

Paul Cusenza, Chief Executive Officer, discusses the advent of Nodal Exchange, its unique offering in the US power market and his belief that much of the OTC cash-settled power market in the US can be put on exchange

Nodal Exchange launched in April this year. What has it been like to start a new exchange in the current environment?

Paul Cusenza, Chief Executive Officer, Nodal Exchange (PC): We have been very happy with our launch and to be offering nodal power contracts with central counterparty clearing in the North American markets for the very first time. LCH. Clearnet is the central counterparty for the exchange, and they bring a wealth of experience as the leading independent clearing house in the world. We completed our ownership structure prior to launch and have a strong set of strategic investors.

Although the current environment remains relatively challenging, the power market industry values the key benefits - managing basis risk and reducing credit risk - that the offering from Nodal Exchange and LCH. Clearnet provides. In fact, the current environment emphasises the need for more central clearing. As such, market participants have been able to manage through the current challenges and distractions to make the launch a success. Participation on our exchange continues to grow, and we look forward to further expansion as we continue to meet the needs of the marketplace.

To what extent do you think the over-the-counter (OTC) market can be put on exchanges?

PC: There has been much legislative discussion this year in the US about requiring that OTC derivatives based on standardised contracts be cleared through regulated central counterparties. As stated by Commodity Futures Trading Commission (CFTC) Chairman Gary Gensler: "Exchange trading and central clearing are the two key and related components of well-functioning markets."

Prior to the launch of Nodal Exchange in April, there were no standard power contracts offered on exchanges that were central counterparty cleared for most of the locations in North America. In order to manage basis risk, power needs to be traded locationally, as half of the volatility in the locational marginal price of electricity is typically from congestion and transmission loss. Historically, market participants have had to do off-exchange OTC transactions to manage this risk.

Today, financially settled trading to manage basis risk can be done on Nodal Exchange with central counterparty clearing by LCH. Clearnet for much of the country. Nodal Exchange is currently offering nodal contracts on about 1,800 locations within the following four Regional Transmission Organization/Independent System Operator (RTO/ISO) markets: ISO-NE (ISO New England), NYISO (New York ISO), PJM (PJM Interconnection), and MISO (Midwest Independent Transmission System Operator). Contracts for CAISO (California ISO) are expected to be available in the spring of 2010.

In order to support liquidity, Nodal Exchange offers both an auction every business day, as well as, a platform for negotiated transactions (i.e., broker transactions) to be submitted for central counterparty clearing. With the advent of Nodal Exchange, we believe that much of the OTC cash-settled power market in the US can be put on exchange.

What makes Nodal Exchange different from other offerings?

PC: Nodal Exchange is unique in that it offers standardised contracts on about 1,800 locations in the markets it serves, as opposed to the very few locations offered on other exchanges. Unlike oil,



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which can be stored in barrels, electricity is usually generated for near-immediate consumption. The variance in local demand, caused by factors such as the weather, impacts how much electricity is needed and consequently from where it can be sourced. Congestion and loss related to transmitting the electricity from place of generation to location of consumption are key factors in determining the locational price of electric power. So, although trading on a few hubs can be reflective of energy cost risk, it does not address the locational risk faced by industry participants.

By having many locations available for trading, Nodal Exchange meets the needs of power market participants. To meet this need of having many locations available for trading, Nodal Exchange uses an auction platform. Nodal Exchange auctions are similar to the complementary auctions held by the RTOs for Fixed Transmission Rights (congestion only). However, Nodal Exchange auctions are held daily rather than monthly and annually providing greater frequency, and all transactions are central counterparty cleared. Prior to Nodal Exchange, such locational risk could only be managed OTC without the credit management benefits of central clearing. Nodal Exchange and LCH. Clearnet provide an offering that effectively meets the needs of the North American power markets by offering superior basis and credit risk management and improved price discovery and market liquidity.

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