

**Award**  
**NASD Dispute Resolution**

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In the Matter of the Arbitration Between:

Elizabeth Appel and Victor Goncharoff, Jr., JTWROS, Claimants v. Merrill Lynch, Pierce, Fenner & Smith, Incorporated, Respondent

Case Number: 04-07585

Hearing Site: Seattle, Washington

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Nature of the Dispute: Customers v. Member

**REPRESENTATION OF PARTIES**

For Claimants Elizabeth Appel and Victor Goncharoff, Jr.,  
JTWROS:

Elizabeth Appel  
Victor Goncharoff, Jr.  
Pro Se  
Bothell, Washington

For Respondent Merrill Lynch, Pierce, Fenner & Smith,  
Incorporated:

Keith Guilfoyle, Esq.  
Merrill Lynch, Pierce, Fenner  
& Smith, Incorporated  
New York, New York

**CASE INFORMATION**

Statement of Claim filed: October 18, 2004

Claimants' Joint Uniform Submission Agreement signed: October 25, 2004

Statement of Answer filed by Respondent Merrill Lynch, Pierce, Fenner & Smith, Incorporated:  
January 21, 2005

Respondent Merrill Lynch, Pierce, Fenner & Smith, Incorporated's Uniform Submission  
Agreement signed: January 21, 2005

**CASE SUMMARY**

Claimants alleged negligence, unsuitability, and failure to supervise. Claimant's allegations involved John Hancock fixed income funds.

Respondent denied the allegations of wrongdoing set forth in Claimants' Statement of Claim and asserted various affirmative defenses.

**RELIEF REQUESTED**

Claimants requested \$42,335.00 in compensatory damages, and costs, including reimbursement of forum fees in the amount of \$625.00.

Respondent requested dismissal of Claimants' Statement of Claim in its entirety and costs.

**OTHER ISSUES CONSIDERED AND DECIDED**

The parties agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered.

**AWARD**

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

**I. FINDINGS OF FACT**

In May 2003, Claimants' grandmother died leaving Elizabeth Appel and her brother, Victor Goncharoff, Jr., her home in Mercer Island, Washington. Claimants decided to invest in a remodel of the older home and then sell the house. Claimant Appel was to arrange this process. She was advised by a mortgage broker to borrow funds in excess of the remodel capital required and invest the proceeds to generate a return higher than the loan rates. The mortgage broker was not affiliated with Respondent.

Claimant, Elizabeth Appel, borrowed \$310,000, with \$75,000 earmarked for the remodel expenses.

Claimants were unfamiliar with the types of investment options available and decided to seek the help of a financial advisor, Respondent, David Hart. Claimant Appel opened an account with Respondent in January, 2004, and added Mr. Goncharoff's name in February, 2004.

Claimants met on January 26, 2004 with Mr. Hart. They explained to him that in borrowing the money, they hoped to generate a return in excess of their 4% loan rate and to service the mortgage payment of \$1,550 per month. Claimants' plan was to sell the home after the remodel was complete (approximately 6 to 9 months); pay off the loan, and divide the proceeds. Claimants, though risk adverse, were willing to assume a moderate level of risk to achieve their investment objective.

Initially, Claimants advised Mr. Hart of their desire for a 6 to 9 month investment period. Mr. Hart advised them he would not recommend any investments that would meet their objective in such a short time frame.

Mr. Hart explained that conservative investments like Certificates of Deposit would not meet their objectives. After further discussion, Claimant Appel indicated she would invest for the long term and that the loan was to be paid from the proceeds of the house sale, not the sale of the stocks. Claimants were made aware of the possible risk of loss in principal to meet their objectives. He detailed several investment options, including accelerated return notes, strides and closed-end funds.

Discussed with Claimants at this meeting was the risk that when market interest rates rise, the market value of the closed-end fund generally will decline and that when interest rates fall, the market value of the closed-end funds generally will increase. Claimants, after discussing each fund, made the decision to invest in three closed-end funds as follows:

- (1) John Hancock Preferred Income Fund II – Primary investment objective of providing a high level of current income consistent with preservation of capital.
- (2) John Hancock Preferred Equity Income Fund – Primary investment objective of providing a high level of current income consistent with preservation of capital.
- (3) Preferred Income Strategies Fund – Primary investment objective of providing current income followed by capital appreciation.

On January 27, 2004, Claimants invested \$74,963.06, \$74,895.57, and \$75,135.10 in the above three funds, respectively.

Prior to May 7, 2004, Claimants never raised any issue about the performance of the three funds. Claimant Appel had online access to their account and did so on April 9<sup>th</sup> and 20<sup>th</sup>, 2004. On April 20, 2004, she specifically checked her unrealized gain or losses in the account.

