

AWARD
NASD Dispute Resolution

In the Matter of the Arbitration Between

Name of Claimants

John and Beverly Shroat

and

03-05954
Chicago, Illinois

Name of Respondents

Merrill Lynch Pierce Fenner & Smith
Russell E. Werner

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

REPRESENTATION OF PARTIES

John and Beverly Shroat ("Claimants") were represented by Steven J. Rotunno, Esq., Kubasiak, Fylstra, Reizen & Rotunno, Chicago, Illinois.

Merrill Lynch Pierce Fenner & Smith ("Respondent MLPF & S") and Russell E. Werner ("Respondent Werner") hereinafter referred to as ("Respondents") were represented by Anne N. DePrez, Esq., Barnes & Thornburg, Indianapolis, Indiana.

CASE INFORMATION

The Statement of Claim was filed on or about August 18, 2003. Submission Agreement of Claimants John and Beverly Shroat was signed on August 7, 2003

Statement of Answer was filed by Respondents Merrill Lynch Pierce Fenner & Smith and Russell E. Werner on or about October 22, 2003. Submission Agreement of Respondent Merrill Lynch Pierce Fenner & Smith was signed on October 14, 2003. Submission Agreement of Respondent Russell E. Werner was signed on October 9, 2003.

CASE SUMMARY

Claimants asserted the following causes of action: gross negligence; breach of fiduciary duty; violation of the Indiana Securities Law; fraud; and violation of the Investment Advisers Act of 1994. Specifically, Claimants alleged, in their Statement of Claim, among other things, that:

Through the direction and advice of Respondents, the Shroats' retirement assets were invested by Respondents 70% in equity mutual funds and 30% in bond mutual funds. The Shroats, already having advised the Respondents that retention of capital was their primary goal, were not, at first, concerned about this more aggressive strategy, particularly since they believed that the Respondents would move their retirement assets in and out of various mutual funds when necessary and for their protection. Moreover, the Shroats understood that the bond mutual funds invested in high-grade corporate bonds and/or U.S. Treasuries which would make those mutual funds considerably less risky and serve as a hedge against declines in the stock market. In fact, the Shroats continued to follow the Respondents' investment advice even when they began to experience losses, because the Shroats trusted the Respondents, and more specifically, bought into Mr. Werner's "just sit tight" sales pitches.

Indeed, in 2000-2002, as the market declined and after significant unrealized losses, Mr. Shroat suggested numerous times to Mr. Werner that in keeping with the Shroats' desire to retain capital and preserve principal, the Shroats should consider selling their securities or a major portion of their securities and go to cash in their Merrill Lynch accounts; and he asked why the Shroats were remaining fully invested. Mr. Werner, however, rejected these suggestions as well, advising that the Shroats should not attempt to "time" the market, and that they should, instead, stay in the market and "wait for it to recover."

Claimants also alleged that during a telephone conference in late 2001, "Mr. Werner referred to many of the Shroats' retirement funds invested in bond mutual funds as "junk bonds." Significantly, until this point in time, the Shroats had believed, and, perhaps more importantly, had been led to believe by Mr. Werner, that these mutual funds were invested in high-grade corporate bonds and/or U.S. Treasury securities which were not of "junk" bond status, but instead were legitimate, secure and relatively risk-free corporate bond investments.

Respondents denied the allegations set forth in the Statement of Claim. Respondents specifically stated:

Mr. Werner based his recommendations for the three non-MFA accounts on the information provided by Mr. Shroat. Mr. Werner recommended that the monies he delivered to Merrill Lynch in late 1997 and early 1998 for the non-MFA accounts be invested in mutual funds focusing on different asset classes (e.g., small, mid and large cap growth stocks, small, mid and large cap value stocks and various types of bonds), and recommended two or three different fund companies for each asset class. These recommendations provided Mr. Shroat with substantial diversification among various investments, investment classes and investment managers. All of this was discussed with Mr. Shroat. Prospectuses and materials for each of the mutual funds in which Mr. Shroat invested were given to him. Each of the prospectuses explained all the material facts concerning the funds, including investment objectives, investment strategies, charges, risks and similar details.

Mr. Shroat was an active participant in the investment decisions made in his non-MFA accounts. He reviewed the materials and made fairly sophisticated decisions – such as

instructing Werner at one point to dollar cost-average and make quarterly reallocation adjustments in one of his accounts.

RELIEF REQUESTED

Claimants requested an award in the amount of \$792,000.00.

Respondents requested that the Panel deny Claimants' request for any recovery and to enter an award in their favor and, further, to enter an order of expungment.

OTHER ISSUES CONSIDERED & DECIDED

The parties have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered. In either case, the parties have agreed to receive conformed copies of the award while the original(s) remain on file with the NASD Dispute Resolution (the "NASD").

