

Award
NASD Dispute Resolution

In the Matter of the Arbitration Between:

Name of the Claimant

Case Number: 03-01537

Josephine F. Dunne

Name of the Respondents

Hearing Site: Washington, D.C.

Merrill Lynch, Pierce, Fenner & Smith, Inc.
Peter Edson Driscoll

Nature of the Dispute: Customer vs. Member and Associated Person.

REPRESENTATION OF PARTIES

Claimant, Josephine F. Dunne, hereinafter referred to as "Claimant", was represented by John P. Connolly, Esq., Attorney at Law, Alexandria, Virginia.

Respondents, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") and Peter Edson Driscoll ("Driscoll"), hereinafter collectively referred to as "Respondents", were represented by Ira L. Oring, Esq., Fedder and Garten, PA, Baltimore, Maryland.

CASE INFORMATION

Statement of Claim filed on February 27, 2003.

Claimant signed the Uniform Submission Agreement on February 21, 2003.

Statement of Answer filed by Respondents on May 19, 2003.

A representative of Respondent Merrill Lynch executed the Uniform Submission Agreement on April 2, 2003.

Respondent Driscoll signed the Uniform Submission Agreement on June 2, 2003.

CASE SUMMARY

Claimant asserted the following causes of action, among others: violation of Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934, and SEC Rule 10b-5, 17 CFR Section 240.10b-5, promulgated thereunder; failure to supervise; violation of the South Carolina Uniform Securities Act; violation of NASD Rules of Conduct; breach of contract; constructive fraud; fraud and deceit; and breach of fiduciary duty. The causes of action relate to the purchase of EMC Corporation stock in Claimant's IRA account.

Unless specifically admitted in their Answer, Respondents denied the allegations made in the Statement of Claim and asserted the following defenses, among others: Claimant approved the transactions in her account; waiver, estoppel and ratification; contributory negligence; laches;

statute of limitations; assumption of risk; economic loss rule; failure to state a cause of action for which relief may be granted; and Respondents acted in good faith and exercised reasonable diligence.

RELIEF REQUESTED

Claimant in her Statement of Claim requested:

Compensatory Damages	\$750,000.00
Punitive Damages	\$500,000.00
Interest	amount unspecified
Attorneys' Fees	amount unspecified
Other Costs	amount unspecified

Respondents in their Statement of Answer requested that the Statement of Claim be dismissed; that all references to this arbitration in Respondent Driscoll's registration as contained in the Central Records Depository be expunged, and that Respondents be award their costs, forum fees, and such other and further relief as the Panel deems just and appropriate.

AWARD

After considering the pleadings, the testimony and evidence presented at the hearing, and the post-hearing submissions, the Panel has decided in full and final resolution of the issues submitted for determination as follows:

Claimant is a 77 year-old former nun and teacher with little or no financial sophistication. In 1981, she opened a non-discretionary IRA account with Respondents Driscoll and Merrill Lynch. She retired permanently in 1996 and relocated to South Carolina from Washington D.C. She notified Respondent Driscoll of these actions and advised that the retirement account assets were intended to provide her income and financial security for the rest of her life.

In managing this account, Respondent Driscoll invested the assets in "growth stocks" and relied on the writing of covered calls to provide income. Although the account was denominated "non-discretionary", it is uncontroverted that after discussion Claimant always followed Respondent Driscoll's recommendations. Accordingly, in light of Claimant's lack of financial sophistication, the Panel has concluded that the account was *de facto* a discretionary account and that Respondent Driscoll owed Claimant a fiduciary obligation in managing the account. *Davis vs. Merrill Lynch Pierce Fenner and Smith*, 906 F.2d 1206 (1990).

