with ETD. There may therefore be an element of constraint on ETD by the cleared OTC contracts (that represent just over a quarter of all cleared product volumes). However, the OFT could not ascertain the strength of this constraint, for example, information on the liquidity within the broker pools or the extent of switching between OTC cleared and ETDs was not provided by the parties or available to the OFT. The evidence that was available in the context of a first phase merger investigation was the fact that the parties are a close constraint to each other in the supply of trading services for ETDs.

94. On this basis, the OFT therefore remained concerned that within both trading services for ETDs and, if looked at from a wider perspective, trading services for all cleared products, the overlap between the parties was significant and therefore this raised unilateral effects concerns, that is, that trading fees could rise post-merger and also a general degradation of service quality and innovation. The OFT then considered whether barriers to entry or, countervailing buyer power would countervail the expected harm arising from this loss of rivalry between the parties on the TTF.

Barriers to entry and expansion

95. The parties submitted that barriers to entry and expansion are low and estimate that possible entrants with the relevant technology could enter the natural gas futures markets with very low capital outlay of less than £[< 5] million. The Parties further submitted that technology could also be

[35] GFI, Marex Spectron, ICAP, and Tullet Prebon

licensed from providers, including exchanges and others such as Trayport which can be used by both on exchanges and brokers. If a new entrant sought to build the entire trading infrastructure itself, entry costs would be higher. The parties estimate that a one-off entry cost for a new participant that was not already operating an exchange or trading platform would include legal registrations (£[<5] million), technology (£[<10] million) and other costs (£[<5] million). The OFT considers that the cost of entry in trading markets as an exchange is not prohibitive.

96. The OFT has considered whether the loss of competition between the parties would be countervailed by entry of new competitors into trading natural gas futures on Dutch TTF market. In assessing whether entry or expansion might prevent an SLC, the OFT considered whether such entry or expansion would be timely, likely and sufficient.[36]

97. The OFT has considered the recent new entry of Powernext[37] in the Dutch TTF natural gas futures in February 2013. Powernext is now supplying ETD trading services with clearing services provided by a contractual relationship with ECC. Powernext's intention to enter this market was announced in a joint press statement with ECC on 6 November 2012.

98. The OFT considers that Powernext's entry is timely and likely – it has entered during the course of the OFT's investigation. The key question is whether Powernext's entry will be sufficient to prevent the merged entity with a significant post-merger market position from increasing trading (or, indeed, clearing) fees and a degradation in quality and innovation.

99. The OFT understands from third parties that customers gravitate to the most liquid platforms. Liquidity, therefore, is an important factor in determining traders' choices of trading venue(s). Post merger, the merged entity's proprietary platform will have the vast majority of liquidity (for cleared products) on the Dutch TTF hub. There is a risk that Powernext's entry may not be sufficient, even in conjunction with ECC, an established clearing house on the TFF, which itself could be negatively impacted by the merger, as outlined below.

[36] Mergers Assessment Guidelines, paragraph 5.8.3

[37] Powernext is a French commodities exchange.

100. Set against this, there are some factors which may indicate that Powernext could succeed. First, Powernext has the support of some of its existing customers in France to trade TTF natural gas futures and second, Powernext will also have the benefit of a market making partner in GDF Suez[ii]. These two factors may assist with Powernext gaining the necessary liquidity in the TTF and establish itself as a credible competitor to the merged entity. Third, Powernext is an existing and established provider of trading services with activity in hubs across Europe and it has proven itself able to enter in a timely manner.[38]

101. The OFT considers that it cannot be certain at this stage whether Powernext will be able to constrain the merged entity although it notes that it may achieved some liquidity as it is supported by a market maker and some customers based in France.

102. The parties also submitted that CME Group (CME), a close competitor of ICE in coal futures in the US, is planning to enter both the UK NBP and the Dutch TTF natural gas futures.[39] The OFT made a number of enquiries in this regard and established that CME were in fact planning to enter the NBP and TTF through its clearing operations CME Clearing Europe and not its trading operations. This was further confirmed by enquiries with the Financial Services Authority and with CME itself.

