

**Disciplinary Panel
American Stock Exchange LLC**

IN THE MATTER
OF
COHEN, DUFFY, MCGOWAN & CO., LLC
AND
THOMAS WALES

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Case No. 03-43
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Hearing Officer – DMF
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DECISION
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June 23, 2005
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In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel Chair determined that both Respondents violated Exchange Rule 980 and Respondent Wales violated Exchange Rule 320(b), as stipulated, and as a penalty imposed a censure and a joint and several fine of \$160,000.

I. Introduction

The American Stock Exchange, LLC instituted a formal disciplinary proceeding against Cohen, Duffy, McGowan & Co., LLC, (“CDM”), a former Regular Member organization of the Exchange, and Thomas Wales, a former Regular Member of the Exchange. The Disciplinary Panel Chair, presiding without convening a full Disciplinary Panel, pursuant to Article V, Section 1(b) of the Exchange Constitution, held a hearing on May 18, 2005, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty. The Exchange, CDM and Thomas Wales entered into that Stipulation for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against CDM and Thomas Wales based upon or arising out of the facts set forth in the Stipulation.

II. Stipulated Facts

CDM and Thomas Wales, without admitting or denying liability, stipulated to the facts, set forth in the Stipulation. The Disciplinary Panel Chair has determined to accept the facts for purposes of this Decision, and they are incorporated herein, as follows:

1.0 During all times relevant herein, CDM was a Regular Member Organization of the Exchange.

1.1 At all times relevant herein, Wales was a Regular Member of the Exchange and employed by CDM as its Executive Director and a specialist on the Exchange floor.

1.2 During all times relevant herein, Spear, Leeds & Kellogg, L.P. (“SLK”) was a Regular Member Organization of the Exchange.

1.3 During all relevant periods herein, CDM contracted with SLK to use SLK as its clearing firm for, among other things, the exercise of expiring equity options. CDM submitted instructions and contrary instructions to SLK regarding the exercise of expiring equity options. These instructions set forth that CDM was required to submit contrary instructions to SLK in the following situations: (a) when CDM determined not to exercise expiring equity options that would normally be exercised, and (b) when CDM determined to exercise expiring equity options that would not normally be exercised. Final decisions to exercise or not exercise expiring equity options were to be made no later than 5:30 p.m., New York time on the business day immediately prior to the expiration date.¹

¹ During the relevant period herein, the Options Clearing Corporation (“OCC”) provided that “every option contract . . . that has an exercise price below (in the case of a call) or above (in the case of a put) the closing price of the underlying security by (i) $\frac{3}{4}$ of a point or more, if the option contract is carried in the customers’ account, or (ii) $\frac{1}{4}$ of a point or more, if the option contract is carried in any other account” shall be exercised (OCC Rule 805-Expiration Date Exercise Procedure).

1.4 During all times relevant herein, Exchange Rule 980 provided, in relevant part, that:

Final decisions by options holders to either exercise or not exercise expiring equity options must be made by members or member organizations not later than 5:30 P.M., New York time on the business day immediately prior to the expiration date (“the exercise cut-off time”). In this regard, members and member organizations must either (i) submit a Contrary Exercise Advice to the Exchange [or] (ii) take no action and allow exercise determinations to be made in accordance with OCC’s Exercise-by-Exception procedure where applicable.

1.5 During all times relevant herein, Exchange Rule 320(b) provided, in relevant part, that:

Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility. The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations.

1.6 During all times relevant herein, Altria Group, Inc., option symbol MO, was listed for trading on the Exchange.²

Contrary Exercise Violation:

2.0 On March 21, 2003, the stock price in Altria closed at \$35.04. At the close of Exchange trading, CDM held 185 March 35 call options in MO. On March 21, 2003, Wales was acting as the specialist for MO. On March 21, 2003, because the stock price closed at \$35.04, four cents above the strike price, CDM’s 185 March 35 call options would not normally have been exercised.

2.1 On March 21, 2003, prior to the 5:30 p.m. deadline, CDM’S head clerk submitted a Contrary Exercise Advice (“CEA”) to the Exchange indicating CDM’s intent to exercise 185 March 35 call options in MO. Prior to the 5:30 p.m. deadline, CDM’s head clerk submitted a written contrary instruction to exercise 185 March 35 call options in MO to SLK’s Margin

² Altria was formerly known as Philip Morris Inc. USA.

