



newsletter

Managing the Transition from One Broker-Dealer to Another

By Andrew J. Dorman and Brian P. Nally



INTRODUCTION
Over the past few years, there has been an uptick in registered representatives

moving broker-dealers. Some jump from big broker-dealer to big-broker dealer; others make the move to an independent broker-dealer. These moves have led to an increase in disputes between the former broker-dealer, on the one side, and the departing registered representative and new broker-dealer on the other. In this article, we discuss the Protocol for Broker-Dealer Recruiting, which provides guidelines for these types of moves, and important features of restrictive covenants

such as non-compete and non-solicitation agreements.

THE PROTOCOL FOR BROKER-DEALER RECRUITING

Adopted in August 2004, the Protocol for Broker Recruiting ("Protocol") was created to establish guidelines for how registered representatives could transition from one firm to another and avoid litigation. The Protocol is designed to protect client privacy by limiting the client information that registered representatives can take with them and restricting the information's use by the advisors and the hiring firm. The Protocol requires the departing representatives to deliver a written resignation letter to their broker-dealer

with a copy of the client information that the representatives plans to take, which must include the account numbers for the clients serviced. They may not, however, list or solicit clients serviced by other advisors in the branch office. As registered representatives begin their move, they may take name, address, phone number, e-mail address and account titles, but nothing else; they are not permitted to take the same information for clients serviced by other members of the firm. After arriving at the new broker-dealer, registered representatives are free to solicit customers serviced while at their former firm and work with such customers to transition accounts to their new firm. The importance of following these steps cannot

be emphasized enough. If registered representatives depart without following these steps, they run the risk of losing some of the protections afforded by the Protocol, such as the ability to solicit clients after joining their new firm, which could subject the registered representative and new broker-dealer to litigation.

WHAT HAPPENS WHEN THE PROTOCOL DOES NOT APPLY?

The Protocol only applies only when both the former and new firms are signatories, which means the Protocol will not govern all transitions. In these types of cases, non-compete or non-solicitation agreements will become the focal point in the transition. These contractual provisions may be used to bring a lawsuit against the registered representative and/or new broker-dealer, although they cannot be used to block a customer's request to transfer. Whether a non-compete or non-solicitation agreement is enforceable will be a matter of state law and will vary based on the facts and circumstances of each case.

Using Ohio law as an example, however, courts will enforce covenants to the extent that the restraints are reasonably necessary to protect the employer's legitimate business interests. In analyzing this issue, courts ask if the restraint (1) is required to protect the legitimate interests of the employer, (2) does not impose an undue hardship on the former employee, and (3) is not injurious to the public. Court also review a number of factors when assessing the reasonableness of a restrictive covenant, including the absence or presence of limitations as to time and space; whether the employee represents the sole contact with the customer; whether the employee is possessed with confidential information or trade secrets; whether the covenant seeks to eliminate competition which would be unfair to the employer or merely seeks to eliminate ordinary competition; whether the covenant seeks to stifle the inherent skill and experience of the employee; whether the covenant operates as a bar to the employee's sole means of support; whether the employee's talent

which the employer seeks to suppress was actually developed during the period of employment; and whether the forbidden employment is merely incidental to the main employment. If a court finds a non-compete agreement to be unreasonable, the court is empowered to reform the agreement so that it is reasonable.

CONCLUSION

Whether you are a broker-dealer or a registered representative, understanding the rules governing these types of transitions will help minimize issues and avoid litigation. First, understand if the Protocol applies—that is, understand if the former and new broker-dealers are signatories to the Protocol. If they are and the Protocol applies, be meticulous in following the Protocol and consider consulting legal counsel to advise you through the process. If the Protocol does not apply, understand what restrictive covenants may apply and consider consulting legal counsel to assess the enforceability of those covenants and how they could impact any transition.

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