103. The OFT has considered whether CME's announcement of its intended entry in to the TTF would have a constraint on the merged entity. First, the entry does not relate to trading services, therefore, in relation to ETDs, there would be no impact aside from any constraint provided by the broker channel, which as noted above, only comprises around a quarter of the overall cleared natural gas futures market on the TTF. Moreover, CME were unable to provide a timeframe for such entry. The OFT therefore considers that whilst there is a likelihood that CME may attempt to enter at some point in the future, the OFT is unclear, at this point in time, as to when such entry may take place.

104. The parties also submitted that entry did not need to be successful. The fact that barriers to entry were low meant that a succession of actual and

[38] The OFT understands that Powernext and ECC did not need a lengthy period in which to enter the TTF.
[39] CME published documents on its website at the end of 2012.

potential entrants was sufficient to exert competitive pressure on an incumbent operator. As evidence of this point, the parties cited their decision to introduce **Straight Through Processing** (STP)[40] for OTC trades in January 2013. They submitted that this was a [ ].[41] Although the OFT appreciates that in principle even the threat of entry or expansion may exert a competitive constraint, the parties did not provide compelling evidence to show that such a threat would be sufficient to mitigate the competition concerns arising from the transaction, that is, an increase in trading fees or degradation of service quality or innovation.

105. On a cautious basis, the OFT therefore considers that the merged entity will, in effect, be the only liquid 'on-exchange' platform offering trading services on the UK NBP and Dutch TTF market. The OFT's investigation shows that liquidity may represent a barrier to entry and may make it difficult for competitors to gain any meaningful measure of volume from the merged entity, as experienced by ECC in the UK NBP.[42] As a result, third parties are concerned that post merger there will be a potential increase in trading prices and a general degradation of quality of service and innovation.

Buyer power

106. The OFT also assessed whether there is any countervailing buyer power which would mitigate or prevent an SLC from arising post-merger.

107. There was no evidence that there is a large customer or group of customers collectively that could have strong countervailing buyer power.

[40] STP is an automated process offered by clearing houses to OTC contracts for clearing services. STP contrasts with the manual process that OTCs would otherwise need to input into the clearing house system. STP is deal with in more detail below.
[41] The parties also submitted that Nasdaq OMX is also an example of an established new and successful entrant in the UK NBP power futures akin to ICE's position on the TTF natural gas futures. However, Nasdaq OMX won a tender process run by the Power Trading Forum (PTF) under the umbrella of the Futures and Options Association (FOA). This was following OFGEM's intervention to try and increase the power trading liquidity and transparency. The OFT did not consider this entry as an example of the ability of market forces to establish competition by inducing entry in less competitive markets. It could also be argued that, in effect, Nasdaq's entry in the UK power market was sponsored by the UK energy regulator.
[42] ECC entered the UK NBP to provide clearing services in UK natural gas futures in 2012. ECC entered without its trading operation (EEX) and so far has failed to gain any clearing volume despite a one year 'clearing fee holiday'.

As demonstrated above, the OFT's competition concerns arise due to a lack of sufficient competitive constraint on the merged entity. On the basis of the evidence available, the OFT considers that there is a low probability for buyer power to mitigate the OFT's competition concerns. This was on the basis that although customers could sponsor entry, there was little evidence that such buyer power would or could be exercised in a timely manner.[43]

Conclusion on horizontal unilateral effects in TTF natural gas futures

108. The merged entity will combine two close competitors with significant liquidity in on-exchange platforms in the TTF. It will lead to a merger to monopoly in trading services for exchange traded natural gas futures and a strong player in all cleared natural gas futures.

109. The OFT has considered carefully whether the recent entry of Powernext would mitigate the extent of the loss of competition in this case but on a cautious basis does not consider there to be compelling evidence to show that Powernext's entry is likely to prove sufficient to allay the OFT's competition concerns.

110. On the basis of all the evidence above, the OFT considers that there is a realistic prospect of an SLC in trading services of ETD in TFF natural gas futures which could result in increased trading fees and a degradation of quality of service and innovation.

VERTICAL ISSUES

111. The OFT has assessed whether the merger will provide ICE with the opportunity to foreclose rivals at the trading level of the supply chain on the Dutch TTF.[44] In particular, the OFT received complaints from OTC brokers that the parties would apply discriminatory terms and conditions for clearing services to them. The OFT notes that there is no horizontal overlap in clearing services resulting from this merger and has therefore assessed these concerns under non-horizontal theories of harm.