Department. SLK's Margin Department received CDM's written contrary instruction prior to the 5:30 p.m. deadline and accepted the written contrary instruction to exercise 185 March 35 call options in MO.

2.2 On March 21, 2003, at 5:36 p.m. Bloomberg news reported a negative ruling by an Illinois Circuit Court judge against Altria ("the news report").³ As a result of the news report, the stock price in Altria, which closed at \$35.04 on March 21, 2003 declined significantly, opening at \$32.35 on the following Monday, March 24, 2003.

2.3 On the basis of this news report at 5:36 p.m., Wales telephoned Exchange employees and left them voicemail messages, stating that CDM was withdrawing its previously submitted CEA.

2.4 On the basis of this news report at 5:36 p.m., Wales instructed the CDM head clerk to contact SLK to cancel the contrary instruction to exercise 185 March 35 call options in MO. After 5:36 p.m., the CDM head clerk telephoned SLK's Margin Department and verbally instructed SLK's Margin Department to cancel the previously submitted written contrary instruction to exercise 185 March 35 call options in MO.

2.5 SLK's Margin Department accepted CDM's head clerk's verbal instruction to cancel the previously submitted contrary instruction and subsequently did not exercise the Firm's 185 March 35 call options in MO. Following his verbal instruction to SLK's Margin Department concerning the Firm's 185 March 35 call options in MO, CDM's head clerk did not submit any written cancellation instruction to SLK.

³ Bloomberg news reported that Illinois Circuit Court Judge Nicholas G. Bryon ruled against Altria in a class-action consumer fraud lawsuit deciding that Altria failed to "inform consumers that its light cigarettes were not less harmful than regular cigarettes."

2.6 As a direct consequence of CDM's failure to follow through on the previously submitted contrary exercise instructions regarding its position of 185 March 35 call options in MO, CDM avoided an unrealized loss of approximately \$50,000.

2.7 Prior to the opening of trading on the next business day - March 24, 2003 - Wales called the Exchange's Senior Vice President of Enforcement and Examinations and told him of his actions in canceling a previously submitted CEA after the 5:30 p.m. cut-off time.

2.8 During investigative testimony before the Exchange on May 15, 2003, Wales admitted that he was aware that the March 21, 2003 news announcement concerning Altria would have a negative impact on the stock price for Altria.

2.9 During investigative testimony before the Exchange on May 15, 2003, Wales admitted that the motivating factor for canceling the previously submitted CEA (which would have resulted in the exercise of 185 March 35 call options in MO) was to avoid a loss as a result of the March 21, 2003 negative news announcement concerning Altria.

Failure to Supervise:

3.0 During the relevant period herein, Wales, as the Executive Director and a specialist at CDM, failed to ensure that: (1) CDM develop, maintain and enforce written supervisory policies and procedures, in the following areas: (i) the submission of CEAs to the Exchange, (ii) the cancellation of previously submitted CEAs to the Exchange, (iii) the submission of contrary instructions, and (iv) the cancellation of previously submitted contrary instructions; (2) the cancellation of the previously submitted CEA was submitted to the Exchange prior to the

exercise cut-off time of 5:30 p.m., and (3) despite missing the exercise cut-off time of 5:30 p.m., the cancellation of the previously submitted CEA was made pursuant to a valid exception.⁴

3.1 On March 21, 2003, Wales failed to ensure that a written cancellation of the previously submitted contrary instruction was submitted to SLK's Margin Department.

3.2 Prior to this current violation, Wales had received a cautionary notice from the Exchange regarding a previous violation of Exchange Rule 980 on January 8, 2003 for the failure to submit a CEA notice to the Exchange following the submission of contrary exercise instructions to the OCC.

III. Violations

Based upon the stipulated facts, the Disciplinary Panel Chair concludes that CDM:

(1) violated Exchange Rule 980 by failing to follow through on a previously submitted CEA in order to take advantage of a material news announcement after the 5:30 p.m. exercise cut-off time.

