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The Protocol For Broker Migration: Have Signatory Firms Effectively Conceded That Certain Client Information Is Not Confidential?

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In these times of economic uncertainty for the financial services industry, brokers and other financial advisors with client relationships are especially valuable. Even as the industry goes through a restructuring and contraction, offers are being extended to talent with pre-existing client relationships.

For many years, Wall Street firms have sought to impose restrictions on their financial advisors to prevent them from resigning to join competing firms, taking client lists, and then soliciting the clients they had serviced while at the prior firm. Typically, the firms did this by requiring their employees to sign restrictive covenant agreements containing confidentiality and non-solicitation provisions.

When a firm learned that its former employee had taken client information to a new firm or was soliciting its clients, the firm frequently sued and sought injunctive relief. The firm typically argued that all client information, including client lists, is confidential and that it would suffer irreparable harm if the departing financial advisor used any such information and/or solicited the firm's clients.

As the number of lawsuits arising out of broker migration escalated, courts increasingly found that the enforcement of confidentiality and non-solicitation agreements had the effect of punishing clients of the departing financial adviser – clients who may have relied upon the advice of the advisor for many years in deciding how to invest their life savings. Because of this, courts began to question whether the public was being seriously harmed when a broker's post-employment restrictions effectively prevented clients from having access to financial advisors of their choice. The lawsuits themselves became very expensive, protracted and disruptive to the firms and employees involved.

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In 2004, three Wall Street firms – Citigroup Global Markets, Inc. (Smith Barney), Merrill Lynch, Pierce Fenner & Smith Inc. and UBS Financial Services, Inc. – responded to these concerns by taking matters into their own hands, and entering into the Protocol for Broker Recruiting ("Protocol"). Under the Protocol, when a financial advisor leaves one signatory firm to join another signatory firm, the new employer and the departing broker will have no liability to the former firm for transferring certain client information to the new firm, or for soliciting certain clients that the departing broker serviced at the prior firm, if the departing broker follows the terms of the Protocol.

Over the past few years, dozens of other financial services firms have joined the Protocol. This growing list of Protocol "members" has led to a recent flurry of court decisions interpreting and applying the Protocol. This article discusses those decisions and their significance.

The Protocol's Content

The Protocol permits departing brokers to take with them to their new firm only certain information: specifically, the "client name, address, phone number, email address, and account title of the clients that they serviced while at the firm." The Protocol further provides that departing brokers must submit a written resignation to local branch management and include a copy of the client information they are taking with them, as well as the account numbers for the clients serviced by the departing broker. Under the express terms of the Protocol, brokers who comply with the Protocol are then "free to solicit customers that they serviced while at their former firms, but only after they have joined their new firms."

Significantly, the Protocol states that it applies only in cases when both prior and new employers are signatories to the Protocol. Several recent decisions, however, have cited a firm's status as a signatory to the Protocol as an indicator of the firm's changed attitude toward the transfer of certain types of client information and the solicitation of certain clients by a former broker, regardless of whether the broker's new firm is a signatory to the Protocol. The Protocol, therefore, now plays a central role in disputes beyond its stated scope.

Court Decisions Concerning The Protocol

Litigation associated with broker migration usually falls within one of three categories:

(1) A signatory firm sues a former employee who joined another signatory firm.

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(2) A signatory firm sues a former employee who joined a non-signatory firm.

(3) A non-signatory firm sues a former employee who joined either a signatory or a non-signatory firm.

A court's application of the Protocol in the first category of cases is expected because it falls within the Protocol's stated scope. In these cases, if the broker followed the Protocol, there should be no liability.

A court's application of the Protocol in the second or third categories, however, is noteworthy because the Protocol should have no relevance in those situations. Recent cases, however, suggest that it does have relevance when the plaintiff is a signatory, regardless of whether the broker's new firm is also a signatory.

Category One: Protocol Application In Cases Involving Signatory Firms

The recent case of *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Reidy* illustrates that courts will enforce the Protocol when both the prior and new firm are signatories. In *Reidy*, the U.S. District Court for the District of Connecticut refused to grant the preliminary injunction sought by Merrill Lynch, a signatory firm, against its former employees after they joined Morgan Stanley, another signatory firm. [1]

Because both Merrill Lynch and Morgan Stanley are signatories to the Protocol, the Court held that "if defendants did not breach the Protocol…then no liability can attach."[2]

Category Two: Protocol Application In Cases Brought By A Signatory Firm Against Brokers Joining A Non-Signatory Firm

Although, by its terms, the Protocol should only be relevant if both firms involved are signatories, courts have recently relied on the Protocol in cases where only the complaining firm is a signatory. For example, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Brennan*, three former employees of Merrill Lynch resigned from that firm to join Bear Stearns & Co.[3] As indicated above, Merrill Lynch is a signatory to the Protocol. Bear Stearns, however, is not.

