

0555R – Review of the Market Operator (OCM) Provision – Workgroup 3



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Agenda

1. Summary of WG2
2. Emerging Scenarios
3. Cost vs Benefit Analysis on remaining scenarios
4. Review group recommendation
5. Next Steps
6. Scheduling of further meetings
7. Feedback

Summary of WG2

Consensus reached in WG2;

- the definition of liquidity for the purpose of Review Group 0555R
- the impact and likelihood of each of the risk statements;
- that risks 3a&b were the most material risks, that either need to be reduced or mitigated;
- to focus on four identified scenarios (of which there were two clear preferences for further work and assessment).

Outstanding actions

1101: To provide a view on how much it would cost them to aggregate outputs from multiple market exchange platforms, calculate and publish cash-out prices in near real time. If possible, to look at a range of scenarios to understand the cost implications of different time delays.

Included within our draft report and also in subsequent slides.

1103: To provide an outline draft of a potential report built around the three questions, with costs, benefits and risks identified for each.

Draft report published onto the JO website, will be referred to within the meeting.

Emerging Scenarios

- **Scenario 1:** Maintain the current arrangements (the ‘do nothing’ option);
- **Scenario 2:** Maintain a single market operator model, but introduce a fixed term retendering / benchmarking exercise of the market provision;
- **Scenario 3a:** Introduce a multiple market model, where all “cash-out relevant” exchanges provide all three markets (Locational, Physical and Title); and
- **Scenario 3b:** Introduce a multiple Title market model, supplemented with one sole provider of the Locational and Physical markets, which would be subject to a fixed term retendering / benchmarking exercise.

Scenario 2 and 3b have been considered further in terms of costs and benefits.

Scenario 2 – Cost Vs Benefit Analysis

Scenario 2: Maintain a single market operator model, but introduce a fixed term retendering / benchmarking exercise of the market provision;

Costs	Benefits
Costs associated with market testing / benchmarking at regular intervals e.g. this could be every five years. (TBC)	Additional competitive pressures in the 24/7 spot market introduced by regularly reviewing the provision of the MO service. Encouraging providers (existing & prospective) to be innovative, maintain efficient charges and a good level of customer service
Any others??	Liquidity and product concentration on one exchange therefore providing the Residual Balancer with a wider market view on one platform
	Single point and efficient provision of the three markets required under the Uniform Network Code (UNC) (Title, Physical & Locational).
	Lowest “cost of change” option as a result of maintaining the current processes and systems which are already established to support the single market operator model.

Scenario 3b – Cost Vs Benefit Analysis

Scenario 3b: Introduce a multiple Title market model, supplemented with one sole provider of the Locational and Physical markets, which would be subject to a fixed term retendering / benchmarking exercise.

Costs	Benefits
Change to the calculation of real time cash-out prices (*1 – see slide 7)	Additional players participating in the GB market, equalling a potential increase in liquidity available
Membership fees for multiple exchange platforms (*2 – see slide 8)	Removes Residual Balancer / Cash-out risk of liquidity splitting between alternative exchanges (R1a&b)
Cost of separate provision of Locational / Physical markets	Potential reduction in transaction fees as a result of competitive pressures and investment in innovation (*3 – see slide 9). Analysis based on information available shows a potential benefit in the range of £47-184K
Potential for Locational / Physical markets to be on a separate platform leading to potential for the market reaction to be slower in the event of L / P action due to not being as visible to traders.	

Cost: (*1) Change to calculation and publication of real time cash-out prices

Cost assessment assumptions:

- Trade data flows from Exchanges to NG (or Xoserve) back to Exchanges for publication of cash-out.
- System will provide a guaranteed response time (seconds)
- 24/7 service required (minus UKLink Housekeeping)
- Cross site system for resilience
- Ongoing support costs estimated to be 15% of setup costs

Cash-out prices calculations resulting from multiple exchanges total cost summary:

Required Changes (Multiple)	Cost Estimate
UKLink End of Day changes (including Multiple cash-out files and invoicing)	Between £500k and £590k
Real time cash-out calculation - NGG	Between £300k and £500k
Ongoing Real time cash-out cost - NGG	Approximately £75k
Systems and network capability costs - Exchanges	unknown

Cost : (*2) Operating on multiple exchange platforms

Multiple membership fees assumptions:

