Nord Pool headquarters in Lysaker, near Oslo. Photo by: Stefan Schroeter

Nord Pool aims for global expansion

After its recent partnership with the US-Swedish stock exchange operator Nasdaq OMX, the Nordic power exchange Nord Pool is looking for further international expansion. The next target is the UK.

By Stefan Schroeter

At noon on a Friday, prices are being set at the Nord Pool Spot power exchange (NPS) in Lysaker near Oslo for electricity to be supplied the following day. This process, which determines wholesale electricity prices in Norway, Sweden, Finland, Denmark and eastern Germany, is managed by just two specialists working at their trading desk - supported, of course, by a highly automated system. In just a few minutes, the computers have done their job and calculated area prices for seven zones in five countries.

Every day prices are calculated for each of the 24 hours for the following day. On this day, the lowest price for one hour – €40.86/MWh – holds in Finland, in the northern part of Norway and in Sweden. 'There is no congestion in the flow of power between these price zones,' explains compliance manager Hilde Rosenblad. Congestion occurs when the capacity of the transmission lines is insufficient to transport enough electricity from one area, where power supplies are high, to another, where supplies are low.

The prices clearly show in which areas there is little congestion. In southern Norway and western Denmark, the price of electricity is relatively low, at €41.00. In contrast, the flow of power to Denmark's eastern island of Zealand and to eastern Germany is restricted as a result of bottlenecks in the transmission lines. The result is higher prices: €46.77 in Zealand and €52.43 in eastern Germany.

As Rosenblad explains, electricity very often flows from Germany and Denmark to Norway, Sweden and Finland during the night, and in the opposite direction during the morning, daytime and evening. This is because the northern area relies predominantly on hydropower, which can be easily shut off at night when demand is low, whereas the German-Danish area relies on thermal power plants, which are more difficult to adjust, and therefore suffer from excess capacity at night.

More volume

The prices set at the NPS not only apply to power supplied the next day, they also act as reference prices for future and forward contracts with terms of up to six years, which are traded through Nord Pool (NP), NPS's sister exchange also based in Lysaker. NPS and NP can boast extensive experience in power exchange trading. Their predecessor, Stattnet Market, started spot trading in the deregulated Norwegian market in 1993. Three years later, Sweden joined the market, and the power exchange was renamed Nord Pool (NP). Finland and Denmark had joined by 2000.

In the same year, NP was involved in the founding of the Leipzig Power Exchange LPX in Germany. Using market-tested systems and expertise from Scandinavia, the LPX competed successfully with the Frankfurt-based European Energy Exchange EEX, but after two years, the two German power exchanges merged into EEX, based in Leipzig. NP subsequently sold its shares in EEX to the German energy exchange Eurex.

In 2002 NP split its growing business into two operations: NPS became responsible for physical power spot trading, NP kept the clearing and derivatives trading activities. Three years later, NP was the first commodity exchange to start trading contracts in European Emission Allowances (EUAs) under the EU Emission Trading Scheme and later Certified Emission Reductions (CERs), emission reduction credits under the Kyoto Protocol. While this activity has remained somewhat limited, NPS and NP have managed to consolidate their leading position in power trading, although they have faced growing competition in recent years. 'This is a race for volume, and it's a price competition,' explains Geir Reigstad, head of the newly formed business unit Nasdaq OMX Commodities (NOC). 'We want to get more volume to our existing platform and we can do that due to our economies of scale.'

Consequently, NP entered into a strategic partnership with the Swedish stock exchange company OMX in December 2007. At the time, OMX was itself being taken over by the US stock exchange operator Nasdaq. Thus, the resulting US-Swedish stock exchange operator Nasdaq OMX acquired NP's clearing and consulting operations and international derivative products. In October 2008, the new business unit for international energy derivatives, NOC, started operations in Lysaker. According to its own appraisal, NOC is world leader in the clearing of power supply contracts and is looking to achieve the same position in energy derivatives and carbon emission contracts. The regulated exchange NP remains a separate entity.

Continents

One of the aims of NOC is to develop derivatives trading in Germany and the Netherlands, where it will have to compete with the existing exchanges EEX and APX. Reigstad believes NOC has a chance because it can accommodate energy companies active in the whole area. 'Many trading participants have assets in the Nordic region and in the German or Dutch region as well, for example Eon and Vattenfall. There is a high degree of correlation between the three markets, so risks in one market can be offset in another area.'

> *'This is a race for volume, and it's a price competition'*

In addition, NOC and NPS have been chosen by the Futures and Options Association in the UK to establish a spot and derivatives power market. Here they will again run into competition from APX. 'We have promised to have the UK market ready by the end of the second quarter this year', says NPS chief executive Erik Saether.

In eastern Europe, Nord Pool Consulting, a subsidiary of NOC, has entered into a partnership with Romanian power exchange Opcom in Bucharest. The aim is to build Opcom into a regional power exchange.

But NP and Nasdaq OMX do not limit their ambitions to Europe. They are aiming for global expansion. Reigstad anticipates that participants trading on exchanges operated by Nasdaq OMX will be attracted into trading in power products with NP. 'This will give them the necessary expertise to start trading products on other continents, giving Nasdaq OMX a reason to start commodity markets in the US or elsewhere in the world.'

Reigstad identifies the carbon market as a particularly interesting international opportunity. Here, he expects to see major changes over the next two to three years, especially in the US, but in Asia too. 'Nasdaq's global presence provides a solid foundation for developing these operations together with NP and NOC'. ■