Merrill Lynch sued the former employees, claiming that they breached various employment agreements by taking client contact information with them to Bear Stearns and then soliciting the clients they serviced while at Merrill Lynch. Merrill Lynch moved for a temporary restraining order on the ground that it would suffer irreparable harm in the absence of injunctive relief. The U.S. District Court for the District of Ohio denied Merrill Lynch's motion. While the Court acknowledged that it previously found such arguments of irreparable harm persuasive, "changed circumstances of the securities industry" – *i.e.*, the emergence of the Protocol – convinced the court that "such arguments no longer merit such weight."[4]

The court did not consider it important that Bear Stearns had not signed the Protocol, but it did consider it significant that Merrill Lynch had signed the Protocol. The Court held that by doing so, Merrill Lynch had effectively conceded that the transfer of client lists to a new firm, whether or not that new firm had signed the Protocol, did not give rise to irreparable harm.[5]

Earlier this year, several other courts followed the reasoning of the *Brennan* court.[6] In *Smith Barney v. Griffin*, for example, a broker resigned from Smith Barney, a signatory firm, to join a firm that had not signed the Protocol.[7] Smith Barney argued that the Protocol, therefore, should not be relevant to the courts' enforcement of the broker's restrictive covenant agreement with Smith Barney. The Superior Court of Massachusetts disagreed.

The court found that because Smith Barney permits brokers to take client contact information to dozens of competing "signatory financial institutions" under the Protocol, it cannot credibly contend in this case that it would suffer irreparable harm if a broker takes the same information to a non-signatory financial institution. The court found that by signing the Protocol, Smith Barney implicitly acknowledged that it does not consider the client information to be confidential.[8]

Category Three: Protocol Does Not Apply In Cases Brought By Non-Signatory Firms

At least one court recently held that the Protocol is irrelevant in disputes where the complaining firm had not signed the Protocol. In *Hilliard v. Clark*, a non-signatory firm, Hilliard-Lyons, moved for a preliminary injunction against brokers who had carefully complied with the Protocol, transferring only client names and contact information to a signatory firm.[9] Nonetheless, The U.S. District Court for the Western District of Michigan granted Hilliard-Lyons' motion to enjoin the brokers from using this client information to solicit clients that they obtained while working for Hilliard-Lyons. The court held that because Hilliard-Lyons had not signed the Protocol, "[n]othing in the record demonstrates Plaintiff's tacit acceptance that its brokers might leave, take information, and begin competing against Hilliard-Lyons."[10] The court rejected the argument that the Protocol "is evidence of the industry standard." Rather, it found that, as a non-signatory to the Protocol, Hilliard-Lyons never compromised its position that it would suffer irreparable harm unless the departing brokers were enjoined from breaching their confidentiality and non-solicitation agreements with Hilliard-Lyons. Thus, despite the departing brokers' compliance with the Protocol, the Court granted Hilliard's request for injunctive relief.[11]

Conclusion

Although there are still relatively few decisions concerning the Protocol, recent cases demonstrate that the Protocol may have significance beyond its original intent. In particular, courts have relied on the signatory status of the complaining firms in cases where departing brokers joined non-signatory firms. These courts have found that by signing the Protocol, a firm effectively recognizes that it does not consider certain client information confidential. Therefore, signatory status may preclude a firm from obtaining injunctive relief for brokers' transfer of client information to both signatory and non-signatory firms.

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[1] Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Reidy, *477 F. Supp. 2d 472, 474 (D. Conn. 2007).*

[2] Id. *at 474.*

[3] Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Brennan, *No. 1:07 CV 475, 2007 U.S. Dist. LEXIS 34501, at *2 (N.D. Ohio Feb. 23, 2007).*

[4] Id. *at *6-7.*

[5] Id. *at *7.*

[6] See Smith Barney Div. of Citigroup Global Mkts. v. Griffin, *No. 08-0022-BLS1, 2008 Mass. Super. LEXIS 44 (Mass. Super. Ct. Jan. 23, 2008), and* Smith Barney v. Burrow, *No. CV F 08-0373 LJO GSA, 2008 WL 2095739 (E.D. Cal. May 16, 2008).*

[7] Smith Barney v. Griffin, *2008 Mass. Super. LEXIS 44.*

[8] Id. *at *20.*

[9] Hilliard v. Clark, *No. 1:07-cv-811, 2007 U.S. Dist. LEXIS 64792 (W.D. Mich. Aug. 31, 2007).*

[10] Id. *at *18.*

[11] Id. *at *30-31.*