- The Industry users who have already subscribed to more than one exchange are excluded from these costs. This is because this is not deemed as an addition as the costs are already being incurred,
- PEGAS' Membership fee is based upon the 'Welcome package' rates detailed in the 27th November Presentation,
- The cost of providing the Locational and Physical markets is already embedded into the membership fees offered by ICE currently, therefore utilising those costs in the analysis account for an approximation of the provision of those markets,
- There are currently 71 OCM members, 35 of these are also PEGAS members:
 - The scenarios used to assess the potential additional costs associated to a multiple market arrangement range from 50% of the difference in members to all members (an additional 36) signing up to both exchanges.
- Trading Gateway allows a user to aggregate the order books of multiple exchanges into one. These costs are estimated to be in the range of £5k to £15k per annum per member. Detailed cost information is not available to NGG; however NGG believe this to be a conservative estimate.

Multiple membership fees total cost results:

	% of additional members	
	50%	100%
Additional membership fees	£ 172,800	£ 345,600
Additional Technical fees estimate	£ 90,000	£ 540,000
Total Additional cost estimate	£ 262,800	£ 885,600

Benefit: (*3) Reduction in transaction fees as a result of competitive pressures and investment in innovation

Transaction fee savings assumptions:

- The baseline data for current transaction fees have been taken from the PEGAS presentation discussed in the Review Group meeting on 27th November.
- The OCM and PEGAS trade volumes - October 2014 to September 2015
 - Volume is split 10% in office hours and 90% out of hours reflecting perception of current behaviour
 - The current volume split is 99% on the OCM exchange to 1% on the PEGAS exchange
 - All weekend volume is classed as “out of hours”
- The benefit scenarios are based upon volumes moving between exchanges, this has a similar affect to competition causing reductions in trade fees.
- The scenarios used are 10%, 20% or 50% movement from the baseline level.

Volume movement	Cost	Saving vs Baseline
Baseline	£ 667,065	
10%	£ 619,934	£ 47,131
20%	£ 585,673	£ 81,391
50%	£ 482,892	£ 184,173

- The table above shows the baseline estimate for the revenue created from Transaction fees associated with trades enacted on the OCM in the period of October 2014 to September 2015. It then shows the reduction in fees if volume moved across onto the current alternative platform. This is a proxy for a reduction in fees.

Summary Cost vs Benefit of Scenario 3b

The table below shows a summary of the total projected quantified costs and benefits from the analysis completed by NGG to date on scenario 3b:

Areas of costs (£)	Low case	High case
Estimated IT System implementation costs - Real time cashout (1)	300,000	500,000
Estimated IT System ongoing costs	75,000	75,000
Estimated End of Day process system changes	500,000	590,000
Potential additional costs of market access	262,800	885,600
Potential Competition impact on transaction costs	- 184,173	- 47,131
Estimated Total	953,627	2,003,469

Review Group Consensus position

Next Steps / workgroup

- Any further quantified evidence for either option?
- Completion of the 0555R workgroup report
- Agreement on the consensus opinion to take back to Panel and report back to Ofgem
- Anything else?

Scheduling of Issues and development areas

Proposed Workgroup agenda schedule

<p>WG1 30th Oct 10am</p>	<p>Information Gathering</p> <ul style="list-style-type: none"> - Background of the OCM, - Ofgem Letter, - Stakeholder feedback, - Industry requirements of a balancing exchange market, - Identifying the Criteria for assessment of potential options (Risk assessments) - Agree meeting schedule
<p>WG2 27th Nov</p>	<p>Basic requirements and options analysis</p> <ul style="list-style-type: none"> - Agreement on risk statements – are they material? - Identification of risk mitigation options / solutions - Assess risk appetite (how much do we need to reduce Likelihood and impact?) - Prioritise risk mitigation options (what's important to you?) - Agree if any which mitigation options need further work
<p>WG3 15th Jan</p>	<p>Draft Workgroup report</p> <ul style="list-style-type: none"> - Cost Vs Benefit analysis - Review group comments on report
<p>WG4 24th Feb</p>	<p>Continue draft and agreement of Workgroup report</p> <ul style="list-style-type: none"> - Agreement on consensus for NGG to report back to Panel / Ofgem
<p>WG5 30th March</p>	<p>Agreement of Workgroup report- If not complete in February meeting?</p>

Your feedback is important to us

- Your feedback is always welcome
- We would like to capture your contact details today so that we can keep you informed of developments
 - We may also try and contact you for your feedback and comments about today and our approach
 - If you would prefer not to be included then please do let us know
- You can also contact us to tell us how we are doing, particularly on topics discussed today:

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- Feedback can also be provided online if you prefer

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