Based upon the stipulated facts, the Disciplinary Panel Chair concludes that Thomas Wales:

(1) violated Exchange Rule 980 by failing to follow through on a previously submitted CEA in order to take advantage of a material news announcement after the 5:30 p.m. exercise cut-off time;

(2) violated Exchange Rule 320(b) by failing to: (i) develop, maintain and enforce appropriate policies, systems and procedures of supervision and control, including written supervisory procedures; (ii) establish a separate system of follow-up and review to ensure

⁴ Exceptions for making final exercise decision after the exercise cut-off time without submitting a CEA include: (i) to remedy a mistake made in good faith, (ii) as a result of a failure to reconcile unmatched Exchange option transactions, or (iii) in the case of an exceptional circumstance.

compliance with the submission and cancellation of CEAs of contrary instructions; and (iii) reasonably discharge his duties as a supervisor and ensure compliance with Exchange rules by employees of CDM.

IV. Penalties and Publicity

The Stipulation proposes that the Disciplinary Panel Chair impose a censure and a joint and several fine of \$160,000 on CDM and Thomas Wales. After considering the stipulated facts and the statements of the parties, as well as the decisions cited in the Exchange's precedent memorandum, the Chair finds that the proposed penalty is appropriate under the facts and circumstances of this case, and therefore it will be imposed. The Chair further finds that the results of this disciplinary proceeding should be publicly disclosed, as provided in Rule 12 of the Exchange Rules on Disciplinary Proceedings.⁵

V. Conclusion

The Disciplinary Panel Chair accepts the Stipulation of Facts and Consent to Penalty and hereby imposes upon CDM and Thomas Wales a censure and a joint and several fine of \$160,000.

FOR THE DISCIPLINARY PANEL

David M. FitzGerald, Chair

Copies to: Thomas Wales (*via overnight courier and first class mail*)
Cohen, Duffy, McGowan & Co, LLC (*via overnight courier and first class mail*)
Thomas J. McCabe, Esq. (*via facsimile and first class mail*)
Jennifer D. Kim, Esq. (*electronically and via first class mail*)
Arlene Collins-Day (*electronically and via first class mail*)

⁵ Rule 12 exempts from publicity those cases in which the Panel finds that the offense "related solely to minor administrative requirements of the Exchange and does not materially affect the public interest or the interest of investors." Those exemptions do not apply to the facts of this case.

Disciplinary Panel
American Stock Exchange LLC

.....	x	
	x	
IN THE MATTER	x	STIPULATION OF FACTS
OF	x	AND
COHEN, DUFFY, MCGOWAN & CO., LLC	x	CONSENT TO PENALTY
AND	x	Case No. 03-43
THOMAS WALES	x	
.....	x	

This proceeding was instituted by the American Stock Exchange LLC (the “Exchange”) against COHEN, DUFFY, MCGOWAN & CO., LLC (“CDM” or the “Firm”) (CRD #33563), a former Regular Member organization of the Exchange, and against THOMAS WALES (“Wales”) (CRD #4193819), a former Regular Member of the Exchange. This Stipulation of Facts and Consent to Penalty is entered into with CDM and Wales pursuant to Article V, Section 2, of the Exchange Constitution in order to settle and conclude all disciplinary actions by the Exchange against CDM and Wales based upon or arising out of the facts hereinafter stipulated. CDM and Wales, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consent to the findings of violations of the Exchange Constitution and Rules and to the imposition of the penalties hereinafter provided. CDM and Wales understand that this settlement is subject to approval by an Exchange Disciplinary Panel and by the Amex Adjudicatory Council and that, if so approved, shall constitute a final decision that may not be appealed by the parties. CDM and Wales understand and acknowledge that the Disciplinary Panel’s decision in this matter will become part of their disciplinary record and may be considered in any future proceeding brought by the Exchange.

