

Power Trading FORUM



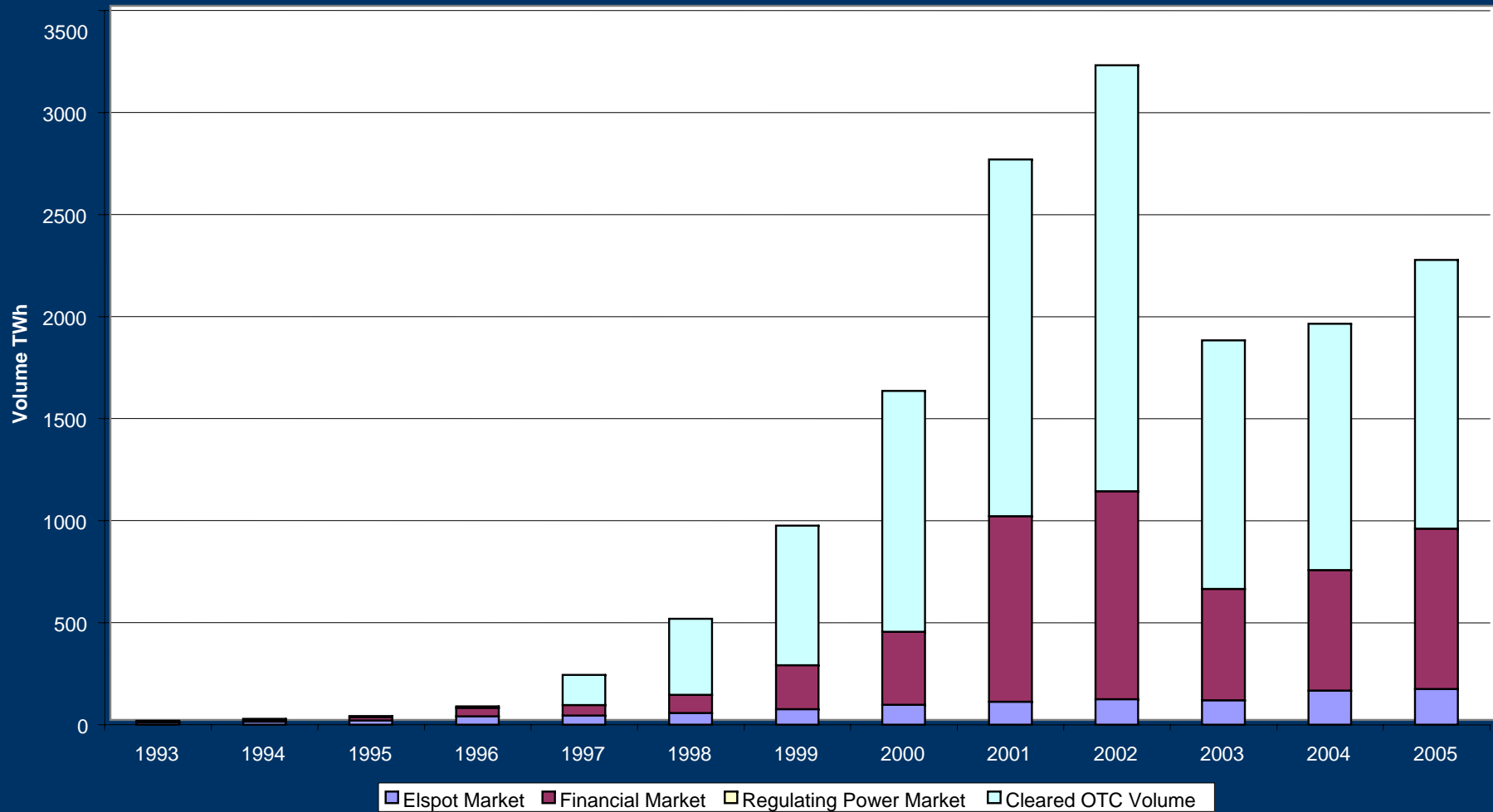
**What can the UK power market learn
from elsewhere?**

Brief insights from Nordpool

Jon Doughty

March 2006

Nordpool Traded Volumes have performed well



Total Nordic Power Exchange generation c. 380 TWh

Key design features of the Nordic market

- Elspot
 - Day-ahead physical delivery power market
 - Auction system for purchases and sale of hourly, block, flexible hourly contracts
 - System price = unconstrained market price derived from auction
 - Covers around 45% of Nordic consumption
- Nord Pool Financial market
 - Reference price for financial contracts is System price from Elspot
 - All contracts cash settled
 - Futures contracts daily mark to market during trading period, final settlement begins at maturity and covers difference between closing price of futures and system price in delivery period
 - Forwards contract collateral lodged to cover settlement
 - Covers around 5x physical load

Key design features of the Nordic market (2)

- Clearing
 - Financial electricity contracts traded at Nord Pool automatically cleared
 - OTC standardised financial contracts can be given up to Nord Pool Clearing
 - Cleared volumes around 2156 TWh of which 786 TWh exchange traded

The Nordic market has responded to liquidity challenges

- Poor liquidity in physically delivered contracts saw peak and off peak products removed to focus liquidity on base load products 1993-94
- OTC cash settled financial electricity costs referenced to Nord Pool system price introduced to promote trading by new market participants and stimulate greater liquidity in 1994
- Nord Pool introduced financially settled forward contracts standardised to OTC market up to 4 years ahead in 1997
- At same time, time horizon of futures contracts reduced from 3 years to 8-12 months
- Futures time horizon shortened to 8-9 weeks ahead from 2003 due to margining requirements on financially settled futures

Key insights

- Clear separation of physical and financial market
- Day-ahead auction provides a neutral, transparent price for wholesale, retail and reference price for power derivatives traded OTC and on the exchange
- Financial market used for hedging price risk and trading speculatively
- Liquidity has proved robust to high levels of price volatility and market shocks
- Over 300+ participants: generators, energy traders, industrials, banks, TSOs