

## WHO'S NEWS

RBC Wealth Management has nabbed a \$2.3 million duo from US Trust/Bank of America. **Rhonda Smith** and **Lynn Syler** joined RBC's Gig Harbor, Wash., branch. They spent 11 years at US Trust and oversaw \$450 million in client assets.

Baird has hired **Karen Ogard** to join its Denver office. She comes from Wells Fargo where she generated over \$1 million on client assets of \$150 million. Ogard spent 26 years with AG Edwards/Wells Fargo.

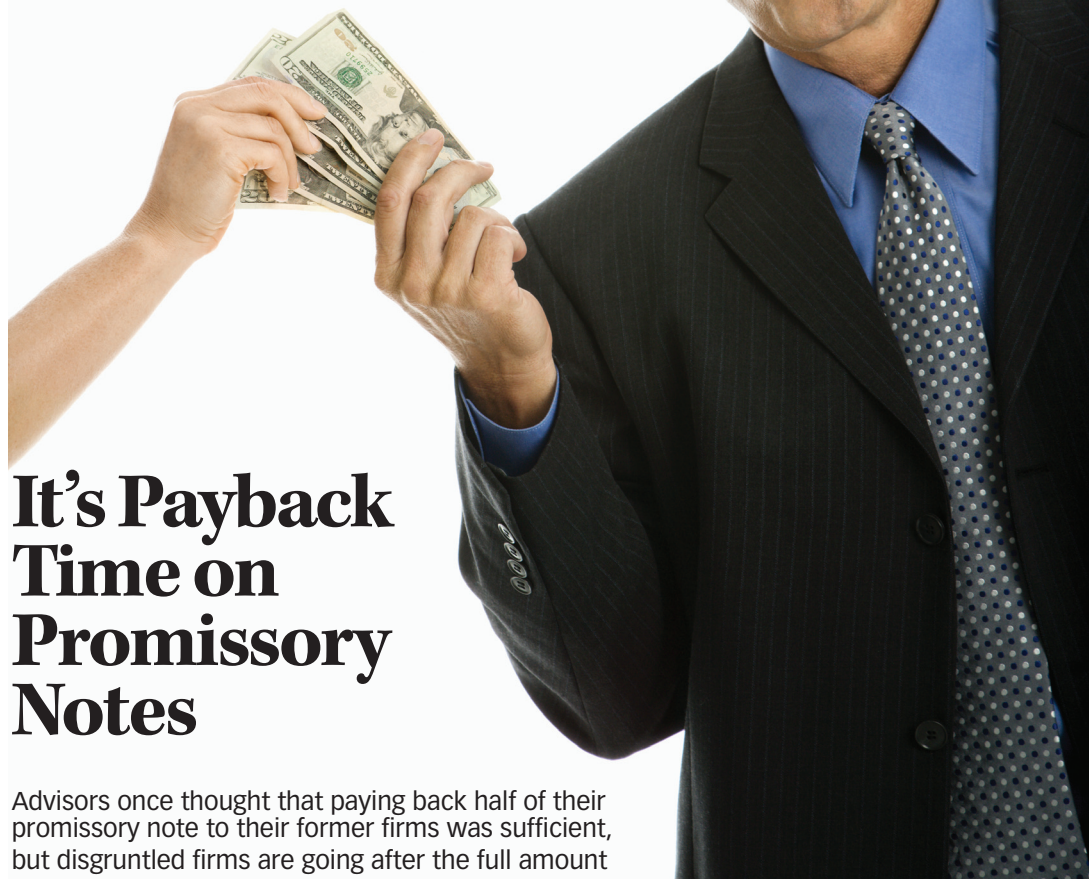
**Mike Dwyer** has joined RBC Wealth Management in Phoenix. He comes from Baird, where he oversaw \$205 million in client assets and generated \$1.7 million in fees and commissions.

Merrill Lynch has recruited **Robert Debeer**, **Russell May** and **Glenn Duphorne** to its Dallas office. The team joins from UBS, where they generated \$2.4 million on client assets of \$524 million.

**Ed Muhlenfeld** and **Rob Huish** have joined First Financial Equity Corp. in Scottsdale, Ariz. They come from Ameriprise where they generated over \$1 million in annual revenue.

The Penn Mutual Life Insurance Co. in Horsham, Pa., named **Thomas H. Harris** senior vice president of the Independence Financial Network. Harris recently served as SVP for Prudential Service Brokerage in Newark, N.J. **OWS**

## BY THE RULES



# It's Payback Time on Promissory Notes

Advisors once thought that paying back half of their promissory note to their former firms was sufficient, but disgruntled firms are going after the full amount

By Thomas Lewis

**A**ggressive recruiting for wirehouse firms was in full swing late last year and earlier this year, as thousands of unhappy advisors sought to jump ship from firms mired in financial trouble.

As part of the process, many hoped to recover some of their net worth by collecting one of the big recruitment packages on offer from a competitor.

But the firms have been fighting back against defecting advisors. Increasingly one of the most effective weapons in their arsenal is the enforcement of promissory notes.