[43] This evidence takes into account that the Powernext entry could be considered as customer sponsored entry.

[44] ICE Clear also provides clearing services for cleared OTC.

112. In line with its Merger Assessment Guidelines, the OFT frames its foreclosure analysis by reference to the following three questions:

- **Ability**: would the merged entity have the ability to weaken the competitive offering of rival services, for example through raising prices or refusal to supply them?

- **Incentive***:* would the merged entity find it profitable to do so?

- **Effect***:* would the effect of any action by the merged entity be sufficient to reduce competition in the affected market to the extent that it gives rise to an SLC.[45]

Foreclosure of OTC (cleared) broker trading activity

113. Pre merger, brokers that require OTC traded natural gas contracts to be cleared can choose between ECC and ICE clear. The OFT would only be concerned with any enhanced foreclosure possibility over and above that which existed pre-merger, that is, the change brought about by the merger. As a direct consequence of the merger, there is likely to be a change in the position of ECC in the provision of clearing services overall including to OTC broker channel. It is therefore necessary, prior to assessing ability and incentive to foreclose the OTC broker channel, to set out the impact of the merger on ECC.

114. ECC was until recently APX's exclusive clearing service provider[iii] for all natural gas futures contracts traded on APX's platform on the TTF through a clearing services agreement (CSA). The CSA was terminated by [ ]. As such, post-merger, the OFT understands that APX traded volumes are likely to be migrated from ECC to ICE Clear in or around [ ].[46] The OFT understands that this will significantly reduce the amount of volume that ECC was clearing pre-merger. Having sufficient volume is important to any CCP as it allows cross margining benefits to its customers thus reducing traders overall clearing costs.

115. The OFT has considered whether ECC will retain customers following this migration and notes that customers must consent to migration of their

[45] Merger Assessment Guidelines paragraph 5.6.6
[46] Informal submission dated 18 October page 40.

trading volumes to the merged entity. However, the OFT has not identified any compelling reasons why a majority of customers would refuse to grant consent. Most third parties contacted by the OFT stated that they would move to ICE Clear. As a starting assumption, therefore, the OFT considers based, on the evidence available, that ECC will lose a significant proportion of APX traded clearing volumes post-merger.

116. The OFT has therefore considered whether ECC will be negatively impacted by the migration of these volumes such that it will not be able to offer clearing services for OTCs. Set against this, the OFT notes that ECC in conjunction with Powernext has entered the trading and clearing of natural gas futures on the TTF, likewise, CME has announced its intention to enter the clearing of natural gas futures on the Dutch TTF as well as other hubs.

117. There are therefore options for clearing natural gas futures for OTCs. However, given the importance of liquidity in this market and the benefits of cross-margining for customers, there remains a possibility that ICE Clear through the migration of APX volumes becomes a 'must have' for any firm trading natural gas futures and that this provides it with an opportunity to engage in a foreclosure strategy vis-a-vis the OTC broker channel. The ultimate aim of such a foreclosure strategy would be to move traders from the broker channel into on-exchange services that is, from OTC cleared onto ETDs.

118. The OFT has, therefore, considered foreclosure strategies through the application of discriminatory terms and conditions on access to ICE Clear for OTC brokers, specifically:

- providing OTC cleared brokers manual access only to ICE Clear as opposed to an automated process currently provided for ICE's ETDs, thus making it less efficient for OTC cleared brokers to clear trades on behalf of their customers

- charging discriminatory high clearing fees to OTC cleared brokers and

- subsidising lower ICE ETD fees through higher OTC clearing fees. This would make ICE's trading platform more attractive to cleared OTC customers forcing OTC cleared broker liquidity on to ICE's trading platform.

Ability

119. The OFT received a number of concerns from third parties relating to foreclosure of OTC brokers. These third parties claimed that ICE is seeking to artificially raise the cost of clearing for OTC trades through discriminatory terms and conditions. For example, they cited the fact that ICE Clear is the only clearing house that does not allow STP for OTC natural gas futures traded by brokers. This means that any clearing carried out through ICE Clear is put through a more complex manual process losing the efficiencies provided by STP. This compared to trades executed on ICE's own proprietary platform which are offered STP. In this regard, the OFT notes that ICE Clear announced during the OFT's investigation that it would be providing STP to OTC broker trades in the coal, natural gas, power and emissions derivatives markets.

