How Morgan Stanley's ex-broker lawsuits could backfire

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Following Morgan Stanley's exit from the Broker Protocol, the wirehouse has launched a wave of lawsuits that could set a precedent for how advisors handle transitions and shape the way firms approach recruiting.

In the process, some experts warn that Morgan Stanley's litigation campaign could inflict significant damage to the firm's reputation within the industry.

In the latest of these lawsuits, Morgan Stanley sought a temporary restraining order and preliminary injunction against the Family and Legacy Group, a team of eight advisors and associates in Farmington Hills, Michigan, that jumped ship to Raymond James earlier this month.

On Monday, Morgan agreed to drop its district court action and Judge Sean Cox ordered the case closed, sending the matter to FINRA arbitration.

That marked the end of "round one," says Bernard Fuhs, an attorney with the law firm Butzel Long who is representing the defendants and maintains that his clients handled their transition "the right way."

"Our hope is that cooler heads prevail," Fuhs says. "Our hope is frankly that they would just dismiss the action. I don't think it should have been filed in the first place."

(Image: Bloomberg News)

The case against the Family and Legacy Group marks at least the sixth such action that Morgan Stanley has brought against breakaway teams and advisors since it quit the Broker Protocol in early November.

A spokeswoman for Morgan Stanley declined to comment on the specific case, but did send these points by email:

- We made the decision to withdraw from the Protocol for Broker Recruiting, in part, because it became replete with opportunities for gamesmanship.
- With our exit from the Protocol, departing advisors are expected to comply with their legal and contractual obligations including restrictions on removing client-related information.
- Advisors who depart Morgan Stanley in a proper and lawful manner should have no concern about a lawsuit being brought against them.
- However, when departing advisors breach their agreements, remove confidential information or trade secrets including personal client information, or engage in other misconduct, they should expect that Morgan Stanley will take appropriate legal action to protect its rights and to protect the client's interests in preventing the misuse of their personal information.

The most recent action involved familiar accusations that the departing advisors took confidential client information and trade secrets that amounted to a violation of their employment agreement, and improperly solicited their clients to follow them to their new firm.

"They didn't do any of that stuff," Fuhs says of his clients.

In this case, a judge was sympathetic to that argument, but Morgan has won temporary restraining orders in other matters barring former employee advisors from contacting their clients, effectively shutting down their practices.

"If you get hit with a TRO and you have any delay in moving, your clients have no one to talk to," says Ross Intelisano, a partner at the New York law firm Rich, Intelisano & Katz.

"That's the risk you're taking," Intelisano says. "You can lose your business."

Assuming the Family and Legacy Group matter proceeds to FINRA arbitration, one of the key points that the defendants will likely argue is that their employment agreements were not binding, given that the advisors came to Morgan when it was a protocol firm. After many years of not enforcing those contracts under the protocol, which permitted exiting advisors to take basic client information such as names and phone numbers with them, Morgan is now trying to "just magically put them back into existence," Fuhs says.

"There's a whole issue here on whether these agreements are even enforceable," he says.

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In many ways, Morgan's litigation campaign fits with a longstanding tension on Wall Street about the relationship between broker-dealers and their advisors, and the tug of war over client accounts.

"It's a continuation of a generations-old strategy," says Bill Singer, a veteran securities attorney who runs the *Broke and Broker blog*. "It's the latest installment of Wall Street's ongoing skirmish of who owns the clients."

Singer places a heavy measure of blame for this dispute on FINRA, which he says has largely stayed on the sidelines instead of stepping in to impose a uniform code of conduct for the firms that it regulates.

"What I never understand is why we don't have rulemaking at FINRA that states that this is what you're allowed to take if you leave and this is what you can't take," he said.

A spokeswoman for FINRA did not immediately respond to questions about the organization's role in regulating broker transitions.

Morgan Stanley, UBS and Citigroup have each abandoned the Broker Protocol, but only Morgan has seen numerous advisor teams leave and then sued in response.

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Among recent career changes, Merrill Lynch lost brokers managing $2.2 billion to rival J.P. Morgan Securities.

Singer calls that strategy "counterproductive" and "short-sighted," questioning why anyone who is established in the industry would want to join up with a firm that is signaling that it will do everything it can to make it difficult for employee advisors to leave.

"You don't need to terrorize your former employees," he says. "At the end of the day, Morgan Stanley is going to destroy its reputation to veteran brokers."

Internally, the lawsuits are likely to produce a "long-term negative effect on the morale of the brokers at Morgan Stanley," as well as diminish the wirehouse's ability to attract talent from outside, Intelisano says.

"I think they are a test case," he says. "I think the other wirehouses are looking to see how it plays out, and also looking to see how it plays out in the long-term with recruiting."

UBS, the other major wirehouse to have exited the protocol, has not seen the same exodus of advisors that Morgan Stanley has. One advisor who left UBS after the firm quit the protocol did not face an immediate lawsuit.

In the meantime, Wells Fargo and Merrill Lynch have both indicated that they plan to stay with the protocol.

Nonetheless, Singer takes a dim view of the future of the accord. He says it is "dissolving" amid an existential crisis gripping the old-line "financial superstores" with business models built around offering clients integrated services from their brokerage, banking, insurance and lending units, among others.

That model contrasts sharply with the increasing competition from RIAs and independent broker-dealers, the emergence of robo advice and the ascendancy of low-cost ETFs and other types of funds.

"I think what we're seeing on Wall Street is a paroxysm that Wall Street is now beginning to get hit by the digital world," Singer says. "As a result, they're trying to cut costs, make it more difficult to lose clients and make it more onerous for registered people to leave. That to me is just a really stupid business plan. You're going to punch yourself out in the ring eventually."

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