THE PROTOCOL FOR BROKER RECRUITING IN COURT: HOW COURTS HAVE INTERPRETED THE PROTOCOL IN INJUNCTIVE RELIEF PROCEEDINGS

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INTRODUCTION

In August 2004 Citigroup Global Markets, Inc. (Smith Barney), Merrill Lynch, Pierce, Fenner & Smith, Inc., and UBS Financial Services, Inc. entered into an agreement entitled The Protocol for Broker Recruiting (the "Protocol"). The Protocol provides:

> The principal goal of the following protocol is to further the clients' interests of privacy and freedom of choice in connection with the movement of their Registered Representatives ("RRs") between firms. If departing RRs and their new firm follow this protocol, neither the departing RR nor the firm that he or she joins would have any monetary or other liability to the firm that the RR left by reason of the RR taking the information identified below or the solicitation of the clients serviced by the RR at his or her prior firm, *provided*, however, that this protocol does not bar or otherwise affect the ability of the prior firm to bring an action against the new firm for "raiding."....
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> When RRs move from on firm to another and both firms are signatories to this protocol, they may take only the following account information[:] client name, address, phone number, email address, and account title of the clients that they serviced while at the firm ("the Client Information") and are prohibited from taking any other documents or information. Resignations will be in writing delivered to local branch management and shall include a copy of the Client Information that the RR is taking with him or her. The RR list delivered to the branch must also include the account numbers for the clients serviced by the RR.
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> ....
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> RRs that comply with this protocol would be free to solicit customers that they serviced while at their former firms, but only after they have joined their new firms. A firm would continue to be free to enforce whatever contractual, statutory or common law restrictions exist on the solicitation of customers to move their accounts by a departing RR before he or she has left the firm.

Since 2004 hundreds of securities industry firms have signed the Protocol. The Securities Industry and Financial Markets Association (SIFMA) currently maintains and distributes lists of Protocol signers.

The Protocol addresses movement of financial advisors licensed by the Financial Industry Regulatory Authority[1] ("FINRA") between firms which are regulated by FINRA. FINRA Rule 13200 requires arbitration of all disputes between members or members and associated persons under FINRA's Code of Arbitration for Industry Disputes,[2] so courts generally lack jurisdiction to hear disputes between FINRA members and their affiliates arising from the movement of an advisor from one FINRA regulated firm to another. However, FINRA Rule 13804 allows parties to "seek a temporary injunctive order from a court of competent jurisdiction" if an arbitration is pending before FINRA and a hearing on permanent injunctive relief has not commenced. Various courts have explicitly or implicitly construed preliminary injunctions, pursuant to Rule 65 of the Federal Rules of Civil Procedure, to be "temporary injunctive orders" within the meaning of FINRA Arbitration Rule 13804.[3] As a result, courts have considered the Protocol only in the context of requests for temporary injunctive relief.

DOES THE PROTOCOL APPLY?

The first issue is whether the Protocol applies to a specific case. Courts generally have held the Protocol only applies to cases where both parties have signed the Protocol,. As stated by the court in *Wachovia Sec., L.L.C. v. Stanton*:[4]

> Where both parties are signatories, they have essentially agreed to reciprocal "poaching" of registered representatives and the registered representative's clients from the former firm, apparently on the assumption that they will gain as much as they lose in the exchange. On the other hand, where the new firm is not a signatory,

[1] FINRA is an independent, self-regulatory organization authorized by Congress to regulate the securities industry under the oversight of the Securities and Exchange Commission.

[2] FINRA Rule IM13000 *et seq*.

[3] *See, e.g., Merrill Lynch v. Murvin*, 2009 WL 528605, *1 (M.D.Fla. March 2, 2009) (Explicitly construing "temporary injunctive order" to include a "preliminary injunction"); *Morgan Stanley & Co., Inc. v. Choy*, 2009 WL 330210, *3–*4 (D. Haw. Feb. 10, 2009) (Implicitly finding a "preliminary injunction" was authorized by Rule 13804); *Bank of America, N.A. v. Lee*, 2008 WL 4351348, *1 (C.D. Cal. Sept. 22, 2008) (implicitly finding Rule 13804 authorized either a "temporary restraining order" or a "preliminary injunction"). *But see Prudential Ins. Co. of America v. Inlay*, 728 F.Supp.2d 1022, 1026-27 (N. D. Iowa 2010) (court reads the "temporary injunctive order" language in Rule 13804 to authorize only a "temporary restraining order" by this federal court pursuant to Rule 65, not a "preliminary injunction.")

