TRANSITIONING BROKERS AND THE BROKER PROTOCOL- WHAT ***NOT*** TO DO WHEN CHANGING FIRMS

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The Protocol for Broker Recruiting (the "Protocol") was created and adopted by three major wirehouses in 2005- Citigroup Global Markets (Smith Barney), Merrill Lynch and UBS Financial Services- to "further the clients' interest in privacy and freedom of choice in connection with the movement of their Registered Representatives between firms". Since the three founding members signed the Protocol, over 1,300 firms have now signed and adopted it.

The Protocol, however, is a surprisingly simple and short document, less than three double spaced pages in length. It contains no definitions and offers only the barest of guidance of what departing brokers leaving one Protocol firm for another can, and cannot do.

The Protocol merely states that if the departing representative, and the new firm, follow the Protocol, "neither the departing Representative nor the firm that he or she joins would have any monetary liability to the firm that the Representative left by reason of the Representative taking [certain specified information] or the solicitation of the clients serviced by the Representative at his or her prior firm". There are five specified pieces of information (please note: *information NOT documents)* that a departing broker can take when leaving a member firm- the names, addresses, phone numbers, email addresses and account titles only of those clients "that they serviced at the prior firm".

Sounds simple, right? Wrong. Not so simple as a number of hapless, and misinformed brokers have found out the hard way. The devil, as they say, is in the details. As succinct as it is, the Protocol contains several very important "carve-out" provisions that, when ignored, have tripped up a number of broker transitions turning those transitions into nightmares. Those "carve-out" provisions include:

1. The Protocol ***does not*** bar the former firm for bringing an action against the new firm for "raiding";
2. Departing brokers are ***prohibited*** from taking any information *other* than the five pieces of information specified above;

3. The departing broker must leave a copy of the full list of Client Information he or she has taken with them when they leave the firm and that list ***must be compiled in good faith;***
4. The new firm must limit the use of that Client Information ***solely*** for solicitation of those clients by the new firm;
5. The departing brokers may use the Client Information to solicit their former clients but only ***after*** they have joined the new firm; and
6. The old firm is free to enforce "whatever contractual, statutory or common law restrictions existed on the solicitation of clients" ***prior*** to the departing broker leaving the firm.

As more and more firms have signed the Protocol over the past ten years, the number of "raiding" and departure cases has dropped considerably, giving brokers considering a transition from a Protocol to a Protocol firm assurance that if they follow the letter and spirit of the Protocol, they will have a high likelihood of a smooth transition. The playing field has been substantially leveled and the Protocol has provided a framework allowing a registered representative to depart one signatory firm for another with some reasonable assurance that, so long as the Protocol is followed, the likelihood of being hauled into court and hit with a temporary restraining order or injunction is greatly reduced. Of course, brokers either departing a non-signatory firm, or leaving a signatory firm for a non-signatory firm do not have the protection the Protocol provides when transitioning from one Protocol firm to another. The Protocol <u>only</u> covers a transition from a Protocol to a Protocol firm. The major firms who have chosen ***not*** to become members of the Protocol are, notably, Schwab and Fidelity.

That is not to say, however, that the Protocol has afforded smooth sailing for every transitioning broker. It has not and does not. There have been a number of publicly reported cases where departing brokers have run afoul of the "carve-outs" of the Protocol and, as a result, have lost the protection they thought they had under it. We will first look at several of those cases and then summarize a list of best practices to follow when making a transition.

Merrill Lynch v. Michael Carr, Jeffrey Hogue et al.-

In late August 2015, four Merrill brokers- Michael Carr, Jeffrey Hogue, Jeffrey Rizzo and Kirk Ruth - resigned from Merrill's Gainesville, Florida office and joined a newly established UBS Gainesville office. The four brokers had a substantial book of combined assets under management of $870 million, which generated over $4.5 million in annual revenues for the team. Carr had been at Merrill since 1997; Ruth since 1994 and Hogue and Rizzo since 2000 and 2013 respectively. The group focused on ultra high net worth individuals and was recruited by UBS to work out of a newly opened UBS office in Gainesville that UBS built specially for their team.