120. In addition, the OFT notes that ICE charges higher clearing fees for OTCs (as of 1 August 2012) on the Dutch TTF market. Clearing fees for trades executed on its proprietary platform are charged at €0.00262 per MWh per side (buyer and seller are each charged this fee), compared to €0.00337 (excludes the registration fee) MWh per side for OTCs.[47]

121. Further, several third parties told the OFT that ICE has adopted a discriminatory strategy in the recent past. According to third parties, the adoption of discriminatory practices yielded ICE trading platform considerable liquidity in NBP natural gas cleared futures.

122. The parties also provided data on fees charged to traders trading on its proprietary platforms on the UK NBP and Dutch TTF both prior to August 2012 and from 1 August 2012. The data clearly shows [ ]. [ ].

123. The parties submitted that in relation to the re-balancing of the trading and clearing fees, there was no change to the overall cost to customers. However, the OFT considers that [ ].[iv] The OFT notes that this evidence of a pre-existing ability to engage in discriminatory pricing may be evidence of an ability to foreclose.

[47] The charging information was taken from ICE's website

Incentive

124. The OFT has assessed whether the merged entity would have the incentive to foreclose OTC brokers who seek to use clearing services by examining the gains and losses the merged entity stands to achieve by following such a strategy.

Gains

125. The OFT considers that the parties may stand to gain:

i. additional income from discriminatory clearing fees applied to traders using OTC brokers and

ii. if the strategy is successful, a second order gain, would be additional trading fees and liquidity if traders switched to ICE's trading platform to avoid the higher clearing fees charged when trading through OTC broker channel.

Losses

126. For this strategy to be profitable, sufficient numbers of OTC brokers should not switch to alternative providers, such as, Powernext/ECC. If sufficient numbers of OTC brokers who use the clearing services of ICE Clear were to switch to ECC, then the merged entity would lose clearing revenue. It is important to note that there would be limited or no loss of trading revenues given that OTC trades are not executed on-exchange.

Third party responses

127. Third parties indicated to the OFT that they would be unlikely to switch away from the merged entity to Powernext/ECC or OTC/ECC. The majority of third parties currently trading natural gas futures on APX, ICE and cleared OTC through brokers, said they would switch their cleared OTC trades to the merged entity. However, those third parties who did not provide a clear answer said that while fees are of course a very important factor, they are not the only factor in determining clearing venues. Liquidity and accessibility are also very important factors.

Effect

128. The OFT notes in the context of effects that ICE is already engaging in differential pricing for OTCs. As such, it could be argued that the merger does not worsen the pre-merger position. However, it is important to note that as outlined above, post-merger there may be fewer or weaker constraints given the transition of APX trading volumes from ECC to ICE Clear. On balance, therefore, it is plausible that such a foreclosure strategy might make cleared OTC brokers a much less competitive proposition for cleared OTC traders. This is because of their higher cost in clearing natural gas futures thereby shifting cleared OTC natural gas futures from brokers to the merged entity's proprietary platform and further increasing the parties' ability to increase trading and clearing fees and worsen the quality of the service provided.

129. The parties submitted that over 90 per cent of liquidity in TTF is traded OTC/bilaterally which means that if the cost of clearing OTC went up customers could seek to trade bilaterally instead. The parties further submitted that the cost of using cleared OTC brokers is unknown and brokers have tailor-made arrangements with their clients. Third party customers have consistently informed the OFT that generally OTC brokers are more costly than trading on exchange because of the brokerage fee involved.

130. Taking the evidence in the round, the OFT considers that there is a realistic prospect that the merged entity would have the **ability** and **incentive** to engage in foreclosure of OTC with the aim of migrating OTC volumes onto the ICE proprietary trading platform. However, the OFT notes that the means of employing this strategy have been deployed pre-merger through the differential overall pricing applied to ETDs versus OTCs. As such, given the fact that end customers have not complained in relation to this theory of harm and aligned with the fact that ECC may remain a viable option for clearing OTCs, the OFT considers that the evidence on the likely effects of this strategy over and above the pre-existing differential pricing is mixed.

131. As such, given that the OFT has found that there is a realistic prospect of an SLC comprising unilateral effects, the OFT has not found it necessary to reach a firm conclusion on the prospect of an SLC arising from non-horizontal effects.