[4] 571 F. Supp. 2d 1014, 1039-40 (N.D. Iowa 2008); *accord, Hilliard v. Clark*, 2007 WL 2589956 at *3 (W.D. Mich. Aug. 31, 2007); *Fid. Brokerage Servs. LLC v. Clemens*, 2013 WL 5936671, at *10, n.1 (E.D. Tenn. Nov. 4, 2013).

> the old firm has no reciprocal benefit to look forward to, and a prohibition on solicitation of clients by a departing registered representative is still reasonably necessary to protect the former firm's client base from "poaching" by the new, non-Protocol firm.

Courts have rejected the argument the Protocol is the "standard of the industry."[5] However, the court in *Merrill Lynch, Pierce, Fenner, & Smith, Inc. v. Brennan*[6] held a plaintiff who signed the Protocol could not establish the departing advisors caused it irreparable harm necessary to obtain an injunction even though their new firm had not signed the Protocol.

Finally, the Protocol contains exceptions for team or partnership agreements and clients transferred pursuant to retirement programs. The court in *UBS Financial Services, Inc. v. Christenson* concluded the Protocol did not apply because a valid team agreement existed, and the Protocol explicitly provides the ability to take contact information and solicit clients does not supersede a written financial advisor team agreement. However, based on the language of the team agreement, the court found the departing advisor could send a neutral announcement containing the identity of his new employer and new contact information to the former clients with whom he worked, so long as the announcement did not encourage clients to leave his former firm or tout the advisor's new employer.[7]

THE PROTOCOL'S EFFECT ON TEMPORARY RESTRAINING ORDERS AND PRELIMINARY INJUNCTIONS

A plaintiff seeking a temporary restraining order or preliminary injunction must establish that (1) he is likely to succeed on the merits; (2) he is likely to suffer irreparable harm in the absence of preliminary relief; (3) the balance of equities tips in his favor; and (4) an injunction is in the public interest.[8] As stated by the court in *Smith Barney v. Griffin*:[9] "The Protocol sheds light on three questions that are critically important in determining whether this Court should issue a preliminary injunction:

1. Does [the Protocol firm] regard Client Information, as defined in the Protocol, truly to be confidential?

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[5] *Hilliard v. Clark, supra*, at *3; Fid. *Brokerage Servs. LLC v. Clemens, supra* at *10, n.1.

[6] 2007 WL 632904 at *2 (N.D. Ohio, Feb. 23, 2007).

[7] 2013 WL 2145703 at *5 (D. Minn. May 15, 2013).

[8] *See, e.g., Winter v. Natural Resources Defense Council, Inc.*, 555 U.S. 7, 10 (2008).

[9] 2008 WL 325269 at *6 (Mass. Sup. Ct. Jan. 23, 2008). The court answered "no" to each question.

2. Is the non-solicitation agreement in the Contract truly necessary to protect the goodwill of [the Protocol firm]?

3. Is a preliminary injunction truly necessary to prevent a substantial risk of irreparable harm?"

Court's also apply the Protocol when considering whether a restraining order/injunction is in the public interest.

1. Success on the Merits

Courts apply the Protocol to analyze non-solicit, non-compete agreements between the departing advisor and his former firm. In *Merrill Lynch, Pierce, Fenner, & Smith v. Reidy*[10] the court denied the motion for preliminary injunction because plaintiff failed to show a likelihood of success on the merits where the parties agreed that if the respondents did not breach the Protocol, then no preliminary injunction would be necessary and plaintiff was unable to show that the defendants violated the Protocol. In *Credit Suisse Securities (USA) LLC v. Lee*,[11] the court denied the motion for an injunction where there was insufficient evidence of a violation of the Protocol's terms and the court was "not persuaded that the respondents exhibited bad faith in violation of the 'spirit' of the Protocol."

In *A.G. Edwards & Sons, Inc. v. Martin*[12] the court found "[t]he Defendants have substantially complied with the Broker Protocol. Thus, the Plaintiff has not shown that there is a substantial likelihood that the plaintiff will prevail on the merits." The court made that finding even though the departing advisors admitted to inadvertently taking documents that contained additional information not allowed by the Protocol. However, the advisors "returned all documents containing the additional information" and plaintiff failed to show the advisors still had in their possession any information not allowed by the Protocol.[13]

Courts use the protocol to analyze claims other than breach of non-compete/non-solicit agreements. The court in *Smith Barney v. Burrow*[14] concluded "[plaintiff] fails to explain how the Trainee Agreement and other agreements nullify the Protocol…." The court found that "[g]iven the Protocol, [plaintiff] is hard pressed to convince this Court that information regarding clients whom [the advisors] serviced

[10] 477 F.Supp.2d 472, 477 (D. Conn. 2007).

