When Does the Broker Protocol Supersede a Notice Provision in a Financial Adviser's Employment Contract?

By John S. Monical and Marielise Fraioli

INTRODUCTION

In 2004, Merrill Lynch, Morgan Stanley, Smith Barney, and UBS invented the Protocol for Broker Recruiting (the "Protocol"). The idea was simple – create a safe harbor process for advisers so that they could move between firms who had agreed to join the Protocol, take their clients with them, and be assured that they would not be subject to a lawsuit or arbitration. As a testament to its efficacy, nearly 1,700 firms have joined the Protocol.

Notwithstanding its success, one enduring gray area in the Protocol has been whether and to what extent the Protocol preempts a notice provision of an adviser's employment contract. A recent Georgia Court of Appeals' decision, *HA&W Capital Partners, LLC v. Bhandari*[1]*,* attempts to answer this question, at least in the state of Georgia.

WHAT IS THE PROTOCOL?

The Protocol is an agreement that establishes rules for broker recruitment. Its self-proclaimed principal goal is "to further the clients' interest of privacy and freedom of choice in connection with the movement of their Registered Representatives[2] ('RRs') between firms." Under its terms, when advisers "move from one firm to another and both firms are signatories to [the Protocol], they may take the following information: client name, address, phone number, email address, and account title of the clients that they serviced while at the firm ('the Client Information')." Advisers who comply with the Protocol are "free to solicit customers that they serviced while at their former firms" after they joined their new firms and, with a few exceptions (e.g., "raiding" cases and team agreements), neither the departing adviser nor the firm that he or she joins "would have any monetary or other liability to the firm that the [adviser] left by reason of the [adviser] taking the [Client Information] or the solicitation of the clients."

Many Protocol firms require their financial advisers to execute employment agreements containing terms prohibiting solicitation of clients or retention of client information. Where both the departing and new firms are signatories to the Protocol, the Protocol acts as a legally

[1] 2018 WL 3135295 (Ga. Ct. App. June 27, 2018)

[2] For purposes of this article, we will use the term adviser without attempting to distinguish between Registered Representatives and Investment Adviser Representatives. Although the Protocol uses the term "Registered Representative", Protocol members generally have accepted joinder by Registered Investment Advisers ("RIAs") and have not objected to application of the Protocol to advisers at those RIAs.

enforceable agreement between those firms that – to the extent those employment agreements are inconsistent with the terms of the Protocol – those employment agreements will not be enforced. While the advisers are not parties to the Protocol, they are third-party beneficiaries of the Protocol agreement. The Protocol thereby effectively provides a legally enforceable safe harbor to advisers who leave under its terms.

NOTICE PROVISIONS – A GRAY AREA UNDER THE BROKER PROTOCOL

The Protocol's safe harbor does not immunize a departing adviser from all liability to the former firm. By its terms, the Protocol only absolves a departing adviser from liability for conduct relating to the adviser "taking the information identified [in the Protocol] or the solicitation of the clients serviced by the [adviser] at his or her prior firm." Therefore, a departing broker could invoke the Protocol to avoid liability to his or her prior firm arising out of solicitation of the former firm's clients but, nonetheless, remain liable to the former employer for other conduct not addressed by the Protocol. For example, the Protocol generally does not change the adviser's contractual obligations to repay a forgivable loan. Similarly, the Protocol does not preempt an adviser's contractual obligation not to disparage a prior firm. These provisions are outside the Protocol's terms.

So, what about an employment agreement that imposes an obligation on an adviser to provide 30 days written notice of departure from the prior firm? Departing advisers may argue that these notice provisions are designed to prevent a departing adviser from soliciting the clients during the date notice is given and the date of departure. During this time, the prior firm has an opportunity to introduce the client to another adviser and attempt to solidify the relationship. Under this argument, liability to the prior firm for violating the notice provision could be "by reason of the adviser solicitation of the clients," which would be preempted by the Protocol. A prior firm, by comparison, may argue that notice provisions are not addressed by the Protocol and are designed to ensure continued service to the client while the firm finds and transitions an account to another adviser. Under this argument, liability for breach of a notice provision is not "by reason of the [adviser's] solicitation of the client", but because the adviser compromised the firm's ability to provide smooth and consistent service to its clients.

