Risk publications

COMMODITY RISK MANAGEMENT & TRADING

REPRINTED FROM

EnergyRisk

risk.net/energy-risk

June 2013

EXCHANGE OF THE YEAR

Nodal Exchange

EnergyRisk Awards 2013

NODAL EXCHANGE

EnergyRisk Awards 2013

Nodal Exchange

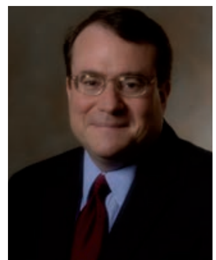
Exchange of the Year

When it comes to commodity exchanges, Nodal Exchange is not a household name. But within US power markets, it has gained notable recognition in its brief history as a company.

Trading electricity has always been a tricky proposition compared to the trading of other energy commodities, as the impossibility of large-scale power storage and the physical limitations around transmission mean there is greater volatility and more locational basis risk. Nodal wins our *Exchange of the Year* award for its development of products that help market participants manage those risks.

The US power market is set up with organised electric grids where pricing takes place at a granular level – that is, at individual generation nodes or load zones across thousands of locations within the country's various regional transmission organisations (RTOs) or independent system operators (ISOs). Before Nodal launched its trading platform in April 2009, however, there were few opportunities to trade at these generation nodes or load zones, and the vast majority of trades were at the major zones and hubs. Now, four years after its launch, Nodal is unique in offering not only settled electricity futures for these major hubs and zones but also hundreds of granular contracts across nodal positions, which has given market participants a way to construct more precise and effective hedges. All such transactions are cleared, thanks to Nodal's partnership with London-based clearing house LCH.Clearnet.

Nodal saw huge growth last year. Its market share, measured in terms of open interest in all cleared North American power futures and swaps, reached 21% in the first quarter of 2013, up from 10% at the end of 2011. Nodal operates in the largest US power markets: PJM Interconnection, which is the RTO for the mid-Atlantic states; New York ISO; the Midwest Independent Transmission System Operator (Miso); ISO New England (ISO-NE); the Electric Reliability Council of Texas (Ercot); and California ISO. Across the markets of PJM, Miso, ISO-NE and Ercot, Nodal has a 60% market share of zonal open positions and 100% market share of nodal open positions (where Nodal is the only offering). Nodal now has 11 clearing members supporting the exchange and more than 80 signed participants that have traded over $35 billion in notional value to date. Many of the largest investment banks and utilities across North America transact on the exchange.



Paul Cusenza

One of Nodal's biggest achievements in 2012 was its creation of products similar to financial transmission rights (FTRs) for select locations. Now, in addition to locational marginal price (LMP) contracts, Nodal allows trading of contracts linked to energy-plus-congestion or energy-only prices, as published by the RTOs or ISOs. That has provided market participants with new tools to hedge both positions in LMPs and their components: energy, congestion and loss. Nodal's energy-plus-congestion products are more flexible than FTRs, which are typically offered only in yearly and monthly auctions by the ISOs and can have limited liquidity.

"By introducing this new contract, it really met the needs of the industry and we saw significant volumes after that contract was introduced," says Nodal chief executive Paul Cusenza. "Our market is liquid, unlike with FTRs, where you don't have a way to trade out. Here you do have a way to trade out, which you can do by either going through a broker and having a block trade, or, alternatively, by signalling into our auction, so we can create liquidity by notifying everybody that someone is interested in trading this particular path or this particular time period. That creates interest in an auction, so then you're able to unwind through the auction processes."

Market participants have expressed enthusiasm about the new products. "We've actually been increasing our activity since they brought their FTR lookalike product – the congestion-only product – on the market," says a New York-based senior transmission trader at a US utility. "It's been a huge benefit to us because there's an ability to clear additional volume beyond what the ISOs will clear for you, and there's definitely a much better opportunity to do hedging because you can actually do contracts at your generation location or very close to it." ■

> *Our market is liquid, unlike with FTRs, where you don't have a way to trade out*
>
> *Paul Cusenza, chief executive, Nodal Exchange*