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August 3, 2015

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No. SR-EDGX-2015-18

Dear Mr. Fields:

Hardcastle Trading USA, LLC ("Hardcastle") appreciates the opportunity to comment on the above-referenced proposed rule filing in which EDGX Exchange, Inc. ("EDGX") proposes to adopt rules governing options trading.

We are against the internalization of orders or preferences of any kind. It is our belief that pure price-time priority is the best and fairest model for a healthy and robust market. We strongly support any efforts to limit or abolish internalization or preferential treatment.

**Internalization**

Internalization is achieved by using a 'directed order' mechanism.[1] The firm submitting the order to the exchange on behalf of the customer flags an order to indicate that an order is to be handled by a particular market maker with whom he has a relationship. Depending on the rules of the exchange, and the presence of other market makers or participants on that exchange offering at the same price, the directed market maker receives a significant portion, if not all of the order.[2]

The ability to internalize an increasing portion of a customer's order has increased as the number of options exchanges has increased, and as newer exchanges have introduced rules that are even more favorable to internalization.

Internalization creates a detriment to investors and other options market participants because it creates a systematic first right of refusal of the order sending firm's affiliated market maker to interact with the order. A systematic first right of refusal is a practice that prevents competition. The order sending firm's market maker can effectively limit competition from other participants in the market by simply matching the price of his competitor. When the competitor receives little or no volume, he is unable to be profitable, and leaves the market. Once he leaves the market, the order sending firm can increase his prices.

[1] Proposed Rule 21.8(f), SR-EDGX-2015-18.
[2] In EDGX Option's case, up to 60% or 100% if 5 contracts or less.

**Preferential Treatment**

This is the concept where exchanges have certain membership types that offer a perpetual 'monopoly' status. Typically there is only one member allowed with this status on such an exchange in a given options class. He is called a "Lead Market Maker", "Designated Primary Market Maker", "Specialist" or "Primary Market Maker",[3] and historically has achieved such status by purchasing an ownership interest in the given exchange. As part of this special membership he is given some obligations, such as to handle specific market situations, or quote for a longer portion of the day than another market making participant. However in return, he is given the first right of refusal to interact with a significant percentage of exchange volume[4], in perpetuity. His affiliate can achieve the same effect as directing order flow to him by simply sending the orders to exchanges where he knows his affiliate is a Lead Market Maker in a particular class.[5]

Perhaps in the beginning, it may have been necessary to have specialists or lead market makers to create a critical mass of volume, and they may have had real responsibilities that were worth the value of the special entitlement. However today, those responsibilities have been watered down, but the perpetual entitlement remains. Their lack of justification is illustrated by the fact that many exchanges successfully operate today without requiring or needing lead market makers.[6]

**Payment for Order Flow**

In both of the practices of Directed Orders and Preferential Treatment, underpinning the relationship between the order flow provider and the market maker is Payment for Order Flow. This is a practice where a market maker pays an order flow provider to direct the orders to him. If the market maker offers an option at $5.00 per contract, he may have a private agreement with a certain order flow provider to send him the order for $0.30. The customer pays $500 for the option contracts,[7] and unknown to the customer, the order flow provider receives $30. These numbers are speculative because no one except the order flow provider and the market maker knows the terms of the agreement. One could argue that this is the 'marketing cost' to encourage order flow providers to persuade their customers to trade options. However, when a retail customer buys a mutual fund, there is a requirement that commissions be disclosed to him. There is no such requirement here. Furthermore, the options market maker has to price his option at $5.00, when he could be pricing it at $4.70 if he did not have to pay for the order flow.[8]

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[3] Proposed Rule 21.8(g), SR-EDGX-2015-18

[4] In EDGX Options case, up to 60% or 100% if 5 contracts or less.

[5] An options 'class' is all of the options with the same underlying security.

[6] In the United States: BATS Options, NASDAQ Options and The Boston Options Exchange.

[7] The normal option multiplier is 100 contracts, so an option displayed at $5.00 costs $500.