THIRD PARTY VIEWS

132. The OFT has received several complaints about the merger from both customer and competitor third parties.

133. The majority of concerns were focused on the Dutch TTF market where UK customers trade and clear natural gas futures and where third parties believe the loss of APX will reduce competition. A particular concern by third party competitors was ICE Clear's refusal to provide STP to OTC cleared natural gas futures.

ASSESSMENT

134. The parties are active in the operation of platforms that facilitate the provision of trading and clearing energy derivatives in the UK NBP hub, Dutch TTF hub and other hubs across Europe.

135. The OFT considers the relevant frame of reference for its assessment to be the supply of on-exchange trading services in at least the EEA separated by the type of contract (spots, prompts and forwards/futures), length of contract, the type of underlying asset (natural gas, power), whether the contract is cleared or uncleared and the specific hub. The OFT has left the precise market definition open however, on a cautious basis, has treated the supply of trading and clearing services separately and also considered ETDs and OTCs as separate products.

136. The parties overlap in the supply of trading services in UK power futures. In the Dutch TTF the parties overlap in trading services in natural gas futures. The parties earn revenues from the supply of such services to UK customers who trade natural gas futures on the Dutch TTF.

137. In the UK market, the OFT found that the parties overlap in trading services for power futures but given that APX has ceased trading in this product, there would be no increment to share of supply post merger. Therefore, in relation to UK power futures, the OFT focused its analysis on potential competition between the parties. The OFT considered the internal documentation of APX and found no evidence that it was planning to relaunch its power futures product having made several failed attempts in the past. In addition the OFT found no compelling evidence that the merger

would lead to a loss of potential competition in each other's respective markets on the UK NBP.

138. The OFT found no other overlaps between the parties in the UK NBP since APX has an institutional role in the provision of trading services for spot contracts on the OCM and ICE is active in the provision of trading services for natural gas futures.

139. In the Dutch TTF, the OFT considered horizontal unilateral effects in the supply of trading services for natural gas futures and non-horizontal effects namely, the foreclosure of OTC brokers in cleared natural gas futures.

140. In relation to horizontal unilateral effects the OFT's investigation found the parties to be close competitors in this market with a substantial combined post merger share of supply. Although the OFT has not concluded on whether cleared OTC trades are in the same market as ETD, the parties' substantial combined share of supply is still present even if the OFT takes into account any competitive constraint from cleared OTC trades. The OFT therefore found that the merger may lead to harm to competition with the possibility of post-merger price rises or quality degradation.

141. The OFT considered whether Powernext (which entered in February 2013) would be a sufficient constraint on the parties' post merger. The OFT considers that it cannot be certain at this stage whether Powernext will be able to constrain the merged entity although it notes that it may achieved some liquidity as it is supported by a market maker and some customers based in France.

142. The parties also submitted that the potential entry of CME into the TTF natural gas futures market would further constrain the merged entity. However, the OFT could not find compelling evidence that CME's potential entry would be sufficient to mitigate the competition concerns. Moreover, the OFT was not certain whether CME's entry would be timely. Overall, whilst the OFT does not consider that entry is sufficient to offset or mitigate the competition concerns identified in this case, it does consider that the entry of Powernext and CME indicates that entry (including customer sponsored entry) is possible in this market.

143. In relation to non-horizontal effects, the merger will lead to the transition of clearing volumes from ECC to ICE Clear which may impact the ability of

ECC to provide clearing services (although the OFT notes that it will be the exclusive provider of clearing services to Powernext). The OFT therefore considered whether the merged entity would have the ability and incentive to foreclose OTC brokers through offering discriminatory terms and conditions relating to price or access to trading or clearing platforms.

144. The OFT found that the merged entity would have the ability and incentive to engage in such a strategy but, in terms of effect, noted that ECC is likely to remain a viable clearing option for OTC brokers. The OFT has not found it necessary to conclude on foreclosure effects given that it has found competition concerns on a unilateral effects basis.

145. The OFT does not consider the prospect of countervailing buyer power sufficient to mitigate or offset any competitive harm arising from the merger and was provided with no compelling evidence of buyer power.

