Argus US Electricity

Incorporating the Energy Market Report

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Power Market Prices and Analysis

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Nodal seeks financial trades

An online power trading and auction platform told *Argus* recently that it has approached independent system operators (ISOs) about clearing some transactions done on those systems to reduce credit risk.

Paul Cusenza, chief executive of the Nodal Exchange, also said the exchange has spoken to the Federal Energy Regulatory Commission (FERC) and the Commodity Futures Trading Commission about clearing the equivalent of financial transmission rights (FTRs), a specialized hedge that is auctioned periodically on ISO markets.

Nodal Exchange is a three-year-old risk management platform based in Vienna, Virginia, that settles trades based on pricing established by ISOs. Most Nodal Exchange deals settle versus pricing on the New England, New York, PJM and Midwest ISOs, with some referenced to California and the Electric Reliability Council of Texas.

Terms of trading in these markets, on which 1,800 delivery locations are listed, extend 68 months, with most transactions in the first 12 months.

A daily auction is conducted with orders due at 11am ET and results available by 1pm. Over-the-counter execution is also available for trades through brokers or with specific counterparties.

"We do not have a screen-based trading model with high volume traders," Cusenza said. "Most of our trades are hedges for people going to settlement."

Location spreads are the most common transaction on Nodal Exchange, and Cusenza explained that most spread trades are merely the congestion difference between two locations.

Dropping physical losses (energy lost in transmission) from ISO FTRs gives the effect of the congestion spread.

Trading of FTRs is supposed to capture the value of energy at different nodes on ISOs based on the value of using the transmission grid, not the cost of energy generation.

Cusenza envisions that ISOs would continue to run FTR auctions, but once parties are matched, the trade would be submitted to Nodal Exchange for clearing. A counterparty already doing business on the exchange would have its FTR position netted against other positions, and be able to hedge the FTR.

A non-participant would either get paid or make payment through the exchange and its clearing partner, London-based LCH Clearnet Group.

Nodal Exchange has more than 60 participants. Many, but not all, are active FTR market players, Cusenza said, because FTRs have no market after an annual auction. Clearing through Nodal Exchange would remove the bilateral credit risk in trying to hedge an FTR, as well as the price risk.

Margining on the exchange is determined by the value-at-risk method. An entity which had its open FTR position cleared in such a scheme would be subject to daily variation margins, which would prevent a market from being manipulated.

The PJM FTR market came under scrutiny in 2007 when a company called Power Edge defaulted on $80mn in FTRs, with losses far exceeding the collateral posted. After a two-year investigation, FERC rejected claims that Power Edge made the trades intentionally so that an affiliate company could profit.

Socialized credit losses of the ISOs are another reason for third-party clearing by a company liked Nodal Exchange, Cusenza said.

"We are willing to work with ISOs in various ways to get the best results," he said. "Creating that bridge to a cleared exchange is useful. For every contract moved to our market, it is one less available to default."