Although there is some question as to whether Respondent Driscoll managed the Claimant account in a "prudent" manner prior to November, 1996¹, there is no question that Claimant's

¹ Despite his very successful investment strategy, Respondent Driscoll permitted the account's assets to be over concentrated in a single high tech stock in disregard of Respondent Merrill Lynch's own Compliance Manual's warning about over concentration and did not follow Respondent Merrill Lynch's instructions to guard against risk

investment objectives changed when she retired and moved to South Carolina in November 1996. Accordingly, the Panel concluded that Respondent Driscoll should have diversified the portfolio at that time. Claimant's expert argued that the portfolio should have been invested in a diversified portfolio of 60 % equities and 40% fixed income securities. At the instruction of the Panel, both sides submitted gain/loss estimates based on the actual results of the account from November 1966 until it was closed in October 2002 versus a hypothetical reinvestment of the account assets in November 1996 into 60% stocks and 40% bonds (represented by the S&P 500 Composite Total Return index and the Lehman Brothers Aggregate Bond Index). Although the projections submitted differ, the Panel finds that the methodology used by the Respondents was correct. Accordingly, the Panel finds that Claimant suffered no greater aggregate losses specific to the actual administration of the account than the results that would have been achieved had the assets been invested using the portfolio allocation model suggested by Claimant.

However, Claimant also alleges that there was additional negligence in the administration of the account. Respondent Driscoll testified that, for the most part, he relied upon the analysis and ratings of Respondent Merrill Lynch's research department in his recommendations to clients. On February 9, 2001 he sent a letter to all his clients, including Claimant, reassuring them in spite of the recent "deterioration" in the price of EMC stock (from \$ 90 to \$57) and enclosed a copy of Respondent Merrill Lynch's research report. Respondent Merrill Lynch still maintained a strong buy for EMC for the intermediate and long term. It does not appear that Respondent Driscoll gave any individual attention to Claimant's special financial circumstances that may have been different from his other clients.

In a series of reports from April 9, 2001 through April 20, 2001, Respondent Merrill Lynch continued to carry a recommendation of "Buy" for both the near and long-term although the price of EMC continued to drop. In its April 9, 2001 report, it dropped its target price from \$130 to \$47; in its April 20, 2001 report, it dropped any mention of a target price; in its July 6, 2001 report, Respondent Merrill Lynch downgraded its intermediate opinion from Buy to Neutral at a time when the stock price was \$31.62 but still recommended the stock as a long-term buy; on July 18, 2001 and again on Oct 8, 2001 and Oct 17, 2001 when the price of EMC stock was \$18.05, \$13.15, and \$13.45 respectively, Respondent Merrill Lynch maintained the same "Neutral" and long-term buy recommendations. Finally, on Oct 3, 2002, when the price of EMC stock was \$5.01, Respondent Merrill Lynch changed its long term Buy recommendation from "Buy" to "Volatility Risk - High". During this period of decline, Respondent Driscoll did not act or recommend any action to protect Claimant's portfolio by any significant sales of EMC stock, the purchase of puts, or the entry of stop-loss orders. He appears not to have given any recognition to Claimant's retirement status and her dependency on the account assets to meet her financial needs, both short and long-term. In this regard, he failed his fiduciary responsibilities to manage the account in a prudent manner.

Claimant also alleges that Respondent Merrill Lynch was negligent in its supervision of the account. The Panel finds that the review procedures established by Respondent Merrill Lynch

are deficient in that they concentrate on actively traded accounts; accounts like Claimant's are never subject to review. In any case, under the doctrine of *respondeat superior*, Respondent Merrill Lynch is responsible for the actions or non-actions of Respondent Driscoll.

In view of the above circumstances, the Panel makes the following rulings:

1. Respondents are jointly and severally liable to and shall pay to Claimant compensatory damages of \$76,700.00;
2. Respondent Driscoll's request for expungement of his registration records maintained by the NASD Central Registration Depository is denied;
3. The parties shall bear their respective costs, including attorneys' fees, except as Fees are specifically addressed below; and
4. Any and all relief not specifically addressed herein, including punitive damages, is denied in its entirety.

FEES

Pursuant to the Code, the following fees are assessed:

Filing Fees

NASD Dispute Resolution will retain or collect the non-refundable filing fees for each claim:

Initial claim filing fee	= \$ 500.00
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Member Fees

Member fees are assessed to each member firm that is a party in these proceedings or to the member firms that employed the associated person(s) at the time of the events giving rise to the dispute. Accordingly, Respondent Merrill Lynch is a party.