STIPULATION OF FACTS:

- 1.0 During all times relevant herein, CDM was a Regular Member Organization of the Exchange.
- 1.1 At all times relevant herein, Wales was a Regular Member of the Exchange and employed by CDM as its Executive Director and a specialist on the Exchange floor.
- 1.2 During all times relevant herein, Spear, Leeds & Kellogg, L.P. (“SLK”) was a Regular Member Organization of the Exchange.
- 1.3 During all relevant periods herein, CDM contracted with SLK to use SLK as its clearing firm for, among other things, the exercise of expiring equity options. CDM submitted instructions and contrary instructions to SLK regarding the exercise of expiring equity options. These instructions set forth that CDM was required to submit contrary instructions to SLK in the following situations: (a) when CDM determines not to exercise expiring equity options that would normally be exercised, and (b) when CDM determines to exercise expiring equity options that would not normally be exercised. Final decisions to exercise or not exercise expiring equity options were to be made no later than 5:30 p.m., New York time on the business day immediately prior to the expiration date.¹
- 1.4 During all times relevant herein, Exchange Rule 980 provided, in relevant part, that:

¹ During the relevant period herein, the Options Clearing Corporation “OCC” provided that “every option contract . . . that has an exercise price below (in the case of a call) or above (in the case of a put) the closing price of the underlying security by (i) $\frac{3}{4}$ of a point or more, if the option contract is carried in the customers’ account, or (ii) $\frac{1}{4}$ of a point or more, if the option contract is carried in any other account” shall be exercised (OCC Rule 805- Expiration Date Exercise Procedure).

“Final decisions by options holders to either exercise or not exercise expiring equity options must be made by members or member organizations not later than 5:30 P.M., New York time on the business day immediately prior to the expiration date (“the exercise cut-off time”). In this regard, members and member organizations must either (i) submit a Contrary Exercise Advice to the Exchange [or] (ii) take no action and allow exercise determinations to be made in accordance with OCC’s Exercise-by-Exception procedure where applicable.

- 1.5 During all times relevant herein, Exchange Rule 320(b) provided, in relevant part, that:

“Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility. The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer including compliance with securities laws and regulations.”

- 1.6 During all times relevant herein, Altria Group, Inc. (“Altria”), option symbol MO, was listed for trading on the Exchange.²

Contrary Exercise Violation:

- 2.0 On March 21, 2003, the stock price in Altria closed at \$35.04. At the close of Exchange trading, CDM held 185 March 35 call options in MO. On March 21, 2003, Wales was acting as the specialist for MO. On March 21, 2003, because the stock price closed at \$35.04, four cents above the strike price, CDM’s 185 March 35 call options would not normally have been exercised.
- 2.1 On March 21, 2003, prior to the 5:30 p.m. deadline, CDM’S head clerk submitted a Contrary Exercise Advice (“CEA”) to the Exchange indicating CDM’s intent to exercise 185 March 35 call options in MO. Prior to the 5:30 p.m. deadline, CDM’s head clerk submitted a written contrary instruction to exercise 185 March

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- 35 call options in MO to SLK's Margin Department. SLK's Margin Department received CDM's written contrary instruction prior to the 5:30 p.m. deadline and accepted the written contrary instruction to exercise 185 March 35 call options in MO.
- 2.2 On March 21, 2003, at 5:36 p.m. Bloomberg news reported a negative ruling by an Illinois Circuit Court judge against Altria ("the news report").³ As a result of the news report, the stock price in Altria, which closed at \$35.04 on March 21, 2003 declined significantly, opening at \$32.35 on the following Monday, March 24, 2003.
- 2.3 On the basis of this news report at 5:36 p.m., Wales telephoned Exchange employees and left them voicemail messages, stating that CDM was withdrawing its previously submitted CEA.
- 2.4 On the basis of this news report at 5:36 p.m., Wales instructed the CDM head clerk to contact SLK to cancel the contrary instruction to exercise 185 March 35 call options in MO. After 5:36 p.m., the CDM head clerk telephoned SLK's Margin Department and verbally instructed SLK's Margin Department to cancel the previously submitted written contrary instruction to exercise 185 March 35 call options in MO.
- 2.5 SLK's Margin Department accepted CDM's head clerk's verbal instruction to cancel the previously submitted contrary instruction and subsequently did not exercise the Firm's 185 March 35 call options in MO. Following his verbal

³ Bloomberg news reported that Illinois Circuit Court Judge Nicholas G. Bryon ruled against Altria Group, Inc. ("Altria" or "MO"), formerly Philip Morris Inc. USA, in a class-action consumer fraud lawsuit deciding that Altria failed to "inform consumers that its "light" cigarettes were not less harmful than regular cigarettes."

