

**Disciplinary Panel
American Stock Exchange LLC**

IN THE MATTER OF
OF
MICHAEL KELLY

:
:
Case Nos. 03-25 & 03-26
Hearing Officer – JN

:
:
Disciplinary Panel Decision
December 24, 2003
:

In accordance with a Stipulation of Facts and Consent to Penalty, the Disciplinary Panel determined that Respondent violated Exchange Rules 958A and 155, as stipulated, and as a penalty imposed a censure and fines totaling \$9,000 for the violations.

DECISION

I. Introduction

The American Stock Exchange, LLC (the “Exchange”) instituted a formal disciplinary proceeding against Michael Kelly (“Kelly”), a regular member of and registered Specialist on the Exchange. A Disciplinary Panel held a hearing on December 19, 2003, pursuant to Article V, Section 2 of the Exchange Constitution, to review a Stipulation of Facts and Consent to Penalty (“Stipulation”) (attached as Exhibit A).¹ The Exchange and Kelly entered into that Stipulation for the purposes of settling this proceeding and concluding all disciplinary actions by the Exchange against Kelly based upon or arising out of the facts set forth in the Stipulation.

II. Facts

Kelly, without admitting or denying liability, stipulated to the facts set forth in the attached Stipulation. The Disciplinary Panel has determined to accept those facts for purposes of this Decision, and they are incorporated herein.

¹ On December 17, 2003, a Panel reviewed a prior Stipulation of Facts and Consent to Penalty and rejected it because the proposed sanction was too low. The instant Stipulation reflects an increase in the sanctions.

III. Violation

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

- 1.) Kelly violated Exchange Rule 958A by failing to execute the customer's June 14, 2001 limit order to buy 10 XLU June '01 33 puts at the quoted market of 1.35, as set forth in paragraphs 1.4 through 1.6, and by failing to execute another customer's October 2, 2001 limit order to buy 20 XLU Dec 30 calls at .80, as set forth in paragraphs 1.8 through 2.0 of the Stipulation.
- 2.) Kelly violated Exchange Rule 155 by trading ahead of the customer order on October 2, 2001 when he purchased for his specialist account one XLU Dec '01 30 call contract at .80, after the customer entered its order to purchase 20 contracts at .80, as set forth in paragraphs 2.1 and 2.2 of the Stipulation. In trading ahead of the complaining customer's order, Kelly avoided his obligation to honor his (Kelly's) posted offer at .80 for nine (9) contracts (10 contracts including D's order).

IV. Penalties and Publicity

The Stipulation proposes that the Disciplinary Panel impose (a) a \$2,000 fine for the June 14, 2001 violation and (b) a censure and fine of \$7,000 for the October 2, 2001 violation as described above. At the hearing, the Parties urged the Disciplinary Panel to accept the proposed penalty as being appropriate to the facts and circumstances of this case. After consideration of the Stipulation and the agreed-upon penalty, the Disciplinary Panel finds the proposed penalty is at the appropriate level to be imposed in this proceeding and therefore accepts the penalty proposed in the Stipulation.

The Disciplinary Panel 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.²

V. Conclusion

Based on the foregoing, the Disciplinary Panel, by unanimous vote, accepts the Stipulation of Facts and Consent to Penalty and hereby imposes a censure and fines totaling \$9,000 upon Kelly.

FOR THE DISCIPLINARY PANEL

Jerome Nelson, Chair

Dated: December 24, 2003
Washington, DC

Copies to: Michael D. Pierson, Esq. (*via facsimile and first class mail*)
Paula A. Bosco, Esq. (*via facsimile, electronic mail and first class mail*)
Arlene Collins-Day (*via facsimile and first class mail*)

² Rule 12 exempts from publicity those cases where 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
MICHAEL KELLY	X	CONSENT TO PENALTY
.....	X	Case Nos. 03-25 & 03-26

This proceeding was instituted by the American Stock Exchange LLC (the “Exchange”), against MICHAEL KELLY (“Kelly”) (CRD #2518447), a regular member of the Exchange and registered Specialist on the Exchange. This Stipulation of Facts and Consent to Penalty is entered into with Kelly pursuant to Article V, Section 2, of the Exchange Constitution in order to settle and conclude all disciplinary actions by the Exchange against Kelly based upon or arising out of the facts hereinafter stipulated. Kelly, without admitting or denying the facts, allegations and conclusions contained in this Stipulation of Facts and Consent to Penalty, hereby consents to the findings of violations of the Exchange Constitution and Rules and to the imposition of the penalties hereinafter provided. Kelly understands 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. Kelly understands and acknowledges that the Disciplinary Panel’s decision in this matter will become part of his disciplinary record and may be considered in any future proceeding brought by the Exchange.

STATEMENT OF FACTS

- 1.0 During all relevant periods herein, LETCO Specialist, LLP (“LETCO”) was a regular member organization of the Exchange.
- 1.1 During all relevant periods herein, Kelly was registered with the Exchange as a Specialist and was actively engaged as a member of LETCO on the Floor of the Exchange.
- 1.2 During all relevant periods herein, Exchange Rule 958A provided:
- (a) Firm Quotes. At all times other than during rotation, a specialist is required to sell (buy) at least ten (10) contracts at the offer (bid) which is displayed when a buy (sell) order reaches the trading post where the option class is located for trading. Options series that are subject to this rule shall be determined from time to time at the discretion of the Exchange. A Floor Official may determine on a case-by-case basis that an exception to this rule is warranted for, among other things, a change in market conditions, an obvious error occurring in the posting of the display market quote due to reporter errors or system malfunctions.
- 1.3 During all relevant periods herein, Exchange Rule 155 provided:
- A specialist shall give precedence to orders entrusted to him as an agent in any stock in which he is registered before executing at the same price any purchase or sale in the same stock for an account in which he has an interest.