[8] Some exchanges have sponsored 'payment for order flow' programs, which can mean that even if an independent market maker executes an order directed at the lead market maker, and the lead market maker does not participate in the trade, the independent market maker is billed a fee, and the Lead Market Maker chooses which order flow provider the fee goes to.

Firms receiving directed orders also have the non-public information about which order flow provider's customers is executing the order, and could use this information to take positions alongside or against that customer in the market to their advantage.

**Price Time Priority**

We believe that price time priority is the best and fairest model because it rewards firms who are the first people willing to trade at a better price. This in turn creates an incentive for people to be aggressive with regard to setting better prices. Pro-rata allocation rewards firms that simply quote large size, for no particularly clear benefit to the market. Size also favors larger firms, as it is they who have the capital to support such large quotes. It is our view the market benefits more by having options listed at a better price, rather than a worse price but with a larger size.

**Recommendations**

*Increased Transparency*

Following the principle that "sunlight is the best disinfectant", we would suggest that the Commission improve transparency by simply requiring disclosure of statistics about internalization relationships, preferential treatment, and payment for order flow; and ask for an explanation about how those relationships are providing a tangible benefit to the overall market.

*Order Protection Rule Improvement*

We would furthermore suggest that given the introduction of all these new exchanges, which superficially appear to be nothing more than "internalization engines" of large firms, that the Order Protection model be modified. Not only should firms regard the NBBO[9] in their order routing decisions, but the addition of new exchanges such as EDGX Options to the NBBO should not undermine existing exchanges that use price time priority.

Today, a firm (A) that is first to present the best price to the market on a price time priority exchange can be bypassed, by his competitor (B) posting the same price on another "internalization" exchange. His affiliate (C) can direct the order to him on that same exchange, where, depending on the rules of the exchange, he (B) can receive a sizeable share, if not, all of the order. Participant (A) receives none of the order.

The only solution for the firm that posted the initial best price (A) to compete, is to become a member of that same exchange, and obtain the rights to post quotes at that same price level at the same time, with the hope of receiving the residual of the order. However, with the increasing fixed monthly costs of exchange membership, market data fees, exchange technology fees, multiplied by the increasing number of exchanges, that is becoming a greater and greater burden. This in turn is combined with the added risk that if he is to post the same size bid or offer on each exchange to compete, he has the risk that all of his

[9] The NBBO is the National Best Bid or Offer. Current Order Protection rules require market participants not trade at a worse price.

orders could be instantaneously executed – a lot of risk to compete for the residue of orders being handled by directed order firms. These risks are multiplied as the number of options exchanges increases.

The Order Protection Rule is limited by the fact that still today, many options on the most liquid of stocks, those that trade in the S&P 500 index, are still priced in nickels rather than pennies.[10] For an independent firm like ourselves to compete on price in those options, we have to price our options better by $0.05 cents per share, or $5.00 per option contract to set a new NBBO. Even then, we are not always afforded order protection because some exchanges (though not in this case by EDGX Options) permit bids or offers to be locked if the bid or offer is known to either to belong to firm or market maker (i.e. not a customer), or the order flow provider's customer expressly permits it.[11]

It would appear that the practices of payment for order flow, designated market makers, and internalization are too prevalent that BATS Global Markets have to instead adopt these measures on a new exchange to compete for additional market share. However we believe that adding sunlight and tweaking the order protection rule, would allow them to grow their price-time priority platform in a positive way that would be beneficial for the market overall, rather than beginning to adopt practices that our industry has not been able to grow out of over the years.

To summarize we believe that the market should get back to basics and price time priority should trump any other scheme to drive orders and order flow to a particular market maker. We also object to any form of payment for order flow as this practice is not understood by the public and we believe is detrimental to a fair, transparent, and robust market.

Yours faithfully,

Mark D. Wilson
Director of Technical Risk Management & Exchange Relations

Brent E. Hippert
President & Chief Compliance Officer

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[10] The penny pilot program began January 26, 2007. Today it still contains a subset of S&P 500 Index symbols.

[11] NYSE Amex Rule 992NY(b)(4); NYSE Arca Rule 6.95(b)(4); BOX Rule 15020(b)(4); ISE Gemini, ISE Rule 1902(b)(4)