

Methodology and Specifications Guide

US Emissions Broker Indexes

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LATEST UPDATE: SEPTEMBER 2003

INTRODUCTION

On Sept. 12, 2003, Platts launched new indexes on US emissions allowances for sulfur dioxide (SO₂) and nitrogen oxides (NO_x), using price information from seven major brokers dealing in US emissions allowances. Platts receives monthly and weekly figures for the four most frequently traded US emissions products and has developed an index for each product. The indexes are intended to capture relevant information needed to publish a representative market value at the close of the given period. The methodology described below was proposed and submitted to Platts' readership for review and comment for a period of one month prior to final adoption by Platts, as dictated by company standards.

US EMISSIONS TRADING

Each SO₂ allowance authorizes one ton of SO₂ emissions. Each NO_x allowance authorizes one ton of NO_x emissions. Allowances in both programs are allotted annually by the US Environmental Protection Agency to sources, such as power generating stations, under a gradually decreasing annual cap, and some allowances are also made available at open auction. Sources opting to reduce their emissions by technical means below their allotted limits may bank or sell their allowances, making emissions trading a key economic incentive in US strategy to reduce air pollution.

Products: US government-defined allowances, allowing one ton of emissions, for:

- SO₂ – current year (spot)
- NO_x – current year vintage
- NO_x – current year plus one
- NO_x – current year plus two

MONTHLY INDEX

Platts publishes once a month an index representative of the market value of SO₂ and NO_x allowances, normally on the 15th of each month or closest prior business day on which monthly options are settled. The index reflects the value of the emissions allowances as of 1600 Eastern prevailing time the business day before options settlement. Each broker independently contributes, for each product:

- Best assessment of prevailing offers known to the broker
- Best assessment of prevailing bids known to the broker
- Last deal done before 4 p.m., to broker's knowledge.

WEEKLY INDEX

Platts publishes on a weekly basis an index representative of the market value of SO₂ and NO_x, between 1600 and 1630 Eastern prevailing time on the last business day of the week. Each broker independently contributes, for each product:

- Best assessment of prevailing offers known to the broker
- Best assessment of prevailing bids known to the broker
- Last deal done before 4 p.m., to broker's knowledge.

INDEX PROCEDURE FOR EACH PRODUCT

1. Determining bid-offer spread:

Platts determines the mean of all bid assessments, within normal standard deviations. Any bid number outside this range is considered by the editors for removal from the computations. Editors use their best judgment and knowledge of the market in deciding whether a number constitutes an outlier, and may attempt to determine if a true error is involved. Editors retain the discretion to remove any number they consider biased. If any number is determined to be an outlier, it is removed from computation, a new mean is calculated, and notation that an outlier was removed is made in the final index. Platts repeats this process to determine the mean of offer assessments.

2. Determining the Index:

Platts reviews the "last done" deal numbers. If 60% of them are the same, that number will be compared to the range of bid-offer means. If it falls within the range of the mean of bids to the mean of offers, it becomes the Index.

If 60% of the "last done" numbers do not match, or if the consensus "last done" falls outside the bid-offer means range, the mean of the bid-offer range will be the Index.

3. All indexes are rounded to whole dollars. Platts publishes for each allowance/vintage:

- the mean best offer
- the mean best bid
- the Index, specifying whether it is the last done deal or the mean of the bid-offer range
- notice of any submitted data that has been removed from calculation as an outlier.

4. Publication:

Platts publishes the Indexes in the daily Platts Coal Trader and

on its website at www.platts.com and at www.usemissions.platts.com

Brokers: Broker assessments are used because brokers traditionally take no positions in these markets and represent both buyers and sellers. Participating brokers are:

- Air Liquid Advisors
- Cantor Fitzgerald Brokerage LP
- Evolution Markets LLC
- ICAP Energy (formerly APB Energy)
- Natsource LLC
- Prebon Energy LLC
- United Power Inc.

Confidentiality: All submitted data is held strictly confidential by Platts, and handled internally on a need-to-know basis. Individual broker submissions are not disclosed outside of Platts and are not used for purposes other than computation of the Indexes.

INDEX SAFEGUARDS

The methodology is designed and regularly reviewed to insure several safeguards. First, the methodology aims to maximize the the number of independent contributors from the US emissions markets. The methodology aims to limit the influence any market participant can exert. The methodology also cross-checks transactional data versus the range of bids and offers to insure that a representative value is published, while limiting the potential for manipulation. Other safeguards come from data sources and from Platts' experience and internal controls. Platts has specialized in assessing energy commodity markets for decades and its editors bring unparalleled expertise to the task. Brokers were approached to contribute to these indices because

they traditionally take no market positions, allowing them to give an unbiased outlook. Moreover, Platts maintains an internal compliance office to ensure methodologies and standards are maintained, and Platts requires its editors to adhere to a strict ethics code, including annual affirmations that they hold no financial interests in the markets they cover.

Corrections: No corrections are accepted after the Index is published, including no further data which, for whatever reason, did not get to Platts. Platts makes every effort to get complete data from all contributing brokerages.

If, for any reason, data from more than half of the contributing brokers does not reach Platts, it is within Platts' editors' discretion to determine whether sufficient data exists for calculation of a valid index.

Errors are acknowledged and corrections published promptly if the error originates in Platts.

UPDATES

Because this is an evolving market, Platts undertakes to review this methodology regularly to ensure it consistently meets the needs of the market. Reviews are made to insure Platts indexes and assessments are consistent with market practices and reflect market values. Such reviews include sourcing of data. Platts editors developed this methodology following the spirit of the Emissions Marketing Association's Index Exploratory Committee's "procedure suggestion" to enhance the credibility and liquidity of US emissions markets. Platts' efforts were supported and done in consultation with a Steering Committee of major market participants. Platts has solicited comments from multiple market players in the course of developing this methodology, and welcomes comments at any time from other observers.

Comments: Please direct comments to Alex Oram, Managing Editor, Platts US Coal, at coal@platts.com, phone +1-202-383-2190.