[11] 2011 WL 6153108 at *8 (S. D. N. Y. Dec. 9, 2011).

[12] 2007 WL 4180943, *2 (N. D. Fla. Nov. 21, 2007).

[13] *Id.*

[14] 558 F.Supp.2d 1066 (E. D. Cal. 2008).

qualify as [plaintiff's] confidential trade secrets.[15] The court also found plaintiff failed to meaningfully to substantiate its unfair competition claims because "[plaintiff's] signing the Protocol indicates that it expected outgoing financial advisors to continue to service their clients and that such continuing service is not unfair competition."[16]

The court in *Smith Barney v. Griffin*[17] found that "by allowing its departing financial advisors to leave with this Client Information [allowed under the Protocol], [plaintiff] is effectively declaring that it does not consider this Client Information to be 'nonpublic personal information' under the federal Gramm-Leach-Bliley Act…. If Client Information is not fairly characterized as "nonpublic personal information," then presumably it can be fairly characterized as public personal information, and, if so characterized, it can hardly be viewed as confidential."[18]

2. Irreparable Harm.

Courts also apply the Protocol to analyze whether the party seeking a restraining order or inunction has suffered irreparable harm. Generally irreparable harm is caused by damage to good will and client relationships and the release of confidential client information which, once shared, cannot be "unshared."[19]

In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Brennan,* [20]the court found that plaintiff, as a signor of the Protocol, could not show irreparable harm even where the departing advisors joined a non-Protocol firm. The court found that "[plaintiff's] signature indicates that they understand the fluid nature of the industry; brokers routinely switch firms and take their client lists with them. By setting up such a procedure for departing brokers to take client lists, [plaintiff] tacitly accepts that such an occurrence does not cause irreparable harm." Moreover, "given the existence of the Protocol, it appears that [plaintiff] and industry peers are well aware of, and content with, the idea that brokers will leave and take client lists with them. Such an agreement significantly undercuts the notion that such behavior destroys customer goodwill."[21]

This reasoning was adopted by the court in *Smith Barney v. Griffin,*[22] which found "[i]f [the departing advisors'] solicitation of former clients truly posed a risk of substantial irreparable harm, one would not expect the Protocol to read, '[Financial advisors] that comply

[15] *Id*. at 1081.

[16] *Id*.

[17] 2008 WL 325269 at *7 (Mass. Sup. Ct. Jan. 23, 2008).

[18] *Id*.

[19] *UBS Financial Services, Inc. v. Christenson*, 2013 WL 2145703 at *6.

[20] 2007 WL 632904 at *2 (N.D. Ohio, Feb. 23, 2007).

[21] *Id*. at *3.

[22] 2008 WL 325269 at *7

with this protocol would be free to solicit customers that they serviced while at their former firms, but only after they have joined their new firms.'" This reasoning was also followed by the court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Baxter.*[23]

Courts in cases not involving the Protocol have also found an advisor's movement to a new firm did not cause the departing firm irreparable harm. In *Morgan Stanley Dean Witter, Inc. v. Frisby & Lovell,* [24] the court found damages were calculable because "the securities industry is highly regulated,… each individual transaction is monitored electronically,… every customer transfer ... is documented,…and "[e]very dollar earned in fees by Defendant ... doing business with those customers that [the plaintiff] considers its own can be traced precisely." In *Wachovia Sec., LLC v. Gates*,[25] the court found no irreparable harm and declined to issue an injunction because "the damage has been done: [the advisors] are now employed by another bank, and their customers are aware of that fact. Since injunctive relief addresses imminent injury, not harm that occurred in the past, issuing an injunction would not be appropriate."

Finally, in *Ameriprise Fin. Servs., Inc. v. Koenig*[26]the court, while recognizing that the plaintiff was a signatory to the Protocol and, therefore, presumably accepts the "fluid nature of the industry," nonetheless entered an injunction, but limited it to "return of confidential information taken in excess of what is permitted under the Protocol." The court found the fact that the Protocol did not allow disclosure of the information "suggests that it is to remain highly protected" and its use could put plaintiff at a competitive disadvantage "and result in loss of customer trust and goodwill which may not be quantifiable at the conclusion of the litigation." Thus, plaintiff showed absent injunctive relief it would suffer irreparable harm.[27]

3. Public Interest.

When considering the public interest in Protocol cases, courts focus on the effect an injunction will have on the clients of the departing advisor. In *Smith Barney v. Burrow*[28] the court found "the public interest is better served with open competition in the securities field and access to advisors of clients' choice. The balance of equities and public interest factors weigh in defendants' favor," warranting denial of a preliminary injunction to enjoin solicitation by defendant financial consultants of clients from a former employer. The court in *Wachovia Sec., LLC v. Gates* (a non-Protocol case) found that "the people whom [the advisors] served are free to maintain their

[23]2009 WL 960773, at *4-6 (D. Utah Apr. 8, 2009);

[24] 163 F.Supp.2d 1371, 1376 (N.D. Ga. 2001).