Claimant Appel was aware that the three closed-end funds were declining in value, but did not call Mr. Hart to discuss the matter.

Upon receipt on May 7, 2004 of the April financial statement, she called Mr. Hart to discuss the approximately \$25,000 decline in value of the account. He advised that the rise of interest rates had impacted their account, as well as many others. Mr. Hart advised Claimant Appel not to panic and to hold on to the investments to see if they could recover.

On May 10, 2004, three days later, Claimant Appel pulled up their account online and discovered the account had now declined in value about \$40,000. She called Mr. Hart on that day and they discussed the interest rate situation, the recent Iraq situation and the pipeline burst. She asked Mr. Hart "should I sell," and received no response. She did not repeat the question again.

Mr. Hart told her if she decided to sell, it would take three days to receive the funds into the cash management account.

Claimant Appel decided to sell and instructed Mr. Hart to do so on May 10, 2004, for a loss of principal of \$42,335.17. Claimants' account with Respondent was a non-discretionary account.

Respondent's Exhibit #4 provides a price analysis on Claimants' account had they not sold on May 10, 2004. Claimants cost basis was \$222,257.75. On July 27, 2004, Claimants' principal, plus dividends would have been \$212,621.51; on October 27, 2004, \$228,915.35, and on January 27, 2005, \$231,809.29. Claimants would not have received any loss if they had held their investments for their original nine-month time frame.

Therefore, the arbitrator found as follows:

1. Claimants failed in their burden of proof on their claim based upon investment unsuitability and lack of supervision.
2. Respondents' recommendations to Claimants to purchase the three closed-end funds were, in fact, suitable and consistent with the essential facts provided by the Claimants, including the Claimants' investment objectives, financial needs and level of investment sophistication.
3. Claimant Appel solely made the decision, on May 10, 2004, to liquidate their account with Respondent.

## **II. AWARD**

1. Claimants' claims are denied in their entirety.
2. The parties shall bear their respective costs, including attorney's fees.
3. All other relief requested and not expressly granted is denied.

### **FEES**

Pursuant to the Code, the following fees are assessed:

#### **Filing Fees**

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

|                          |             |
|--------------------------|-------------|
| Initial claim filing fee | = \$ 175.00 |
|--------------------------|-------------|

**Member Fees**

Member fees are assessed to each member firm that is either a party in the matter or an employer of a respondent associated person at the time of the events that gave rise to the dispute, claim, or controversy. Accordingly, the member firm Merrill Lynch, Pierce, Fenner & Smith, Incorporated is a party, and the following fees are assessed:

|                          |                     |
|--------------------------|---------------------|
| Member Surcharge         | = \$ 875.00         |
| Pre-Hearing Process Fee  | = \$ 750.00         |
| Hearing Process Fee      | = \$1,000.00        |
| <b>Total Member Fees</b> | <b>= \$2,625.00</b> |

**Forum Fees and Assessments**

The arbitrator assessed a forum fee for each pre-hearing conference or hearing session conducted. A pre-hearing conference and hearing session is any meeting between the parties and the arbitrator. The following fees are assessed:

|  |                     |
|--|---------------------|
| One (1) pre-hearing conference session with a single arbitrator @ \$450.00/session | = \$ 450.00         |
| Pre-hearing conference: March 23, 2005 1 session                                   |                     |
| Two (2) Hearing sessions @ \$450.00/session  | = \$ 900.00         |
| Hearing: July 20, 2005 2 sessions  |                     |
| <b>Total Forum Fees</b>  | <b>= \$1,350.00</b> |

The arbitrator assessed \$1,350.00 of the forum fees jointly and severally to Claimants.

**Fee Summary**

1. Claimants Elizabeth Appel and Victor Goncharoff JTWROS are charged jointly and severally with the following fees and costs:

|  |                    |
|--|--------------------|
| Initial Filing Fee                         | = \$ 175.00        |
| Forum Fees                                 | = \$1,350.00       |
| Total Fees                                 | = \$1,525.00       |
| Less payments                              | = \$(625.00)       |
| <b>Balance Due NASD Dispute Resolution</b> | <b>= \$ 900.00</b> |

2. Respondent Merrill Lynch, Pierce, Fenner & Smith, Incorporated is charged with the following fees and costs:

|  |                  |
|--|------------------|
| Member Fees                                | = \$ 2,625.00    |
| Less payments                              | = \$(2,625.00)   |
| <b>Balance Due NASD Dispute Resolution</b> | <b>= \$ 0.00</b> |

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

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**ARBITRATOR**

*Thomas D. Loftus, Esq.*

*Public Arbitrator*

**Arbitrator's Signature**

*Thomas D. Loftus*

Thomas D. Loftus, Esq.  
Public Arbitrator

*7-28-05*

**Signature Date**

*7/28/05*

**Date of Service**