SECURITIES LAW SERIES

Navigating Raiding Cases in the Securities Industry

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DISCLAIMER

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Introduction

Raiding, hiring groups of brokers from a competitor, happens frequently in the securities industry giving rise to complex disputes and damage claims. Whether your firm is the victim or the accused raiding entity, you will need to understand these basics:

- What is raiding in the securities industry?
- Which legal claims are asserted?
- How are the amounts of damages calculated?

Every circumstance has its own unique facts. As such, the information here should be considered an overview and you should consult a securities lawyer for the applicability in your situation.

What is Raiding in the Securities Industry?

An employee is generally free to decide whether he stays at or leaves his current employer. However, when multiple employees band together to join a competing firm, litigation often soon follows.

Raiding is a serious charge in which one company accuses another of intentionally trying to damage its business by poaching an office, business line or a team of significant producers. The stakes are high in raiding cases with claims for damages often running in the millions of dollars.

This e-book outlines important considerations for litigants who are starting a lawsuit for raiding or defending against a claim of raiding.

For brokerage firms in the securities industry, it can be difficult to discern the "line in the sand" between fair recruiting practices and recruiting by means of unfair competition (raiding).

Once litigation ensues, raiding claims can be difficult to settle because of, (1) disagreement in the securities industry regarding what constitutes a compensable "raid"; (2) lack of explained awards from arbitration panels when deciding raiding claims; (3) the absence of any generally acceptable methodology for calculating damages; and (4) the unique fact patterns of each raiding claim.

According to a recent American Bar Association article *Raiding in the Securities Industry: The Search for Consensus*, polling among conference participants found indicia of a raid if forty percent of the production of business unit were taken, or if the alleged raider's behavior showed "malice/predation" and/or "improper means".

The conference participants expressed differences on whether a one-person office could be raided, and how to treat satellite offices or offices in decline?

Legal Claims Commonly Asserted in Raiding Cases

Five primary legal claims are typical in raiding cases including Breach of Contract, Breach of Fiduciary Duty and Duty of Loyalty, Tortious Interference, Misappropriation of Trade Secrets or Confidential Information and Unfair Competition.

Let's look at the legal and factual basis for each of those claims.

Breach of Contract

Facts commonly alleged could include breach of post-employment restraints including restraints against competition or restraints against solicitation of customers or employees.

Breach of Fiduciary Duty and Duty of Loyalty

Facts commonly asserted would seek to establish the degree of planning and coordination between the departing employees and the hiring company.

Tortious Interference

Tortious interference is also known as intentional interference with a contractual relationship.

Tortious interference with contractual relations occurs when one person intentionally damages someone else's contractual or business relationships with a third party causing economic harm.

In other words, the competitor might intentionally encourage the targeted company's employees to breach their employment contract, non-competition or non-solicitation agreement, confidentiality agreement, or even contracts with customers and vendors.

Notable Case: *Front v. Khalil*, 103 A.D.3d 481, 483 (1st Dept. 2013)

Misappropriation of Trade Secret or Confidential Information

Uniform Trade Secret Act (UTSA) defines misappropriation as,

"*The acquisition of a trade secret of another with knowledge or reason to know that the trade secret was acquired by improper means… and the disclosure or use of a trade secret of another without express or implied consent.*"

The UTSA defines a trade secret as,

"*Information, including a formula, pattern, compilation, device, method, technique, or process*" that carries economic value to the owner by reasonably not making the trade secret known or available to the owner's competitors.

New York does not adopt UTSA. New York protects confidential information, which might not rise to the level of "trade secret."

Notable Case: *Ashland Mgmt. v. Janien*, 82 N.Y.2d 395, 604 N.Y.S.2d 912, 624 N.E.2d 1007 (1993)

Unfair Competition

An unfair competition claim goes hand-in-hand with any employee raid lawsuit. It is a broad tort in business coupled with bad faith.

In order to support unfair competition claims, the claimant must demonstrate three things:

1. Claimants and respondents are competitors; and
2. Respondent competed in bad faith; and
3. Claimant suffered damages due to respondent's bad faith competition.

Notable Case: Barbagallo v. Marcum LLP, 925 F.Supp.2d 275 (E.D.N.Y. 2013).

What Are the Likely Results of Raiding Claims?

A study in 2016 analyzed almost 100 arbitration awards concerning raiding disputes. The claimant was awarded damages about sixty percent of the time.

However, of the winning cases, the claimant was awarded at least

half of the requested damages only about twenty-five percent of the time.

The median award was $500,000.

Common Defense in Raiding Cases

The "Life Boat" defense may be viable if the Respondent can prove that:

1. The producers were planning on leaving the Claimant for honestly held, objectively verifiable and substantial reasons, and
2. The producers initiated communication with the hiring company and expressed an intention to seek new employment, and
3. The hiring company acted in good faith, and
4. the producers would have terminated their prior employment and accepted new employment whether or not hired by the respondent.

Calculation of Damages in Raiding Claims

Once a competitor Respondent's liability for raiding the Claimant's producers is demonstrated, the question then becomes: How should the Competitor Respondent fairly compensate the Claimant?

What Damages Can or Cannot Be Recovered from Raiding Claims?

Before looking at the detailed factors for estimating the damages in a raiding claim, these principles typically govern the big picture of what damages may or may not be recoverable.