146. The OFT also considered whether the corporate governance provisions and the indirect involvement of the Dutch State would prevent such horizontal and non-horizontal effects from occurring. This is because Gasunie, a minority shareholder in the merged entity with veto rights, is wholly owned by the Dutch State who has an interest in maintaining and developing the TTF hub. On balance, the OFT considers that these factors would not serve to offset or mitigate the competition concerns identified.

147. The OFT therefore considers that the relevant merger situation gives rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of trading services in Dutch TTF natural gas futures in the EEA.

EXCEPTIONS TO THE DUTY TO REFER

148. The OFT's duty to refer under section 33(1) of the Act is subject to certain discretionary exceptions, including the markets of insufficient importance or **'de minimis'** exception under section 33(2)(a), and the undertakings in lieu exception under section 73(2).

149. The OFT has found a realistic prospect of an SLC (horizontal) in relation to the supply of trading facilities of TTF cleared natural gas futures. The OFT’s duty to refer this case is therefore met. The OFT may decide not to refer a merger to the Competition Commission (CC) if it believes that the

market to which the duty to refer applies is not of sufficient importance to justify a reference. In deciding whether or not to apply the **de minimis** exception, the OFT will exercise its discretion, taking account of the facts of each individual case and its circumstances and having regard to its guidance and decisional practice in the area.

Availability of undertakings in lieu and de minimis

150. As set out in its Exceptions Guidance,[48] the OFT believes that it would be proportionate to refer a problematic merger (that is not to apply the **'de minimis'** exception) where it is 'in principle' open to the parties to offer a clear-cut undertaking in lieu of reference. This is because the recurring benefits of avoiding consumer harm by means of undertakings in lieu in a given case, and all future like cases, outweigh the one-off costs of a reference.

151. Cases that the OFT considers are in principle suitable for resolution by undertakings in lieu are typically those where the part of the transaction that raises concerns can be divested to an independent third party purchaser.[49] The OFT's Exceptions Guidance also stresses that '[t]he OFT will take a conservative approach to assessing whether undertakings in lieu are in principle available. To the extent that there is any doubt as to whether undertakings in lieu would meet the 'clear-cut' standard, it will not be included in the 'in principle' assessment. In other words, it must be clear that the competition concerns in the case in question are obviously such as to make the case a candidate for resolution by undertakings in lieu.'[50]

152. In this case, the OFT considers that there are genuine doubts as to whether the SLC identified could be resolved by a clear-cut undertaking in lieu.

153. As set out above, the OFT has identified competition concerns in relation to the supply of trading services in the TTF natural gas futures market

[48] OFT guidelines (OFT1122) on Exceptions to the duty to refer and undertakings in lieu of reference ;(OFT Exceptions Guidelines) paragraphs 2.24 – 2.27. See also completed acquisition by Dunfermline Press Limited of the Berkshire Regional Newspapers business from Trinity Mirror plc 4 February 2008.

[49] OFT's exceptions guidelines; paragraph 2.24.

[50] OFT's exceptions guidelines paragraph 2.27.

based in the Netherlands. The OFT is conscious, however, that the parties' respective derivatives platforms facilitate the trading of a range of derivatives products which in ICE's case includes a wide range of energy derivatives (oil, natural gas, coal and power) and emissions derivatives.

154. In addition, there is also the associated provision of clearing and settlement of such derivatives. These services are provided on an integrated basis, both in terms of platforms, technology, software and staffing, to customers. As such, a structural remedy would need to involve a carve-out of APX's or ICE's natural gas futures operations only. The OFT considers, based on the evidence available, that there are doubts as to whether such a business can be clearly separated in physical and commercial terms from either party's existing business and sold to an effective purchaser.[51]

155. The OFT also considers whether any plausible undertaking in lieu would be proportionate either on the basis that it is tantamount to unwinding of the transaction or it is not a proportionate response to the harm identified. The OFT considers that a carve-out of the whole of the TTF natural gas futures business would be disproportionate to the harm to UK customers. The OFT considers this to be the case considering that almost 80 per cent of total TTF revenues from natural gas trading and clearing is derived from non UK customers.

156. Overall, the OFT does not consider there is an 'in principle' clear-cut undertaking in lieu available given the extensive integration of the TTF natural futures business with the rest of the parties' business activities. The OFT also considers that any carve-out would be disproportionate to the nature and extent of harm which has been identified in its SLC analysis, namely, only a limited impact on a small number (in absolute and value terms) of UK customers. The analysis of the application of the de minimis exception is therefore considered below.