JUNE 14, 2001:

- 1.4 On June 14, 2001 (the “Trade Date”), the Exchange received a telephone complaint from a customer alleging that Kelly failed to execute the customer’s limit order to buy 10 XLU¹ June ’01 33 puts at the quoted market of 1.35.
- 1.5 On the Trade Date, the opening quote in the XLU June 33 puts was 1.10 – 1.35 (20 x 20) at 9:31:44. At 10:00, with the quoted market at 1.10 – 1.35, the customer placed a limit order to buy 10 contracts at 1.35. However, Kelly failed to fill the customer’s limit order at 1.35.

- 1.6 At 10:01:20, the market was requoted to 1.30 – 1.55 (20 x 20), then again requoted to 1.35 – 1.55 (10 x 20) at 10:01:30, reflecting the customer’s bid. At 10:02, the customer cancelled the order, and Kelly acknowledged the customer’s cancellation request the same minute. At 10:02:14, the market was then requoted to 1.30 – 1.55 (20 x 20).
- 1.7 Following the customer’s complaint, Exchange staff contacted Kelly on June 15, 2001, the day after the Trade Date, to inquire about the circumstances surrounding the customer’s order. Kelly indicated at that time that he was experiencing ongoing system problems relating to the slow updating of XTOPS² during the Trade Date. Kelly stated that, based on those problems, he had to requote the market after receiving the customer’s order. Kelly also stated that the Service Desk was aware of the problem; however, there was no record that Kelly reported the problem on the Trade Date. Additionally, Kelly admitted, and Exchange staff confirmed, that Kelly had not consulted with any floor official before quoting the market that morning because of an alleged system problem. Kelly refused to offer the customer an execution.

OCTOBER 2, 2001:

- 1.8 On October 2, 2001 (the “Trade Date”), the Exchange received a telephone complaint from a customer alleging that Kelly failed to honor his quoted market with respect to the customer’s limit order to buy 20 XLU Dec 30 calls at .80.

¹ Denotes the option symbol for the utilities sector. During all relevant periods herein, XLU options were traded only on the American Stock Exchange.

² Refers to the Exchange’s comprehensive system for automatic and instant options pricing.

- 1.9 At 10:23:37 on the Trade Date, the XLU Dec 30 calls were quoted .65-.90 (20 x 20). At 10:25, a limit order (not the customer's) was entered through "D"³ to sell one contract at .80. At 10:26:04, Kelly requoted the market to .65-.80, reflecting the "D" order. Between 10:26 and 3:10 p.m., the bid side of the market was requoted twelve (12) times within a very narrow range, while the offer side remained at .80. At 3:10:55, the market was requoted .75-.80, still reflecting the "D" offer.
- 2.0 At 3:13, the complaining customer placed a limit order to buy 20 XLU Dec 30 calls at .80. However, Kelly failed to fill the customer's order.
- 2.1 At 3:14:34, approximately 1 minute and 34 seconds after receiving the customer's order, Kelly traded ahead of the complaining customer's order by buying one (1) contract at .80, filling the "D" order. Kelly's purchase was the only trade executed that day in the XLU series.
- 2.2 At 3:14:35, Kelly requoted the market .80-1:00 (20 x 20), reflecting the customer's order one second after Kelly's trade was posted. The customer's order remained active for the rest of the trading day.
- 2.3 Following the customer's complaint, Exchange staff contacted Kelly on October 3, 2001, the day after the Trade Date, to inquire about the circumstances surrounding the customer's order. Kelly stated that he had already announced that he was taking the then-existing "D" offer when the complaining customer's order was received. Kelly also stated that he refused to provide an execution to the customer based on his position that the trade was already consummated when he received the customer's order.

³ Dean Witter Reynolds, Inc.

- 2.4 Exchange staff's review of the trading activity with respect to the underlying XLU security revealed that there were no significant moves during the life of the "D" order (i.e. between 10:25 and 3:14:34). Although Kelly claimed he only decided to trade against the order immediately prior to receiving the customer's order, the staff noted that the "D" order to sell 1 contract at .80 had been reflected for nearly five (5) hours before being executed.

CONCLUSION:

By reason of the foregoing Stipulated Facts, a Disciplinary Panel may conclude that:

- 2.5 Kelly violated Exchange Rule 958A by failing to execute the customer's June 14, 2001 limit order to buy 10 XLU June '01 33 puts at the quoted market of 1.35, as set forth in paragraphs 1.4 through 1.6, and by failing to execute another customer's October 2, 2001 limit order to buy 20 XLU Dec 30 calls at .80, as set forth in paragraphs 1.8 through 2.0.
- 2.6 Kelly violated Exchange Rule 155 by trading ahead of the customer order on October 2, 2001 when he purchased for his specialist account one XLU Dec '01 30 call contract at .80, after the customer entered its order to purchase 20 contracts at .80, as set forth in paragraphs 2.1 and 2.2. In trading ahead of the complaining customer's order, Kelly avoided his obligation to honor his (Kelly's) posted offer at .80 for nine (9) contracts (10 contracts including D's order).

DISCIPLINARY ACTION:

A Disciplinary Panel may impose the following penalty upon Kelly:

- (a) a fine of \$2,000 for the June 14, 2001 violation; and
- (b) a Censure and fine of \$7,000 for the October 2, 2001 violation.

AMERICAN STOCK EXCHANGE LLC

By: _____

Glen Barrentine
Senior Vice President & Director
Member Firm Regulation

Agreed to on this _____ day of December 2003.

Michael Kelly