THE GEORGIA COURT OF APPEALS ANALYSIS

In *HA&W Capital Partners, LLC v. Bhandari,* the Georgia Court of Appeals was tasked with deciding the Protocol's impact on notice provisions contained within a moving adviser's employment contract. At issue was a group of advisers whose employment agreements with HA&W Capital Partners ("HA&W") required them to give either 60 or 90 days' notice in advance of their departure. The advisers terminated their employment without providing written notice and immediately commenced work at a competing firm.

HA&W filed a complaint and requested a temporary restraining order. In response, the advisers contended that the Protocol shielded them from any liability that may have arisen for failing to follow the advance notice provision. The advisers' position, put simply, was that the Protocol is designed to allow advisers freedom of choice in their employer and to allow them to freely solicit their clients, all within the parameters of the Protocol. They maintained that the advance notice provision had effectively served to restrict their freedom of movement and was deliberately designed to give their prior firm a jump on transitioning their clients to other advisers. The trial court agreed with the advisers' position, finding that as a matter of law the protocol precludes the departing adviser's liability as to the advance notice provisions.

The Court of Appeals disagreed. The Court of Appeals reasoned that the Protocol, as a contract, must be construed according to its express terms. Accordingly, where the Protocol is silent on notice, it cannot "categorically invalidate[] notice provisions in employment agreements." Because the firm "does not allege that the former employees are liable by reason of taking client information or soliciting clients," but rather "alleges that the former employees are liable by reason of having terminated their employment without prior notice," the Court of Appeals held that a claim seeking enforcement of the notice provision "does not contravene the express terms of the Protocol."

At first glance, the Georgia Court of Appeals' decision might seem to strike a serious blow to those who would argue that the Protocol precludes liability for notice provisions, but upon closer inspection, the Court of Appeals was careful to note the limitations of its ruling. Among other things, the Court specified that the ruling does not address the issue of damages. The Court of Appeals noted that plaintiff acknowledged that it was not seeking to hold the departing advisers liable for special damages based on taking client information, or engaging in client solicitation, as this would "contravene the plain language of the protocol." In other words, the prior firm was not basing damages on the soliciting away of clients. Rather, its potential claim for damages arose solely from the inability to conduct an orderly transition due to the departing advisers' breach of the notice provision. The Court of Appeals indicated that because plaintiff's theory was seeking no special damages, plaintiff may be able to recover only nominal damages. As a result, the plaintiff's claim – while not preempted by the Protocol – appears to have been severely limited by it.

CONCLUSION

HA&W Capital Partners, LLC v. Bhandari reflects the complexity of determining when and whether the Protocol preempts a notice provision in an adviser's employment contract. In some cases – depending upon the language of the provision and the specific state law involved – the Protocol may preempt a notice provision on the surface. In other cases, it may not preempt a notice provision at all. In still other cases, the Protocol may not preempt the notice provision on the surface, but may preempt causes of action or the recovery of certain damages arising from a breach of the notice provision. Departing advisers and firms would be wise to consider the terms of their written agreements, including advance-notice provisions, when evaluating litigation risk associated with the move to a new firm.

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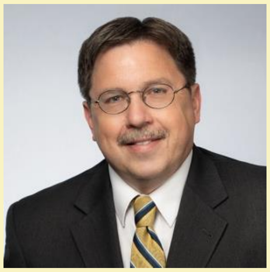

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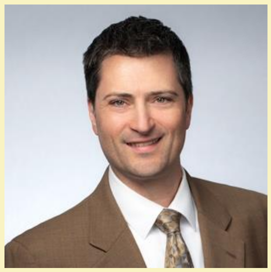

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