Application of the de minimis exception

157. The OFT considers that the market(s) concerned will generally be of sufficient importance to justify a reference where the annual value in the

[51] In the completed acquisition by Capita Group plc of IBS Opensystems plc 19 November 2008, paragraph 112, the OFT discounted an 'in principle' divestment remedy on the basis that it had concerns whether the software services of IBS were clearly and effectively separable.

UK is more than £10 million. Where the annual value is between £3 million and £10 million, the OFT will consider whether the expected customer harm resulting from the merger is materially greater than the average public cost of a reference.[52]

158. Where the value of a market(s) is less than £3 million, the OFT would expect to refer a merger where there are exceptional factors and where the customer harm was particularly significant.

159. In this case the parties provided two figures for the value of the UK market in TTF natural gas futures; £[<3] million on a UK location basis and £[<3] million on a UK invoicing basis. The OFT notes that at £[<3] million the market is significantly below the benchmark figure of £3 million for which a reference would generally not be justified.[53] However, on a location basis the value of the market is close to the benchmark figure of £3 million and therefore, the OFT has analysed whether a reference is justified on the basis of exceptional factors according to the principles set out in its Exceptions Guidance.

160. In considering whether the expected customer harm resulting from the merger is materially greater than the average public cost of a CC reference, the OFT will base its assessment on a number of factors. These factors are set out in detail in its Exceptions Guidance[54] and were applied in favour of exercise of the discretion in a number of previous cases[55] and against the exercise of the discretion.[56] These factors are:

- market size
- strength of OFT's concern
- magnitude of competition lost by the merger, and

[52] The average figure is currently around £400,000.
[53] Exceptions guidelines, paragraph 2.15.
[54] OFT's exceptions guidelines; paragraphs 2.28 to 2.43
[55] Completed acquisition by Midland General Omnibus Limited of the commercial bus services of Felix bus services Limited 30 May 2012; Completed acquisition by Arriva Midlands North Limited of the business and assets of Liyell Limited trading as Midland 21 January 2013; and Anticipated acquisition by Orbital Marketing Services Group Ltd of Ocean Park Limited 14 November 2008.
[56] Completed acquisition by Nufarm Limited of AH Marks Holdings Limited 29 August 2008.

- durability of the mergers impact.

161. In addition to the above factors the OFT believes it is also appropriate for it take into account the wider implications of the decision it takes to exercise its discretion on **de minimis** for the treatment of future cases. The OFT will be less likely to apply its discretion on **de minimis** where it believes that that the merger is one of a potentially large number of similar mergers that could be replicated across the sector in question (replicability).

Application of the de minimis exception to the present case

162. The OFT considered each of the factors above in determining whether to exercise its discretion in this case

163. **Market size** – As noted above, the parties' submitted two estimates of the market size. The OFT considers the invoicing basis as a more accurate proxy of the UK market size in this case. Firms which may be operating multiple locations whilst having a presence in the UK, may not necessarily be a UK firm. On the other hand, the invoice basis takes into account the location of where procurement decisions are taken and this may indicate the location of the financial decision making centre of a firm. The OFT therefore considers the relevant market size for TTF natural gas futures to be £[< 3] million.[57] This is the aggregated figure for all trading and clearing fees earned by the parties, including those OTC contracts cleared by ICE (ECC provides clearing on behalf of APX). On this basis the market size is small and significantly below the benchmark figure for considering markets of insignificant importance.

164. The OFT considered whether the size of the relevant market could be expected to increase due to proposed regulatory reforms relating to the trading of OTC derivatives. It has been argued by some third parties that EMIR may increase the level of clearing activity that may consequently increase the size of the market. However, the OFT notes that it is, as yet, unclear what impact EMIR will have on the energy commodity markets.

[57] Based on the parties' estimate for the period November 2011 to October 2012

165. In addition, a further consideration is that third parties told the OFT that the Dutch TTF is set to grow to the same levels as the UK NBP within the next five years.

166. **Strength of OFT concern** - The merger results in the elimination of a competitor in 'on-exchange' trading of TTF natural gas futures with a significant combined share of supply. The OFT was unable to be confident within a first phase merger control assessment whether the new entrant, Powernext would be successful against a combined ICE/APX.