[25] 2008 WL 1803612, at *2-3 (E.D. Va. Apr. 21, 2008).

[26] 2012 WL 379940, at *7 (D .N.J. Feb. 6, 2012)

[27] *Id.*

[28] 558 F.Supp.2d 1066, 1083–84 (E.D. Cal. 2008).

relationships with those defendants, even if doing so means transferring their accounts to another financial institution. Granting the relief requested by the plaintiffs would restrict those customers' choices, and thus would not serve the public interest."[29]

Finally, in *UBS Financial Services, Inc. v. Christenson,*[30] the court attempted to balance the public has an interest in enforcing contracts, including covenants not to compete with the public interest in allowing consumers to choose the advisor with whom they would like to do business. The court balanced these competing interests by granting the preliminary injunction, but allowing Christenson to inform his former clients of his new address and employer.

VIOLATIONS OF THE PROTOCOL

While the Protocol provides a substantial benefit to a departing broker, it does not immunize the departing broker from all liability to his former firm. By its terms, the Protocol only absolves a departing broker from liability for conduct relating to "the RRs taking the information identified [in the Protocol] or the solicitation of the clients serviced by the RR at his or her prior firm." In other words, a departing broker could invoke the protections of 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 his/her former employer for other wrongful conduct.

Courts have held the Protocol does not protect a departing advisor who takes information not allowed by the Protocol. The court in *Morgan Stanley & Co. v. Choy*[31]granted a preliminary injunction prohibiting former employees of plaintiff from soliciting plaintiff's clients because immediately prior to their resignation from plaintiff, the defendants took physical files from the plaintiff's office and mailed the files to their clients along with cover notes requesting the clients keep the information for their next meeting. The files contained historical performance records for each client's accounts, but also contained plaintiff's operational material, such as contracts, authorization forms, and cancelled checks. The court found that "[t]he mailings to clients may not have violated the exact words of the Protocol, but they appear to have violated the spirit of the Protocol." The court based its conclusion on the facts that (1) the mailings contained information which a broker could not himself take under the Protocol, (2) the timing of the mailings (and one of the defendant's testimony that he would not have made the mailings if he had not planned to resign), (3) the mailings were not approved by compliance, and (4) the Protocol List given to plaintiff was intentionally formatted poorly and may have been incomplete.[32]

[29] 2008 WL 1803612, at *2-3 (E.D. Va. Apr. 21, 2008).

[30] 2013 WL 2145703 at *6 (D. Minn. May 15, 2013).

[31] 08 Civ. 00467 (D. Haw. 2008), October 29, 2008 Order at *9-11.

[32] *Id.* at *18-19.

Similarly, the court in *Ameriprise Fin. Servs., Inc. v. Koenig* found a departing advisor violated the Protocol when he forwarded protected client information for several clients, including financial plans prepared at his former firm, to his personal email address approximately one week before he attempted to resign, in addition to contacting three clients he serviced prior to resigning to "discuss important changes" to his practice.[33] However, the court in *Credit Suisse Securities (USA) LLC v. Lee*[34]found a departing advisor's actions did not violate the "spirit of the Protocol" where the departing advisors e-mailed electronic versions of performance reports to their clients shortly before they resigned where there was no suggestion that his former employer lacked equal access to the performance reports: "there surely is a difference between an empty filing cabinet that sends the former employer scrambling to recreate the missing documents and a handful of electronic reports to which the former employer has equal access."

CONCLUSION

The courts have relied on the Protocol to deny motions temporary and preliminary injunctive relief against departing advisors and their new firms. The acceptance of the Protocol by the courts and consenting parties is important. Failure to follow the Protocol may have serious consequences. For information on the Protocol or additional topics on the area, please contact the author or your Polsinelli attorney.

[33] 2012 WL 379940, at *4-5 (D. N.J. Feb. 6, 2012)

[34]2011 WL 6153108 at *6-7 (S. D. N. Y. Dec. 9, 2011)