- instruction to SLK's Margin Department concerning the Firm's 185 March 35 call options in MO, CDM's head clerk did not submit any written cancellation instruction to SLK.
- 2.6 As a direct consequence of CDM's failure to follow through on the previously submitted contrary exercise instructions regarding its position of 185 March 35 call options in MO, CDM avoided an unrealized loss of approximately \$50,000.
- 2.7 Prior to the opening of trading on the next business day - March 24, 2003, Wales called the Senior Vice President of Enforcement and Examinations and told him of his actions in canceling a previously submitted CEA after the 5:30 p.m. cut-off time.
- 2.8 During investigative testimony before the Exchange on May 15, 2003, Wales admitted that he was aware that the March 21, 2003 news announcement concerning Altria would have a negative impact on the stock price for Altria.
- 2.9 During investigative testimony before the Exchange on May 15, 2003, Wales admitted that the motivating factor for canceling the previously submitted CEA (which would have resulted in the exercise of 185 March 35 call options in MO) was to avoid a loss as a result of the March 21, 2003 negative news announcement concerning Altria.

Failure to Supervise:

- 3.0 During the relevant period herein, Wales, as the Executive Director and a specialist at CDM, failed to ensure that: (1) CDM develop, maintain and enforce written supervisory policies and procedures, in the following areas: (i) the submission of CEAs to the Exchange, (ii) the cancellation of previously submitted

CEAs to the Exchange, (iii) the submission of contrary instructions, and (iv) the cancellation of previously submitted contrary instructions; (2) the cancellation of the previously submitted CEA was submitted to the Exchange prior to the exercise cut-off time of 5:30 p.m., and (3) despite missing the exercise cut-off time of 5:30 p.m., the cancellation of the previously submitted CEA was made pursuant to a valid exception.⁴

- 3.1 On March 21, 2003, Wales failed to ensure that a written cancellation of the previously submitted contrary instruction was submitted to SLK's Margin Department.
- 3.2 Prior to this current violation, Wales had received a cautionary notice from the Exchange regarding a previous violation of Exchange Rule 980 on January 8, 2003 for the failure to submit a CEA notice to the Exchange following the submission of contrary exercise instructions to the OCC.

CONCLUSIONS:

By reasons of the above, a Disciplinary Panel may conclude that:

- 4.0 CDM violated Exchange Rule 980 in that, in order to take advantage of a material news announcement after the 5:30 p.m. exercise cut-off time, it failed to follow through on a previously submitted CEA, as described in above paragraphs 2.0 through 2.9.
- 4.1 Wales violated Exchange Rule 980 in that, in order to take advantage of a material news announcement after the 5:30 p.m. exercise cut-off time, he failed to

⁴ Exceptions for making final exercise decision after the exercise cut-off time without submitting a CEA include: (i) to remedy a mistake made in good faith, (ii) as a result of a failure to reconcile unmatched Exchange option transactions, or (iii) in the case of an exceptional circumstance.

follow through on a previously submitted CEA, as described in above paragraphs 2.0 through 2.9.

- 4.2 Wales violated Exchange Rule 320(b) in that he failed to: (i) develop, maintain and enforce appropriate policies, systems and procedures of supervision and control, including written supervisory procedures; (ii) establish a separate system of follow-up and review to ensure compliance with the submission and cancellation of CEAs and of contrary instructions; and (iii) reasonably discharge his duties as a supervisor and ensure compliance with Exchange rules by employees of CDM, as described in above paragraphs 3.0 through 3.2.

DISCIPLINARY ACTION:

By reason of the foregoing Stipulated Facts, a Disciplinary Panel may impose the following penalties upon CDM and Wales:

- (a) a censure;
- (b) a joint and several fine of \$160,000 (this fine takes into consideration that CDM avoided an unrealized loss of approximately \$50,000 through cancellation of a previously submitted CEA).

ON BEHALF OF:
AMERICAN STOCK EXCHANGE LLC

By: _____
David Rosenstein
Vice-President and Chief Counsel
Enforcement Department
NASD Amex Regulation Division

Agreed to this _____ day of _____, 2005.

