

A Primer on Platts Indexes and Assessments for North American Natural Gas and Electricity Markets

This primer provides an overview of how Platts creates indexes and assessments for North American natural gas and electricity markets. It also summarizes changes to Platts processes and methodologies since 2003 and the growth in data used to create indexes.

For those seeking more information, detailed methodologies are available at [platts.com](http://www.platts.com). The methodology for North American natural gas is at <http://www.platts.com/Natural%20Gas/Resources/Methodology%20&%20Specifications/index.xml>. The methodology for North American electricity is at <http://www.platts.com/Electric%20Power/Resources/Methodology%20&%20Specifications/index.xml>. In addition, Platts editors are available to answer questions regarding our market coverage, price reporting and methodologies. The names, telephone numbers and e-mail addresses of editors are at the end of this document.

More information is also available from numerous Platts filings to the Federal Energy Regulatory Commission. As a publisher whose business is to provide price and market transparency, Platts is an active participant in public proceedings at FERC concerning price-index formation and market and price transparency. Platts filings present information on its natural gas and electricity indexes and its views on price and market transparency. They are available on the FERC website (www.ferc.gov).

Background information on Platts

Platts is a division of The McGraw-Hill Companies that provides news and pricing for energy markets worldwide. Platts has more than 450 employees in 15 countries, including about 250 employees in the United States. A number of those editors and reporters focus exclusively on producing news and pricing information for the US natural gas and electricity sectors, working on publications such as *Gas Daily*, *Megawatt Daily*, *Platts Energy Trader*, *Electric Power Daily*, *Inside FERC*, *Inside FERC's Gas Market Report*, and *Power Markets Week*. Platts has in place a code of ethics with which all of its employees, including its editorial staff, must comply. Components of the code specifically address standards for market reporting. Company policies, among other things, prohibit editorial personnel and their spouses from trading in commodities or stocks, bonds or options of companies in the energy industry.

Platts has an independent compliance staff whose function is to ensure that Platts' market editors and reporters follow the stated methodology, records retention policy and code of ethics. In addition, The McGraw-Hill Companies' internal auditor, an independent group that reports directly to the parent company's board of directors, reviews the Platts compliance program.

Changes in methodology and index formation

Even before companies began acknowledging misreporting of price data to index publishers in the fall of 2002, Platts proposed new standards for price reporting. Those

standards were adopted in final form in North American gas and electricity markets more than three years ago, on July 1, 2003. The new standards are largely reflected in and therefore in line with those stated in the Federal Energy Regulatory Commission's July 24, 2003, policy statement on US natural gas and electric price indexes.

In brief, the new standards require companies to assume responsibility for full and accurate reporting to Platts and other index publishers and mandate that the data-reporting function is the responsibility of the mid- or back office (risk management and/or compliance) and not the trading operation. Back or mid-office reports containing transactional-level data are sent electronically to Platts, and no prices in daily and monthly spot price surveys are collected directly from traders.

The adoption of the standards marks a watershed in price-index formation. It is clear since the new standards went into effect that companies take their responsibility for full and accurate reporting very seriously: The standards are enforced by Platts, are formally required by the FERC policy statement and have been driven home by the aggressive pursuit by federal authorities of false-reporting cases for practices that occurred before the standards were adopted. In addition, the FERC policy statement requires that companies audit their internal processes once a year, and FERC in 2006 began auditing companies for compliance with the policy statement.

As a result of the new standards, confidence in the integrity of Platts indexes as well as participation by companies in index formation have grown dramatically since 2003. Detailed information on the volumes behind the indexes is in Platts public filings to FERC.

Platts methodologies

Platts' standards for data quality are at the heart of its gas and electricity methodologies and its processes to produce reliable indexes and assessments. They are designed to ensure that market participants provide complete and accurate price information.

To that end, Platts' standards require formalized reporting relationships with gas and electricity market participants in which transactional-level data is submitted from a central point in the mid- or back office (a segment of the reporting entity that does not have a commercial interest in the reported prices). In addition, the reporting entity must sign a written certification that it is making a good-faith effort to report completely and accurately and will have staff assigned to respond to questions concerning data submittals. The entity also is obligated to make reasonable efforts to inform Platts in the case of any errors or omissions, and as necessary, modify its internal processes to eliminate or minimize the likelihood of future errors or omissions in its data submissions.

