

NON-CONFIDENTIAL: Review of materials provided in the ICE/Trayport merger provisional findings confidentiality ring

Note prepared for Shearman & Sterling

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1 Introduction

This annex sets out the analysis of the information provided by the CMA as part of the confidentiality ring for the provisional findings in the ICE/Trayport Phase II merger investigation. We have been provided with the Disclosed Materials which consist of:

- the unredacted version of paragraphs 36 to 42 and annex 2 to appendix B of the Provisional Findings; and
- the underlying figures for GFI used to calculate the percentages at paragraph 37 of appendix B of the Provisional Findings.

The Disclosed Materials can be used to understand whether increasing Trayport's fees to ICE's rivals is able to affect the competitive position of these rivals. The CMA has presented two comparisons for Trayport costs to brokers and exchanges, specifically, Trayport fees as a proportion of rivals' operating costs and rivals' EBITDA. The CMA also present Oxera's analysis comparing Trayport costs to revenues of ICE's rivals.

EBITDA is not an informative comparator for identifying the importance of Trayport fees to the competitive position of ICE's rivals. Operating costs are a reasonable comparator; however they are less likely to give a meaningful scale for payments to Trayport than revenues. This is because there may be different reporting standards for operating costs across firms and variations in exceptional items will affect annual comparisons. Consistent with this, we note that the CMA has flagged that its estimates of [REDACTED] operating costs are 'rough'.¹ Hence, the

¹ The CMA state that calculations for [REDACTED].

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[redacted] operating costs ratio is less reliable than others and in any case, will be a less relevant comparator because the Trayport fees are the result of a risk-sharing agreement between [redacted] and Trayport.

Consistent with previous submissions,² this information confirms that Trayport fees are small against these comparators. Thus even large changes in these fees are unlikely to have an impact on the competitiveness of ICE's rivals. The CMA has concluded that Trayport fees account for only a small proportion of their operating costs. Increasing these fees by 20% would increase operating costs by less than [redacted].³ For the preferred Oxera comparator metric of broker revenues, a 20% increase in Trayport fees would result in an increase of no more than [redacted] in trading fees faced by brokers.⁴

2 Analysis of Disclosed Materials

The CMA has reviewed Trayport fees paid by a number of brokers and exchanges and compared these to several financial metrics in order to 'put these figures into context', as set out in paragraph 35 of Appendix B.⁵ As per CC/OFT merger assessment guidance, considering the fees charged by Trayport to brokers and exchanges in the context of the relevant market is done in order to assess:

- the materiality of Trayport costs to venues; and
- the extent to which changes in Trayport costs would impact ICE's rivals competitiveness.⁶

The CMA has identified 'revenue, costs, [and] profits' as possible comparator metrics for Trayport fees.⁷ We consider revenue to be the most relevant measure for identifying the scale of Trayport's fees in this case, as it provides a direct comparison against the prices charged by venues to their customers. Operating costs are generally also a relevant measure of scale, and a comparison against operating costs would show what portion of a venues' costs are due to Trayport. EBITDA is not an obvious metric for this purpose, as EBITDA may not scale at the same rate as a firm's size, and is not likely to be informative of the impact on customers of changes in Trayport fees.

The remainder of this note considers:

- EBITDA as an uninformative comparison for Trayport fees (Section 2.1);
- revenue and operating costs as more suitable comparisons for Trayport fees (Section 2.2); and
- analysis of why the ratio between [redacted] Trayport fees and operating costs reported by the CMA [redacted] (Section 2.3).

² As reported in 'Oxera Supporting Economic Analysis', slides 3-6

³ As reported in CMA Provisional findings, para. 8.53 footnote 128.

⁴ As reported in Table 12 of CMA Provisional findings, Confidential Appendix B, para. 39.

⁵ CMA Provisional findings, Appendix B, para. 35

⁶ See Merger assessment guidelines, CC2/OFT1254, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284449/OFT1254.pdf, para. 5.6.10 (a)

⁷ CMA Provisional findings, Appendix B, para. 35

2.1 EBITDA is an uninformative comparison for Trayport fees

Comparing Trayport fees with EBITDA does not provide a suitable measure of the materiality of Trayport fees to a venue, nor does it provide a suitable indicator of the extent to which costs of Trayport would impact ICE's rivals' competitiveness. The reasons for this are listed below.

- EBITDA may not scale with the size of a business – for example, a small business with low turnover and low costs can have the same EBITDA as a business with higher turnover and higher costs.
- As concerns a potential increase in Trayport fees, the ratio of this to EBITDA may not change at all depending on the timing and extent of pass-through of costs to venues' customers. This is not informative of whether the cost increase has had a material effect on the costs of the venue or the prices to venues' customers.
- Results presented by the CMA suggest that small changes in EBITDA can drive very large changes in the ratio of Trayport costs to EBITDA – for example, EBITDA implied for [REDACTED] is [REDACTED] in 2015 and [REDACTED] in 2014, but the ratio of EBITDA to Trayport fees varies from [REDACTED] in 2015 to [REDACTED] in 2014.⁸ The wide range illustrates the lack of usefulness of this metric.