These notes are usually included as part of a new recruit's package. The firm will give the advisor a certain percentage or multiplier of his trailing 12-month production in upfront cash with one catch: The advisor must repay the money if he doesn't stay with the firm for a specified period of time.

Over the past year, firms have been getting noticeably tougher in ensuring they collect the departing advisors' loans. Often times, financial advisors are under the misconception

that a member firm will accept a 50% repayment of a promissory note. In reality, member firms are aggressively pursuing payment of the entire principal amount—and then some.

Most promissory notes contain a provision permitting the firm to recoup all interest, costs and attorneys' fees spent in the collection of the promissory note, and many FINRA arbitration panels will enforce these payments as well.

Generally, advisors can't expect a lot of sympathy from FINRA when they've failed to repay a promissory note.

The arbitrators know most financial advisors will depart a firm, accept new employment at another firm, and receive a significant up-front bonus from their new employer.

And advisors shouldn't rely on any help from their new firm either. Most firms hiring a financial advisor will not defend or participate in any arbitration arising out of repayment of the prior employer's promissory note. Most firms support the industry position that a financial advisor must repay the money owed on a promissory note if the term of the promissory note is not satisfied.

### New Procedures

Given the rash of promissory note cases currently being filed with FINRA, the regulator has set in place some new procedures to speed up the hearing of these cases.

Under FINRA Rule 13806, which came into effect on Sept. 14 this year, a single public arbitrator will, on an expedited and simplified basis, adjudicate promissory note cases—if the only issue in the claim is the money owed on a promissory note. Previously, arbitration for the repayment of a promissory note took a slow track at FINRA, and required a firm to wait almost a year before collecting the amount owed.

Under the new rule, the parties choose a single public arbitrator from a roster of arbitrators approved to hear statutory discrimination claims. If the advisor does not file an answer to the firm's statement of claim, a simplified discovery procedure will be used. And, the single arbitrator will render an award based on the pleadings and other materials submitted by the parties.

If an answer is not filed, the advisor can expect a ruling in

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favor of the member firm for the full amount due from the advisor including principal, and potentially interest, costs and legal fees.

If the advisor files an answer to the statement of claim, but does not assert any other claims or counterclaims, a regular discovery procedure will apply. Regardless of the amount in controversy, the single arbitrator will schedule a hearing.

It's important to note that the new procedures are only for deciding a firm's claim that an advisor failed to repay a promissory note.

If the firm or the financial advisor makes any other claim, the case will be transferred to the traditional arbitration system. Under the traditional system, regular discovery procedures will apply and the number of arbitrators will be based on the amount of the counterclaim in dispute. If the advisor's counterclaim is for \$100,000 or less, a single arbitrator will be selected.

However, if the counterclaim is in excess of \$100,000, then a three-person panel comprised of one non-public arbitrator and two public arbitrators will be selected.

So the significance of an advisor filing a counterclaim or third-party claim is that the case is removed from expedited arbitration and will take the normal FINRA track.

### Possible Defenses

Unfortunately for advisors, there aren't many legitimate defenses available to a promissory note arbitration.

Often, a financial advisor will argue that they were not given the support, marketing or sales assistant coverage needed to be successful. These arguments are usually not persuasive to a FINRA Panel.

A promissory note is a contract between the firm and the advisor, and if the advisor leaves employment early, payment is due to the firm.

There are, however, some situations in which a legitimate defense to repayment of a promissory note can occur. For instance, if the financial advisor was either forced to quit or discharged from the firm, defenses might be available.

This has become more possible as some firms increasingly require achievement of certain revenue levels from the financial advisor.

If the financial advisor does not meet that revenue level, he or she may be asked to leave the firm. In that situation, a legitimate defense exists to the repayment of the promissory note.

Furthermore, if a financial advisor has a legitimate discrimination claim against the firm, many firms will not attempt to collect the promissory note, for fear of a counterclaim alleging discrimination.

### Remember the Protocol

Advisors also need to consider the impact of the Protocol for Broker Recruiting. The 2004 Protocol has been signed by all of the major wirehouses and allows departing advisors to take their clients' basic contact information with them. But, other details, such as account numbers and positions, must be left behind.

So what does this have to do with promissory notes? Several firms include language in their promissory notes requiring the repayment of the promissory note before the advisor is allowed to solicit accounts previously serviced at the prior firm. However, if both the prior firm and the new firm have signed the protocol, compliance with the protocol (which allows advisors to contact their clients once they have left their old firm) would trump the non-solicitation provision contained in the promissory note.

However, if *either* of the member firms is not a protocol member, the protocol will not apply. And, the non-solicitation provision contained in the promissory note can be enforced if the note is not repaid by the financial advisor.

The bottom line is that FINRA Rule 13806, which calls for expedited arbitration if the sole issue is collection of the note and there is no assumption of claims or counterclaims, is, in many ways, beneficial for member firms.

But, it's crucial to remember that any type of counterclaim or third-party claim filed by the advisor will negate the expedited arbitration. And, as a result, the case will move back into the traditional arbitration system. **OWS**

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