Recoverable damages can include:

- Lost profits
- Compensation paid to producers during time period of breach of loyalty
- Loss of business value and/or goodwill
- Possible consultant fees, expert witness fees etc.
- Damages not routinely recovered can include:
- Punitive damages
- Attorneys' fees

How to Estimate the Claimant's Possible Award

Although in the securities industry, arbitration panels are the only forum for raiding claims, the panels are not required to, and usually do not articulate the reasons behind a finding of liability or how they come up with the amount of damages if any.

Below are compilations from various publications in terms of how to reasonably estimate the possible award to which the Claimant should be entitled.

Step 1: Avoided costs are subtracted from lost revenue in arriving at net profit lost. (sub sub title)

Avoided costs usually include producer's salaries and other variable costs associated with maintaining the producers who jumped ship.

Step 2: Separate loss of profits attributable to the raid from other reasons for the decline that might be unrelated to the raid. (sub sub title)

Seeking damages from a successful raiding case is not the right way to recover all losses that the Claimant incurred during the time of raiding. It is unreasonable to solely rely on the profitability before and after the raid because it can be affected by general economic environment or any other reasons than raiding.

Step 3: It is important to note that the Claimant has a duty to mitigate its damages. (sub sub title)

Mitigation of damages in this scenario means the claimant has to demonstrate that it has attempted reasonable efforts in replacing the lost producer. The qualified candidate to replace a lost producer might be hard to find, however, it does not mean that the Claimant is entitled to give up on mitigating its damages.

Step 4: Applying present value in calculation. (sub sub title)

Because the lost profit represents an estimate of future expected revenue from the date of the raid, the future value of accumulated yearly loss of revenues should be discounted to a present value as of the date of the raid to represent meaningful calculation.

Fortunately, there are well-designed financial tools for calculating present value.

Step 5: Both parties present calculation of damages, arbitration panel decides the final number. (sub sub title)

As the Respondent has the opportunity to also present its calculation of damages, a sound damage analysis is essential in persuading the arbitration panel. But be aware that the panel can disregard either party's calculation and come up with its own number.

A sound damage analysis requires the application of reasonable assumptions. Below are two common approaches reasonable assumptions can be based on in deciding the dollar amount of lost revenue:

1. Historical Approach. The historical approach uses the producers' previous record of production prior to the raid to estimate the amount of production lost resulting from the raid. In applying historical approach, it is important to decide how far back to go because the record should be far back enough to avoid transitory impact from the raid, yet recent enough to be meaningful.
2. Benchmark Approach. Benchmark approach uses the pro-

duction of similarly situated producers who stayed with the Claimant as a benchmark to decide the amount of lost production. Naturally, it is important to choose the appropriate benchmark for the approach to be meaningful. Usually, appropriate benchmark means producers who are within the same geographical and demographic area, and similar brokerage activities. One can also apply reputable third parties' calculation of benchmark as reliable source.

A Sampling of Recent FINRA Arbitrations

14-01797 Fulcrum Advisory Services, LLC, Fulcrum Securities, LLC v. Bloxom et al.

14-00897 David Lerner Associates, Inc. v. Kovac, et al.

15-02080 BMO Harris Financial Advisors, Inc. v. Moscicki et al.

15-01217 David A. Noyes & Company v. Falco et al.

ABOUT THE AUTHOR

Since he began practicing law in 1996, Robert Herskovits has represented securities industry participants in a variety of litigation, arbitration and enforcement actions, first as associate general counsel to an NYSE broker-dealer firm, and later as an attorney and partner at various law firms.

Rob is a certified arbitrator for FINRA, AAA, and the NFA, and has participated in an estimated 200 arbitration proceedings before FINRA.

At the end of 2011, Robert formed Herskovits PLLC to provide legal representation to broker-dealers, investment advisors, securities industry professionals, and investors in securities litigation, securities arbitration and securities industry regulatory defense for matters appearing before FINRA and other self-regulatory bodies, as well as before the SEC, state securities authorities, and state and federal courts. In addition to dealing with regulatory matters, Robert provides representation in employment, contract, and general commercial litigation for these same financial services clients.

The impetus for founding his own firm was Robert's recognition that securities and financial services industry clients were not always being well-served by some of the larger law firms, particularly with regard to billing inefficiencies. He recognized that, sometimes, their large size and broad practice structure actually hindered them from constructing the hands-on, personal relationships necessary to truly understand their client's priorities and goals in representative matters.

He formed Herskovits PLLC to fill a void in the marketplace by offering clients involved in the securities profession experienced legal services while still recognizing and appreciating the budgetary limitations imposed on these businesses by a weak economy and a constrained market.

Robert's insight is to provide a broad range of business-related services in a small-firm atmosphere, so that his clients do not have to deal with multiple firms or, alternatively, work with multiple attorneys at a single large firm who are unfamiliar with the particular concerns that securities industry participants face. Herskovits PLLC knows its clients, understands its clients' business, and provides its clients with offer cost-effective representation.

Robert is dedicated to providing legal expertise and advocacy that will empower his securities and financial services clients to operate their businesses and pursue their professions with as little disruption and cost as possible when faced with problems, whether they are customer or employee disputes, enforcement actions, or regulatory investigations.

Prior to forming Herskovits PLLC, Robert was a partner with Gusrae Kaplan Nusbaum PLLC, for more than five years.

Robert is the Co-Chair of the Committee for Securities and Exchanges of the New York County Lawyers' Association, and is admitted to practice in the States of New York and Mississippi and before various federal courts throughout the country, including the U.S. Supreme Court.