2.2 Revenues and operating costs are more suitable comparisons for Trayport fees

A more suitable methodology for identifying the materiality of Trayport fees and the impact of these fees on the competitiveness of ICE's rivals would be to compare Trayport fees to financial measures that better reflect the scale of a business operation. Hence, we agree with the CMA's assessment that revenues or costs could be used to assess Trayport fees.⁹ That being said, in this case, costs – in particular operating costs as used by the CMA – may not be the most appropriate comparison for Trayport fees. This is because:

- operating costs may be difficult to define on a like for like basis across all relevant firms;
- where firms have shared costs across a number of business units, identifying the proportionate costs for one business unit (i.e. European utilities) may be difficult or inconsistent across firms;
- exceptional costs that occur in specific years can drive volatility in the ratio of operating costs to Trayport fees; and
- there can also be differences in cost efficiency between firms. Operating costs can differ between firms, leading to differences in the Trayport fee to operating cost ratio, but these differences reflect little on the importance of Trayport fees for venues or their customers.

Revenue is the most suitable measure for assessing the materiality of Trayport's fees, as this allows a like for like comparison of venues and is easy to measure in this context. Additionally, comparing a venue's revenues to Trayport fees identifies how substantial Trayport fees are relative to the price venue users pay. This is clearly relevant to an assessment of whether a change in Trayport fees

⁸ CMA Provisional findings, Confidential Appendix B, Annex 2

⁹ CMA Provisional findings, Appendix B, para. 35

would be sufficiently material for traders to make different trading or clearing decisions which could affect the competitiveness of ICE's rivals.

2.3 [REDACTED] high Trayport fee to operating cost ratio

The ratio of [REDACTED] Trayport costs to operating costs as reported by the CMA [REDACTED] however the [REDACTED] ratio is identified as being based on rough estimates.¹⁰ Given the information provided by the CMA, we can neither identify the exact Trayport fees used by the CMA for [REDACTED] nor the exact operating cost estimates used for [REDACTED].¹² However, using the average figures for Trayport fees across [REDACTED] and [REDACTED]¹³ and the range of ratios provided allows us to imply a range of operating costs for [REDACTED]. These operating costs are [REDACTED], as seen in Table 2.1.

Table 2.1 Estimated [REDACTED] operating costs

	Trayport fees (£, m)	[REDACTED] operating costs lower estimate ² (£, m)	[REDACTED] operating costs upper estimate ³ (£, m)	[REDACTED] implied operating costs (£, m)	[REDACTED] operating costs (£, m)
2015	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
2014	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
2013	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

Note: Operating costs are calculated by dividing the value of Trayport fees by the ratio of Trayport fees to operating costs.¹ Trayport fees are an average of [REDACTED] and [REDACTED] fees.² Lower estimate of [REDACTED] operating costs is based on a [REDACTED] ratio of Trayport fees to [REDACTED] operating costs.³ Higher estimate of [REDACTED] operating costs is based on a [REDACTED] ratio of Trayport fees to [REDACTED] operating costs.

Source: Oxera, based on materials disclosed by the CMA in the provisional findings confidentiality ring

We also note that [REDACTED]. Other arrangements for Trayport's services do not have this feature. Thus comparing the ratio of [REDACTED] Trayport costs to [REDACTED] operating costs to the same ratio for other venues is not informative.

¹⁰ CMA Provisional findings, Appendix B para. 41, Footnote 3

¹¹ The CMA report an average Trayport cost for [REDACTED] and [REDACTED] to be [REDACTED] in 2015, [REDACTED] in 2014 and [REDACTED] in 2013. These numbers have not yet been reconciled with numbers submitted by Trayport. We understand that the CMA is taking the average amount paid to Trayport by [REDACTED] and [REDACTED] Group ([REDACTED] exchange, [REDACTED] and [REDACTED]). CMA Provisional findings, Confidential Appendix B, para. 41.

¹² Exact Trayport fees for [REDACTED] are not provided as discussed in footnote 11, and a range of ratios of Trayport fee to operating costs is presented by the CMA, which further prevents identification of operating costs. CMA Provisional findings, Appendix B, para. 41.

¹³ This [REDACTED] as Trayport 2015 Revenue data identifies [REDACTED] ([REDACTED]), consisting of [REDACTED], [REDACTED] and [REDACTED] payments to Trayport in 2015 at £[REDACTED]m and [REDACTED] payments to Trayport in 2015 at £[REDACTED]m.

¹⁴ [REDACTED] and Trayport, (2011) 'Trayport interface development and support agreement', 23 September, p. 7