



December 28, 2010

**By Electronic Mail**

Elizabeth Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: *Notice of Filing of a Proposed Rule Change to Create a Directed Order Program;  
File No. SR-BATS-2010-034*

Dear Ms. Murphy:

Citadel LLC (“**Citadel**”)<sup>1</sup> appreciates the opportunity to submit this comment letter in response to the BATS Exchange, Inc. rule filing referenced above (the “**Rule Filing**”). The Rule Filing proposes to allow BATS Options Members to submit orders to the BATS Exchange Options Market (“**BATS Options**”) priced at the midpoint of the National Best Bid and Offer (“**NBBO**”), including when the midpoint is a fraction of a penny.

Because the Rule Filing would allow sub-penny quoting, the Commission should not approve the Rule Filing in its current form. In 2007, the options markets began a pilot program to reduce the minimum quoting increment for specified options classes to a penny.<sup>2</sup> The Penny Pilot is currently scheduled to run through the end of 2011. As part of the Penny Pilot, each of the exchanges are required to produce reports including detailed statistical information and analysis regarding the impact of penny quoting on (1) spreads; (2) peak quote rates; (3) quote message traffic; (4) displayed size; (5) depth of book liquidity; and (6) market structure.<sup>3</sup>

Striking the right balance in setting minimum quoting increments is both critically important to the markets and complex. With the Penny Pilot, the Commission has wisely chosen to proceed carefully, systematically, and with due regard to careful analysis of market data at

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<sup>1</sup> On an average day, Citadel accounts for approximately 8-9% of U.S. listed equity volume, and 25-30% of U.S. listed equity option volume. Founded in 1990, the Citadel group of companies includes an asset management division that principally executes alternative investment strategies across multiple asset classes, and Citadel Securities that includes investment banking, a sales and trading platform, an industry leading market making franchise, and Omnium, a recognized administrator serving financial institutions. Citadel operates in the world’s major financial centers, including Chicago, New York, London, Hong Kong and San Francisco.

<sup>2</sup> See Exchange Act Rel. No. 34-55156; File No. SR-NYSEArca-2006-73 (Jan. 23, 2007).

<sup>3</sup> See Exchange Act Rel. No. Release No. 34-56565; File No. SR-CBOE-2007-98 (Sept. 27, 2007).

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each step. The Rule Filing would disrupt this carefully designed Pilot program and corrupt the data to be collected for the remainder of the Pilot.<sup>4</sup>

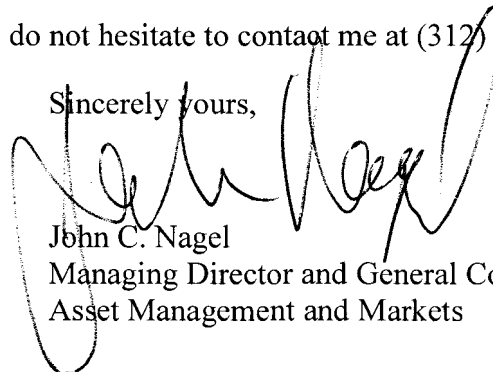
Aside from quoting increment issues, we note the critical importance of the requirement in the Rule Filing that a market maker must be quoting at the NBBO in order to participate in the execution of a directed order. We strongly support this requirement because it rewards active provision of liquidity and quote competition.

The Commission should consider, however, whether it is appropriate for an options exchange to calculate the midpoint of the NBBO for members. The Rule Filing would allow BATS Options Participants to simply price their orders at the midpoint of the NBBO and thereby allow the exchange to automatically price and adjust their orders based on the BATS Options view of the NBBO.

This aspect of the Rule Filing raises three concerns. First, this functionality likely will be used by members who have not invested the resources to track the NBBO on their own. Such members are, we believe, less likely to have invested the resources needed to appropriately risk manage quotes inside the NBBO. Second, this type of functionality will give members who use it an inherent speed advantage. The exchange's own systems will calculate the NBBO and automatically adjust member orders more quickly than those members who calculate the NBBO on their own and must wait for, process, and respond to, messages from the exchange. Third, this type of functionality does not contribute to price discovery. Market participants who invest substantial resources to price options help ensure that options are priced accurately to the benefit of the entire market. Market participants who use the exchange's midpoint pricing functionality will not make any meaningful contribution to the price discovery process.

If you have any questions, please do not hesitate to contact me at (312) 395-2100.

Sincerely yours,



John C. Nagel  
Managing Director and General Counsel  
Asset Management and Markets

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<sup>4</sup> Although BATS Options has not yet announced its fee schedule for midpoint priced orders, we note that unduly high rebates and fees could raise additional concerns about the impact of the Rule Filing on quoting increments and market structure, and would thus warrant careful scrutiny.