

Central Appalachian Coal Futures Overview

In 1996, the New York Mercantile Exchange (NYMEX) began providing companies in the electric power industry with secure and reliable risk management tools by creating a series of electricity futures contracts fashioned to meet the particular regional needs and practices of the power industry. The buying and selling of these futures contracts and the related options contracts have given the industry a much-needed price reference and risk management tool. In the restructured electric power industry, where annual sales nationally are over \$250 billion, and price increases can no longer be passed along to customers, the pricing of resources used to generate electricity becomes more important.

Since coal is now the largest single power generating fuel in the United States, the once relatively sedate cash markets for coal have become more volatile and very strong market forces. Thus, electric utilities are no longer eager to enter into long-term coal supply contracts that once were the industry norm. Instead, there is now a preference for short-term and more price-flexible contracts that rely more on cash market purchases as power producers try to reduce their inventory holding levels.

U.S. coal exports, chiefly Central Appalachian bituminous, make up a significant percentage of the world export market and are a relevant factor in world coal prices. Because coal is a bulk commodity, transportation is an important aspect of its price and availability. In response to dramatic changes in both electric and coal industry practices, the New York Mercantile Exchange, after conferring with coal producers and consumers, sought and received regulatory approval to offer coal futures and options contracts. On July 12, 2001, NYMEX began trading Central Appalachian Coal Futures.

Coal futures provide the electric power industry with another set of risk management options, as well as offer the coal industry new and necessary risk management tools:

- Coal producers can sell futures contracts to lock in a specific sales price for a specific volume of the coal they intend to produce in coming months.
- Electric utilities can buy coal futures to hedge against rising prices for their base load fuel.
- Power marketers can mitigate their generation price risk and hedge with electricity futures to control their delivery price risk.
- Non-utility industrial coal users, such as steel mills, can use futures to lock in their own coal supply costs.
- International coal trading companies can use futures to hedge their export or import prices.
- Power generating companies that use both coal and natural gas to produce electricity can use coal futures in conjunction with natural gas futures to offset seasonal cost variations and to take advantage of the "spark spread" – the differential between the cost of the two fuels and the relative value of the electricity generated by each of the two fuels.

For the NYMEX futures market, coal contracts specify delivery by seller to the buyer at barge terminals on two limited sections of river located in Central Appalachia ([see map](#)), near the confluence of the Big Sandy and the Ohio Rivers. The sections are a 12-mile stretch of the Ohio River and the adjoining Big Sandy River (where coal barge terminals are within the lowermost 9 miles). The actual origins of the coal are not defined, but the coal must meet a set of specifications as to heat, ash, moisture, sulfur, volatile matter, hardness or grind ability, and sizing and must be delivered in 1,550 ton trading units.

NYMEX contract detail description and specifications can be found, respectively, at:

<http://www.cmegroup.com/>
<http://www.cmegroup.com/tools-information/build-a-report.html?report=dailybulletin>