Literally within one week after leaving Merrill, however, the departing brokers were hit with a Temporary Restraining Order issued by a Florida Federal Court, which totally stopped the brokers in their track and left them dead in the water. Following their departure, Merrill filed suit in Federal District Court in the Northern District of Florida and sought, and ultimately obtained a temporary restraining order prohibiting the advisers from initiating new contact with their former Merrill clients; ordering them to return all customer information to Merrill; ordering them to immediately cease having any contact with any former client they serviced, or whom they became aware of while working at Merrill, and banned them from accepting any business from any former Merrill client they solicited following their departure. In essence, the Court ordered them to pretty much shut down their entire operation and have no contact with their former clients, virtually all of their combined book of $870 million of assets. A true nightmare for that group.

The defendant brokers, in turn, argued to the Court that the Broker Protocol allowed them to continue to solicit their former Merrill clients but the Court disagreed. Why? What went wrong? Well, the brokers, and obviously whomever was advising them (or not advising them as often is the case) never paid attention to the exceptions and "carve-outs" of the Protocol and, as a dire consequence, they lost all benefits the Protocol normally affords a departing broker.

Merrill accused the team of "sabotage", misappropriating trade secrets and breaching their contracts. Merrill successfully alleged in its court papers- and the Court agreed- that the four departing brokers provided Merrill with incorrect and misleading contact information for their clients, including at least one $10 million account, on the Client Information list they left behind following their resignation; charged the brokers took contact information on inherited accounts in violation of the Protocol and made disparaging remarks about Merrill to Merrill clients to induce them to move their accounts from Merrill to UBS. Merrill also alleged, and the brokers did not dispute, they took various pieces of electronic equipment upon their departure from Merrill. Merrill also alleged, and the brokers did not dispute, they had solicited former Merrill employees to join them at UBS in violation of the no-solicitation of employee agreements they had signed with Merrill.

In granting Merrill the requested restraining order, the Federal Judge found that "Merrill Lynch has shown that it was entitled to a temporary restraining order to prevent defendants from taking further action to solicit their former clients. Merrill Lynch provided evidence that defendants acted in bad faith in the course of their departure by retaining electronic devices owned by Merrill Lynch, manipulating client contact information in Merrill Lynch's records and soliciting support staff to join them in their move in contravention of various agreements.

Obviously, the Court found there was sufficient credible evidence sufficient to issue an order restraining and prevent the four former Merrill brokers from further solicitation of any of their former clients. Merrill alleged that once they left the firm, the former brokers told their clients that Bank of America also Merrill Lynch was dictating investment strategies to its advisers that are required to be followed without concern for customer's best interest, that the firm was charging excessive fees and that Merrill Lynch's Gainesville office would be closing, all found to be untrue and intentionally false statements intended to unfairly induce clients to leave Merrill and join the brokers at their new firm.

So, four brokers with a huge, collective book of business- $870 million of assets under management- snatched defeat from the jaws of victory by ignoring the Protocol and, as a result, they lost the Protection the Protocol would have otherwise afforded them

Morgan Stanley v. O'Brien-

Denis O'Brien had been employed at Morgan since 2004. When he joined the firm he signed Morgan's standard form of Financial Advisor Employment Agreement which restricted him from soliciting Morgan clients and using or disseminating Morgan is confidential information.

One day O'Brien printed a list of the clients he serviced at Morgan from the Morgan database and, without Morgan's knowledge or consent, he changed 206 contact telephone numbers for 156 of those clients in Morgan's database. The next day, he resigned from Morgan without prior notice and left a copy of the list he generated, which included the correct, not the altered phone numbers of his clients, and promptly joined Raymond James. Both Morgan and Raymond James were signatories to the Protocol.

After his resignation, Morgan reassigned O'Brien's accounts to other brokers in the office, which is fairly standard and routine, and those brokers started to call the clients to solicit them to keep their accounts at Morgan. As is the practice and custom, the brokers tried contacting those firm clients using the firm's database of client contact information. Since O'Brien had manipulated and changed the client contact number in Morgan's system, however, the firm was unable to contact many of the clients. Morgan's IT department investigated and determined that O'Brien had entered the system and modified the clients' contact information by changing phone numbers and other client information.

Morgan promptly filed suit in Connecticut Federal Court and sought, and obtained, a temporary restraining order against O'Brien. Morgan argued to the Court that O'Brien violated the letter, and spirit of the Protocol by failing to prepare the Client Information list he left behind in good faith and by changing the client contact information of more than 150 of his former clients. Morgan also argued that, the Protocol notwithstanding, O'Brien violated

Morgan's restrictive covenants which prohibited him from soliciting clients and taking trade secrets from Morgan.