While the data-quality standards are common to the methodologies for various gas and electricity indexes, there are some differences in methodologies. Platts publishes prices in three discrete natural gas markets and two discrete electricity markets. Following is a brief overview of the various gas and electricity indexes and assessments and how they are constructed.

Daily gas indexes

Platts publishes daily gas indexes at 84 locations. The indexes include only fixed-price physical deals for next-day delivery. The index is a volume-weighted average of all remaining deals after editors have reviewed the data and eliminated outliers. If no deals are reported for a point, no price is published. In addition to the volume-weighted average, called the midpoint, Platts published an absolute range, a common range, the volume behind the index, and the number of deals.

Monthly bidweek indexes

Platts publishes monthly bidweek gas indexes at 63 locations. The indexes include fixed-price physical deals, as well as physical basis deals for points east of the Rockies and West Texas. Only transactions done during bidweek for delivery the next month are included; bidweek is defined as the last five business days of the month.

The index is a weighted average of deals (excluding outliers) at points with volume above 25,000 MMBtu/day. In the limited instances of thin, illiquid markets, if the reported transactions at the illiquid point do not produce an average that substantially correlates with those at more liquid related points, Platts will make an assessment if adequate alternative market information is available. Such information includes an analysis of bid/ask spreads, basis relationships to values at related liquid pricing points, implied physical values derived from financial swaps and derivative index deals and daily market trading during bidweek. If there is not enough information, Platts will not publish a price. In addition to the index, Platts publishes a range. And for all but a small number of illiquid points, Platts also publishes the volume and number of transactions underlying each index.

Gas forwards--daily assessments of forward financial basis swap market

Platts publishes daily assessments for gas forwards, which trade as financial basis swaps priced at a differential to the Henry Hub price. Assessments are published for 14 points for time periods extending out through several seasons and a few calendar years.

These assessments differ fundamentally from the physical monthly bidweek and daily indexes in methodology and how they are used by the market. The methodology is a market-on-close assessment based on values at the close of gas futures trading on the New York Mercantile Exchange. The market-on-close methodology establishes the value at the close of the market rather than averaging values of trades done throughout the day and relies much more on editorial judgment than on average values of reported data. The purpose of the forward gas assessments is to bring more price transparency to lower-liquidity forward markets and “fill in the gaps” for locations and periods for which there is little or no trading activity. Unlike the daily and monthly bidweek indexes, the assessments are typically not used for pricing transactions and for hedging, but rather as a

tool for valuing forward positions (mark-to-market) and for general information on forward values.

Daily electricity indexes

Platts publishes daily electricity indexes based on fixed-price day-ahead bilateral deals for 33 locations. The daily electricity methodology is quite similar to the daily gas methodology but differs in one aspect: Assessments rather than volume-weighted averages are used in thin markets. The importance of these indexes for price discovery has declined in areas with centralized independent system operator (ISO) markets because of the sharp reduction in physical bilateral trading in those markets. However, the indexes remain important in non-ISO markets, including those in Texas and the West.

Electricity forwards--daily assessments of forward electricity contracts

Platts publishes daily assessments of electricity forwards at 17 locations for time periods extending out at least three calendar years in Eastern and Central markets and at least four calendar years in Western markets. Like the forward gas assessments, the forward electricity assessments differ fundamentally from the daily electricity indexes in methodology and how they are used by the market. The methodology is a market-on-close assessment that establishes values at the close of gas futures trading (forward electricity prices are closely tied to the prices of gas futures and gas forwards) and relies more on editorial judgment than do daily indexes based on volume-weighted averages.

The purpose of the forward electricity assessments is to bring more price transparency to lower-liquidity forward markets and “fill in the gaps” for locations and periods for which there is little or no trading activity. The assessments typically are not used for pricing transactions, but rather as a tool for valuing forward positions (mark-to-market) and for general information on forward values.

Contacts for additional information

For general information, and for questions on Platts policies and processes and on reporting price data to Platts, please contact Brian Jordan, Platts editorial director, North American natural gas & electricity markets, 202-383-2181, brian_jordan@platts.com.

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