

discussed above, price basing as described under criterion (a) directly confirms that the prices being generated on the market have significant utility with regard to discovering prices in connection with cash market transactions. Furthermore, publication of a section 2(h)(3) market's prices in a widely distributed industry publication, and industry consulting those prices on a more than occasional basis, confirms that the prices are thought to be sufficiently reliable and acceptable to be considered to be a significant source of price discovery.

In evaluating a section 2(h)(3) market's price discovery role, assessments under criterion (a) would include an analysis of whether cash market participants are quoting bid or offer prices or entering into transactions at prices that are set, either explicitly or implicitly, at a differential to prices established on a section 2(h)(3) market. Cash market prices are set *explicitly* at a differential to the section 2(h)(3) market when, for instance, they are quoted in dollars and cents above or below the reference market's prices. Cash prices are set *implicitly* at a differential to a section 2(h)(3) market's prices when, for instance, they are arrived at after adding to, or subtracting from, the section 2(h)(3) market's price, but then quoted or reported as a flat price.<sup>13</sup> The Commission will also consider whether cash market entities are quoting cash prices based on a section 2(h)(3) market's prices on a more than occasional basis.<sup>14</sup>

individual transactions in the associated cash market. These transaction prices may not be published or otherwise available (indeed, cash market transaction prices may be proprietary), which would preclude application of these statistical techniques. Moreover, these techniques likely would not be familiar to industry participants and may be costly to perform. For these reasons, the Commission is not proposing to base its criteria on the econometric techniques used in the academic literature.

<sup>13</sup> For example, if crude oil prices were generated on a section 2(h)(3) market, price basing practices that would satisfy criterion (a) would include cases where cash market bids or offers would be explicitly quoted at a differential to the prices generated on that market (e.g., ten cents per barrel above the exempt market's price for crude oil delivered in July). In addition, criterion (a) would encompass cases where cash market bids, offers or transaction prices are quoted as a whole price (e.g., \$30/barrel) and such price is calculated implicitly by adding to, or subtracting from, the section 2(h)(3) market's prices a specified price differential (e.g., a \$30/barrel quoted price is derived as the sum of a ten-cent per barrel differential plus the exempt market's price of \$29.90/barrel).

<sup>14</sup> As in cash markets underlying many established futures markets, the differential for a particular cash market bid, offer or transaction may vary from time to time in response to changes in various factors that affect the relationship between cash market prices and prices discovered on a section 2(h)(3) market.

With regard to criterion (b), consideration would be given to whether prices established on a section 2(h)(3) market are reported in a widely distributed industry publication, such as Platts Oil Gram, Inside FERC or the Lundberg Survey. In making this determination, the Commission would consider the reputation of the publication within the industry, how frequently it is published and whether the information contained in the publication is consulted by industry participants for pricing cash market transactions on a more than occasional basis.

Under the proposal, an exempt commercial market would be required to notify the Commission when it has reason to believe that one or more of the markets that it is operating in reliance on section 2(h)(3) meet either of the specified criteria.<sup>15</sup> The Commission specifically asks commenters to discuss potential financial costs and legal risks created by the proposed notification requirement. Do the aforementioned factors, specifically, that prices be used on "more than an occasional basis," and that they be "widely distributed," provide enough specificity to enable trading facilities to make a determination regarding notification obligations. If not, what further guidance could be provided that would enable a determination?

Upon receipt of such a filing, the Commission's staff would conduct an assessment of the facility's markets operated in reliance on section 2(h)(3) to identify those markets that perform a significant price discovery function for the associated cash market. The scope of the inquiry conducted by the Commission would vary. In the course of its assessment, Commission staff might contact cash market participants to verify the extent to which they refer to the market for price basing. The assessment might also examine whether the section 2(h)(3) market, although occasionally performing a price discovery function, failed to do so on a more than occasional basis and thus

<sup>15</sup> In addition, the Commission may, at any time, *sua sponte*, conduct an assessment as to whether an exempt market is serving a significant price discovery function for the associated cash market. In this regard, the Commission would consider a number of factors in deciding whether to initiate a review of a market's price discovery function, including whether the market holds itself out as performing a price discovery function for the underlying cash market. To facilitate its review of a market's price discovery function in such cases, the Commission is proposing to require that an electronic trading facility operating in reliance on section 2(h)(3) notify the Commission when the facility commences holding its markets out as serving a price discovery function.

does not perform a significant price discovery function.

If the available information indicates that a market is serving a significant price discovery function for the underlying cash market, the Commission would notify the section 2(h)(3) market that it appears to be performing a significant price discovery function and provide the market with an opportunity for a hearing through the submission of written data, views and arguments. The Commission, after consideration of all relevant information, would issue an order determining whether or not the section 2(h)(3) market serves a significant price discovery function.<sup>16</sup>

#### *C. Information To Be Disseminated by a Price Discovery Market*

The Commission has not previously addressed the nature and scope of the information that should be disclosed by a price discovery market subject to section 2(h)(4)(D), other than by incorporating in its rules the Act's requirement that the exempt commercial market disseminate publicly "price, trading volume and other trading data to the extent appropriate with respect to transactions executed in reliance on the exemption as specified in the order." See Commission Rule 36.3(c)(2). In determining the nature and scope of the information that should be disclosed under the proposed rules, the Commission has looked to other provisions of the Act that impose public dissemination requirements on other categories of regulated and unregulated markets.

With respect to other markets, sections 5(d)(7) and (8) of the Act require designated contract markets to make available to the public: (i) Information concerning the terms and conditions of the contracts and the mechanisms for executing transactions; and (ii) daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts. Sections 5a(d)(4) and (5) require registered derivatives transaction execution facilities to disclose publicly: (i) Information concerning contract terms and conditions, trading conventions, mechanisms and practices, financial integrity protections, and other information relevant to participation in trading on the facility; and (ii) if the Commission determines that the

<sup>16</sup> The proposed rules would also provide the market with an opportunity to request at any time that the Commission review the continuing appropriateness of its determination in light of changed facts or circumstances.