The Court granted Morgan a temporary restraining order on the grounds that, the Protocol notwithstanding, O'Brien "violated the spirit of the Protocol by…O'Brien's deliberate use of the Morgan Stanley computer system and his calculated corruption of more than 200 customer telephone numbers ostensibly to prevent Morgan Stanley from immediately contacting his portfolio of clients upon his departure evidences bad faith and a contempt for his clients' right to choose whether to remain at Morgan Stanley or move to Raymond James".

The Court then ordered O'Brien to immediately return to Morgan all documents and materials relating to any of his former Morgan customers; enjoined him from using any of that information and from contacting or soliciting any of his former clients. Again, another broker stopped dead in the water in the midst of a transition by loss of the benefit of the Protocol.

The above are two cases where brokers mishandled what otherwise should have been a smooth transition under the Protocol and lost the entire benefit the Protocol otherwise would have afforded them.

<u>Best Practices When Leaving a Protocol Firm for Another Protocol Firm</u>

The two cases referenced above, and others from around the country, provide a good roadmap of what to do- and what <u>NOT</u> to do- when transitioning from a Protocol to a Protocol firm. After years of experience with broker transitions and the Broker Protocol, we offer these best practices to follow when contemplating your own transition:

- Only compile a list of the five categories of information specified in the Protocol. Put together a spreadsheet or document with only that information. ***DO NOT TAKE DOCUMENTS; PHONES; PDA'S; DO NOT TAKE CLIENT STATEMENTS. YOU DON'T NEED THEM AND ARE NOT ALLOWED TO TAKE DOCUMENTS.*** Very often brokers have come to us after they have been served with injunction papers and after they have taken unnecessary but damaging documents, laptops, phones, pda's etc. You must only take the information, not documents, specified in the Protocol;

- Don't be penny wise and pound-foolish. Interview, and hire experienced, competent counsel familiar with the industry and broker transitions. Litigation after the fact is extremely costly and can ruin your business and career. Upfront counseling, on the other hand, is relatively inexpensive. Would you pilot your own boat through rocky shores or hire a captain who has made the trip hundreds of times before? Good counsel and competent advice is critical to avoid costly and disastrous results;

- Be very careful about approaching and soliciting former co-workers to leave the firm with you. The Protocol ***does not*** vitiate non- solicitation agreements of former co-workers and courts will enforce them. Get good legal advice on what is, and what is not a solicitation of a former sales assistance of team member;

- Do not alter, in any way, the former firm's client contact base or data for your clients. Just don't. The Protocol, and courts, have been clear on that point. You can compete but you must compete fairly and honestly;

- Do not "jump the gun". You can send proper solicitation letters; emails and phone calls to your clients, but ***only*** after you leave your firm. We have seen many cases where the new firm asks for a client list before you start at the new firm, on the grounds they want to "put together the ACAT packages and be able to hit the ground running". Don't do it. The Protocol prohibits it. Don't give your client list of contacts to the new firm until you have resigned and started working at the new firm.

- Do not denigrate, besmirch or say negative things about the firm you are leaving. First, it does not reflect well on you since your clients know you worked at that firm for a number of years. Second, negative statements just don't reflect well, period. Put a positive spin on your transition. "I felt my new firm would offer a better array of services and products best suited for your investments needs" sounds much more professional than "the firm I left was a bunch of crooks that only wanted to sell you high commission, proprietary products". What would you want to hear? Always take the high road. In life and in transitions.

- Make sure you actually are leaving a protocol firm for another protocol firm. Lists of signature firms are on the Internet. All knowledgeable attorneys have up to date lists. The Protocol only applies when leaving a protocol firm for another protocol firm. If you are not leaving, or joining a Protocol firm, be sure to get good advice before even considering a move. Thinking the Protocol applies when it does not can be a disaster.

Shustak Reynolds & Partners has been advising brokers, financial advisers, registered investment advisers and others in the financial services industry for 40 years. We know how to do transitions right and how to avoid the many pitfalls that can lead to ruinous transitions. Call us. We are here to help you make your transition as smooth and hassle free as possible. Litigation is expensive; advice is not.