UNITED STATES OF AMERICA
BEFORE THE DEPARTMENT OF THE INTERIOR

Federal and Indian Coal Valuation…………. Docket No. ONRR-2011-0004

COMMENTS OF PLATTS

The Department of the Interior, Office of Natural Resources Revenue, in the May 27, 2011 Federal Register, issued an advance notice of proposed rulemaking in which it requested comments and suggestions before it proposes changes to the existing regulations governing the valuation of coal produced from Federal and Indian leases for royalty purposes.

Platts, a leading global publisher of prices for energy markets and other commodities, welcomes this opportunity to respond to the request. Platts will focus its comments on the two questions posed in the notice regarding published index prices for coal:

1) Are there published index prices that accurately reflect the actual market value of coal? If so, what are those index prices and to what areas of the country or to what types of coal do they apply?
2) Does the concentration of Federal or Indian production in some areas of the country create any potential problems with relying on index prices in those areas, now or in the future?

In addition to addressing those specific questions, Platts will provide background information on index prices in markets in general and in the U.S. coal market in particular.

Background: Use of index prices in commodity markets

Index prices, also known as price assessments, reflect trading in the physical spot market, which is a shorter-term physical market in which standard products are traded. In many commodity markets, physical spot trade typically accounts for 10 percent to 20 percent of the total market, with the remainder of the physical market comprising longer-term deals. Physical spot markets, also sometimes known as balancing markets, are used by market participants to buy and sell incremental supply when they are long or short. In general economic terms, the market price in the physical spot market reflects the marginal price of a commodity.

Buyers and sellers agree to long-term contracts because they want to ensure long-term supply and sales. However, if they sign such term contracts at fixed prices, they risk locking in a price with no assurance that the price will not end up, over the life of the contract, well over or under the current market price. Many market participants prefer to transact at the market price, or spot price, than to take the risk of a fixed price and thus they agree to a price based on an index price or price assessment that reflects the current market or spot price.

In the North American natural gas market, for example, a Platts analysis of data reported by wholesale natural gas buyers and sellers to the Federal Energy Regulatory Commission shows that in 2010 about two-thirds of purchases and sales were priced based on published index prices.

It is important to note that market participants and other users of index prices have the flexibility to negotiate adjustments to published market assessments to reflect differences in product specifications, delivery locations, and other factors. For example, counterparties could agree to an "index minus" price for a contract for a product with lower specifications that the standard product on which the assessment is based.

The use of published index prices in other energy markets for purposes of valuing bilateral physical contracts, financial contracts and governmental functions, including royalty payments, is well established. For example, under a DOI August 1999 final rule, Platts gas indices can be used to value natural gas production from Indian leases. Under the Department's royalty-in-kind program, Platts daily and monthly gas prices were used to price swing and baseload gas sales.

Similarly, FERC found in a 2004 order that published gas indices "are widely used in market-based, commercial settings where parties are negotiating at arm's length" (Docket No. PL03-3-005, November 19, 2004, at 16). Gas index prices can be used in FERC jurisdictional pipeline tariffs and to price capacity release, and also are used in hundreds of publicly traded basis swap and other financial transactions.

Background: The development of the U.S. coal market

The U.S. coal market has evolved significantly since the existing coal valuation regulations were put in place more than 20 years ago, in 1989. In addition to the traditional long-term, fixed-price contracts between coal suppliers and buyers, the market now includes an over-the-counter spot market where standard coal products trade, often through brokerages. Products can be for physical delivery or financial hedging, and are for standard forward time periods, including the prompt month, the prompt month plus one additional month, three forward quarters, and one forward calendar year.

The development of standardized products and a shorter-term spot market enabled the development of daily assessments, which Platts began publishing in 2003. The daily assessments for standardized products provided a settlement mechanism for cash-settled financial swaps for Central Appalachian rail coal and Powder River Basin coal, launched in 2004 by the New York Mercantile Exchange, now a division of CME Group. (NYMEX had earlier listed a physical futures contract for a standardized product in Central Appalachian barge, in 1998.)