AWARD

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

1. Respondents Merrill Lynch Pierce Fenner & Smith and Russell E. Werner are jointly and severally liable for and shall pay to Claimants John and Beverly Shroat the sum of \$92,427.00 (Ninety Two Thousand Four Hundred Twenty Seven Dollars and No Cents) as compensatory damages.
2. Respondents Merrill Lynch Pierce Fenner & Smith and Russell E. Werner are jointly and severally liable for and shall pay to Claimants John and Beverly Shroat the sum of \$19,200.00 (Nineteen Thousand Two Hundred Dollars and No Cents) as interest.
3. Respondents Merrill Lynch Pierce Fenner & Smith and Russell E. Werner are jointly and severally liable for and shall pay to Claimants John and Beverly Shroat the sum of \$25,000.00 (Twenty Five Thousand Dollars and No Cents) as attorneys fees.
4. That to the extent not specifically awarded or otherwise provided for above, all other claims and requests for relief by any party hereto are denied with prejudice.
5. Other than the Forum Fees noted below, the parties shall each bear all other costs and expenses incurred by them in connection with this proceeding, including but not limited to attorneys fees, not specifically awarded or otherwise provided for above.

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 = \$375.00

Member Fees

Member fees are assessed to each member firm that is a party in these proceedings or to the member firm(s) that employed the associated person(s) at the time of the event(s) giving rise to the dispute. In this matter, the member firm(s) is Merrill Lynch Pierce Fenner & Smith.

Member surcharge	\$	2,250.00
Pre-hearing process fee	\$	750.00
Hearing process fee	\$	4,000.00
Total Member Fees	\$	7,000.00

Adjournment Fees

Adjournments requested during these proceedings:

Hearing Date(s), April 27-29, 2005 adjournment requested by Claimants. Fee = \$1,200.00 waived by Arbitration Panel.

Forum Fees and Assessments

The Arbitration Panel assesses forum fees for each hearing session conducted or each decision rendered on a discovery-related motion on the papers. A hearing 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:

3 Pre-hearing session(s) with Panel	@	1,200.00	\$	3,600.00
August 23, 2004	1	session		
January 25, 2005	1	session		
June 17, 2005	1	session		
9 Hearing sessions	@	1,200.00	\$	10,800.00
September 14, 2005	2	sessions		

September 15, 2005	2	sessions	
September 16, 2005	2	sessions	
January 9, 2006	2	sessions	
January 10, 2006	1	session	
Total Forum Fees			\$ 14,400.00

The Arbitration Panel has assessed \$14,400.00 of the forum fees jointly and severally to Merrill Lynch Pierce Fenner & Smith and Russell E. Werner.

Administrative Costs

Administrative costs are expenses incurred due to a request by a party for special services including, but not limited to, additional copies of arbitrator awards beyond those provided without charge, copies of audio transcripts, retrieval of documents from archives, interpreters, and security.

Claimants, requested copies of hearing tapes for September hearing sessions, cost \$150.00

Fee Summary

Claimants, John and Beverly Shroat are jointly and severally liable for:

Initial Filing Fee	= \$	375.00
Administrative Costs	= \$	150.00
Total Fees	= \$	525.00
<u>Less payments</u>	= \$	-1,575.00
Balance to be refunded by NASD Dispute Resolution	= \$	-1,050.00

Respondent, Merrill Lynch Pierce Fenner & Smith, is liable for:

Member Fees	= \$	7,000.00
Total Fees	= \$	7,000.00
<u>Less payments</u>	= \$	-5,250.00
Balance Due NASD Dispute Resolution	= \$	1,750.00

Respondents, Merrill Lynch Pierce Fenner & Smith, and Russell E. Werner, are jointly and severally liable for:

<u>Forum Fees</u>	= \$	14,400.00
Total Fees	= \$	14,400.00
<u>Less payments</u>	= \$	-0.00
Balance Due NASD Dispute Resolution	= \$	14,400.00

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All balances are due to NASD Dispute Resolution

ARBITRATION PANEL

David A. Youngerman, Esq. - Public Arbitrator, Presiding Chair
Harvey A. Nathan, Esq. - Public Arbitrator
Craig W. Henderson - Non-Public Arbitrator

Concurring Arbitrators:

David A. Youngerman
David A. Youngerman, Esq.
Public Arbitrator, Presiding Chair

March 1, 2006
Signature Date

Harvey A. Nathan, Esq.
Harvey A. Nathan, Esq.
Public Arbitrator

Signature Date

Craig W. Henderson
Craig W. Henderson
Non-Public Arbitrator

Signature Date

3/6/06
Date of Service (For NASD office use only)

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