Member surcharge	= \$ 2,800.00
Pre-hearing process fee	= \$ 750.00
Hearing process fee	= \$ 5,000.00
Total Member Fees	= \$ 8,550.00

Forum Fees and Assessments

The Panel has assessed forum fees for each session conducted. A session is any meeting between the parties and the arbitrator(s), including a pre-hearing conference with the arbitrator(s), that lasts four (4) hours or less. Fees associated with these proceedings are:

One (1) Pre-hearing session with Panel @ \$1,200.00	= \$ 1,200.00
Pre-hearing conference: November 17, 2003 1 session	
Six (6) Hearing sessions @ \$1,200.00	= \$ 7,200.00

Hearing Dates:	May 24, 2004	2 sessions
	May 25, 2004	2 sessions
	May 26, 2004	2 sessions
Total Forum Fees		= \$ 8,400.00

1. The Panel has assessed \$2,100.00 of the forum fees to Claimant.
2. The Panel has assessed \$6,300.00 of the forum fees jointly and severally to Respondents.

SEE SUMMARY

1. Claimant is assessed and shall pay the following fees:

Initial Filing Fee	= \$ 500.00
Forum Fees	= \$ 2,100.00
Total Fees	= \$ 2,600.00
Less payments	= \$ 1,700.00
Balance Due NASD Dispute Resolution	= \$ 900.00

2. Respondent Merrill Lynch is assessed and shall pay the following fees:

Member Fees	= \$ 8,550.00
Total Fees	= \$ 8,550.00
Less payments	= \$ 8,550.00
Balance Due NASD Dispute Resolution	= \$ 0.00

3. Respondents are jointly and severally assessed and shall pay the following fees:

Forum Fees	= \$ 6,300.00
Total Fees	= \$ 6,300.00
Less payments	= \$ 0.00
Balance Due NASD Dispute Resolution	= \$ 6,300.00

All balances are payable to NASD Dispute Resolution and are due upon receipt pursuant to Rule 10330(g) of the Code.

ARBITRATION PANEL

Robert S. Plotkin	-	Public Arbitrator, Presiding Chairperson
John A. Gray, Esq.	-	Public Arbitrator, Panelist
Michael P. Gwinn	-	Non-Public Arbitrator, Panelist

Concurring Arbitrators' Signatures



Robert S. Plotkin
Public Arbitrator, Presiding Chairperson

7/20/04
Signature Date

John A. Gray, Esq.
Public Arbitrator, Panelist

Signature Date

Michael P. Gwinn
Non-Public Arbitrator, Panelist

Signature Date

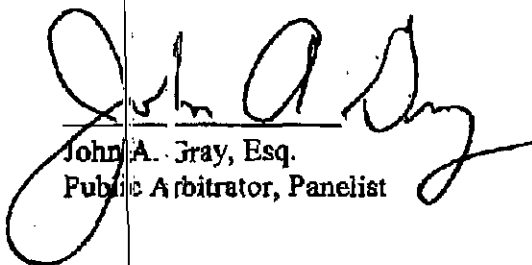
July 21, 2004
Date of Service (For NASD Dispute Resolution office use only)

Concurring Arbitrators' Signatures

Robert L. Plotkin

Public Arbitrator, Presiding Chairperson

Signature Date


John A. Gray, Esq.
Public Arbitrator, Panelist

7-21-04
Signature Date

Michael M. Gwinn

Non-Public Arbitrator, Panelist

Signature Date

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Concurring Arbitrators' Signatures

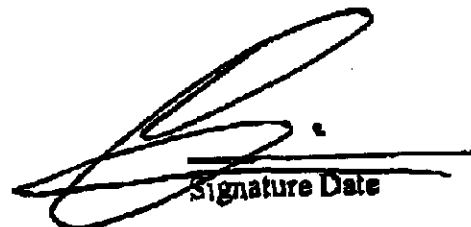
Robert S. Plotkin
Public Arbitrator, Presiding Chairperson

Signature Date

John A. Gray, Esq.
Public Arbitrator, Panelist

Signature Date

Michael P. Gwinn
Non-Public Arbitrator, Panelist


Signature Date

7/19/04

July 21, 2004
Date of Service (For NASD Dispute Resolution office use only)