More recently, the IntercontinentalExchange launched three financial swaps for the standard Central Appalachian barge and rail coals and standard Powder River Basin coal. The two exchanges between them currently offer one physical futures contract and five financial swap contracts for standard U.S. coal products. The daily assessments published by Platts are used as the basis for settling those five financial swaps contracts.

While there are no available statistics regarding the use of index prices or the size of the spot market for U.S. coal, market participants and brokerage firms regard the Platts daily assessments as highly relevant and of substantial value. Market participants and brokerages, which have been instrumental in the development of a more transparent and liquid spot market, contribute to the formation of Platts' assessments by providing price and market information daily.

Answers to questions regarding index prices

The notice asks: “Are there published index prices that accurately reflect the actual market value of coal? Is so, what are those index prices and to what areas of the country or to what types of coal do they apply?”

Platts publishes index prices or assessments that represent the actual market value of coal for standard products in standard delivery periods.

The four standard products are Central Appalachian barge-delivered coal, Central Appalachian rail-delivered coal, and two low-sulfur Powder River Basin coal products, one with 8,800 Btu/lb. and the other with 8,400 Btu/lb. Platts provides daily assessments for each of those standard products.

These standard products are well-defined in terms of content and delivery specifications. Those specifications for the standard products assessed by Platts, detailed on page 11 of the attached Platts Methodology and Specifications Guide − Coal, are the same specifications defined and adopted by the Coal Trading Association and used by NYMEX and ICE to define the physical futures and financial swaps products they list.

Platts Daily OTC Assessments/OTC Broker Index assessments for the four standard products are published on page 1 in its Coal Trader publication. A sample copy is attached. (To meet the needs of the market, the same set of four assessments is published in two separate tables using different nomenclature.)

Platts Daily OTC Assessments/OTC Broker Index are formulated based on systematic Market on Close practices and reflect market values at the end of the trading day, defined by Platts as 4 pm Eastern prevailing time for North American coal markets. More detail on how those assessments are calculated can be found on page 2 of the attached methodology.

Platts also publishes weekly assessments for the traditional physical market, for coal sold by suppliers directly to buyers rather than through the more transparent over-the-counter brokerage market. Those assessments are published on page 2 of Platts’ weekly publication, Coal Outlook. A sample copy is attached.

Weekly assessments of the traditional physical market include five assessments for coal from the Powder River Basin, Colorado and Utah: 1) PRB 8,800 Btu/lb., 0.8 SO_2 lb./MMBtu; 2) PRB 8,400 Btu/lb., 0.8 SO_2 lb./MMBtu; 3) Colorado 11,700 Btu/lb., 0.8 SO_2 lb./MMBtu; 4) Colorado 11,000 Btu/lb., 0.8 SO_2 lb./MMBtu; and 5) Utah 11,500 Btu/lb., 0.8 SO_2 lb./MMBtu. Platts also publishes weekly assessments for production from the Appalachian and Illinois basins.

The notice poses a second related question regarding index prices: “Does the concentration of Federal or Indian production in some areas of the country create any potential problems with relying on index prices in those areas, now or in the future?”

Valuing coal in any location using index prices requires careful consideration and analysis of how the coal being valued compares with the production on which the assessment is based in terms of location, specifications, market fundamentals and other market conditions. Prior to such analysis, it is difficult to assess what issues might arise from using index prices to value coal from a particular location. However, Platts notes that there are price assessments for Western coal that appear, potentially, to be relevant for valuing coal on Federal and Indian lands in the West. The use of gas index prices to value production on Federal or Indian property has been accepted practice for years and should serve as a guide to use of index prices for solid mineral valuation.

Conclusion

Platts, as a publisher of price assessments widely used in the US and international coal markets, welcomes the opportunity to comment in this proceeding and looks forward to providing ONRR, as it considers issues in this proceeding relating to index prices, additional comments or answers to additional questions.

Respectfully submitted,
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