167. The OFT, however, notes that it is clear that entry and exit in this market is possible as shown by the recent launch of Powernext/ECC and that certain characteristics of the Powernext entry may to some extent mitigate the OFT's competition concerns. The parties have also submitted details of other potential entrants in the TTF natural gas futures market such as CME, outlining details of planned entry in the near future, which may also serve to constrain the merged entity in the future. Likewise, the prospect and threat of continual entry may also have an impact. The OFT therefore believes that the strength of its concerns is relatively low to medium.

168. **Magnitude of competition lost** - In terms of natural gas futures trading, the parties submit that most trades take place bilaterally (off exchange). This is reflected in the market share data provided by the parties where OTC bilateral trades (uncleared) account for around 90 per cent of volume. In terms of cleared product volumes on the Dutch TTF, around 27 per cent of cleared products are accounted for by OTC brokers the remainder being accounted for by ETD. The parties submit that the real constraint to ICE is from OTCs rather than APX.

169. However, the OFT considers that ETDs and uncleared OTCs are separate product markets, in which case APX could be considered a significant competitor. However, the OFT considers that there may be some constraint on the parties from cleared OTC, but was unable, within a first phase merger control assessment, to determine the strength of this constraint. The OFT therefore considers that any price increases or degradation of quality and innovation resulting from the merger could be a mid to low range risk.

170. **Durability** – The OFT considers that the effectiveness of new entry is dependent on 'liquidity' and there is some evidence that gaining volume in

this market quickly may act as a barrier to expansion following entry. Set against this, the Parties submit that there are a number of potential entrants that could enter the Dutch TTF natural gas futures market such as CME, NASDAQ OMX and Powernext. Since the notification of this transaction to the OFT, Powernext has now entered the market and CME is also preparing to launch. The OFT also notes that ICE, itself, has managed to gain [20-30] per cent of the TTF natural gas futures market in a period of two years. As such, it is plausible that any changes to the regulatory landscape could provide opportunities for new entrants to make inroads into this market and that therefore the SLC may not be of a substantial duration. On balance, the OFT considers the duration to be less than two years and therefore a low risk.

171. **Replicability** – As outlined in the OFT guidelines on exceptions to the duty to refer, the OFT will consider whether the merger in question is one of a potentially large number of similar mergers that could be replicated across the sector in question.[58] The OFT does not consider that this applies in this case given that there are a limited number of on exchange trading platforms and exchanges across Europe and any merger and acquisition activity involving them is the subject of wide public scrutiny and attention meaning that firms are likely to take into account competition implications when assessing whether to proceed with such transactions and/or seek relevant approvals from competition authorities.

Conclusion on exceptions to the duty to refer

172. In taking the above factors in the round and conscious of the fact that this merger may have an impact on a small number of UK customers amounting to revenues of only £[<3] million (well below the £3 million threshold at which a reference would normally not be justified), the OFT considers that no exceptional factors apply in this case.

173. In addition the OFT considers a relatively low expectation of an SLC and that the magnitude of price increases and degradation of quality of service and innovation to be around the mid to low risk range. Furthermore, OFT considers that the factual matrix will not be replicated and the duration of any harm that may result from the merger would not be for a long period. On this basis, the OFT considers it appropriate to exercise its discretion not

[58] OFT Exceptions guidelines paragraph 2.40.

to refer on the grounds that the case does not warrant an investigation by the CC.

DECISION

174. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

ENDNOTES:

[i] The OFT clarifies that ICE's activities in the Netherlands are conducted through its UK operations.

[ii] The OFT clarifies that the correct description of GDF Suez is 'GDF Suez Trading'.

[iii] The OFT clarifies that the termination of the exclusivity agreement between APX and ECC comes into effect on 31 March 2013.

[iv] The OFT clarifies that ICE currently charges a higher clearing fee to OTC trades than ETD trades. Although, the overall fee charged by ICE is the same for both OTC and ETD, the total fee charged by ICE is made up of different components. For ETD customers, the total fee covers the cost of executing the trade, a registration fee and a clearing fee. For OTC customers this covers registration and the cost of clearing only, as OTC customers are charged a brokerage fee for executing the trades on brokers' platforms.