

N.A.S.D. AWARD

NASD Regulation, Inc. Office of Dispute Resolution

In the Matter of the Arbitration Between

Names of Claimants

J. C. Bradford & Co.
John R. Schwartz

98-00439 consolidated with
98-00451

Name of Respondent

Merrill Lynch, Pierce, Fenner & Smith, Inc.

REPRESENTATION

For Claimant J.C. Bradford & Co. ("Bradford"): Linda Gibbons Willis, Esq., Associate General Counsel, J.C. Bradford & Co., Nashville, Tennessee.

For Claimant John R. Schwartz ("Schwartz"): Hubert C. Lovein, Esq. of the law firm of Jones, Cork & Miller, Macon, Georgia.

For Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"): Thomas T. Loder, Esq. and Joseph Dougherty, Esq. of the law firm of Rubin & Associates, P.C., Paoli, Pennsylvania.

CASE INFORMATION

Statement of Claim filed: February 4, 1998.

Supplement to Statement of Claim of John R. Schwartz and Affirmative Defenses to Merrill Lynch's Statement of Claim filed: March 25, 1998.

Claimants' Request for Referral of Respondent for Disciplinary Proceedings filed: February 20, 1998.

Claimant Bradford's Submission Agreement signed: February 5, 1998.

Claimant Schwartz's Submission Agreement signed: February 5, 1998.

Letter response from Merrill Lynch to the request of John Schwartz for immediate interim injunctive relief dated February 10, 1998.

Answer of Merrill Lynch, Pierce, Fenner & Smith, Inc. to the Statement of Claim of Schwartz and Bradford and Counterclaims of Merrill Lynch filed: March 13, 1998.

Merrill Lynch's temporary Statement of Claim filed: February 5, 1998.

Respondent Merrill Lynch did not file an executed Submission Agreement.

Claimants' submission entitled "Why the Merrill Lynch Non-Solicitation Covenant is Invalid and Unenforceable Under Georgia Law" filed.

Memorandum of Merrill Lynch in Response to Claimants' Argument that Schwartz's Contract and Trade Secret Obligations are Not Valid Under Georgia Law filed.

HEARING INFORMATION

An injunctive relief hearing lasting two sessions was conducted with an arbitrator on February 13, 1998. The evidentiary hearing lasting four sessions was conducted on March 30 and 31, 1998 in Atlanta, Georgia.

CASE SUMMARY

This case arises out of the Claimant Mr. Schwartz's resignation from his employment as a registered representative with Respondent Merrill Lynch in January 1998 and Mr. Schwartz's commencement of employment with Claimant J.C. Bradford & Co., the facts and circumstances of that resignation and commencement of new employment and the legal obligations of the parties to each other. All parties have filed Statements of Claim, Answers and/or Counterclaims.

Claimants filed a Statement of Claim which anticipated actions Merrill Lynch would take and sought both a preliminary and permanent injunction against Merrill Lynch from taking such actions.

Respondent Merrill Lynch itself sought a preliminary injunction in Federal court and the next day, February 4, 1998, filed, via facsimile, a "temporary Statement of Claim" against Mr. Schwartz with the NASD. The Federal court issued a preliminary injunction on February 5, 1998, to be in effect until a final decision on the merits by an NASD arbitration panel. This court order was subsequently dissolved by a single arbitrator pursuant to the NASD Code of Arbitration Procedure ("Code") Rule 10335(d)(1). Merrill Lynch went back into court and a second order was issued on March 4, 1998 vacating the arbitrator's interim vacation of the court's preliminary injunction.

Merrill Lynch's "temporary Statement of Claim" alleged:

- 1. Breach of employment contract;*
- 2. Misappropriation and conversion of trade secrets and business property;*
- 3. Breach of fiduciary duty; and,*
- 4. Unfair competition.*

In its Answer and Counterclaims, Merrill Lynch alleged as to Mr. Schwartz and/or J.C. Bradford & Co. that their conduct constituted:

- 1. Breach of employment contract by Mr. Schwartz;*
- 2. Conversion and misappropriation of Merrill Lynch's trade secret customer lists by Mr. Schwartz and J.C. Bradford & Co. in violation of the contract with Mr. Schwartz and the Georgia Trade Secrets Act;*
- 3. Tortious and intentional interference by J.C. Bradford & Co. with the fiduciary and contractual relationships between Merrill Lynch and its employees;*
- 4. Tortious and intentional interference with the fiduciary and confidential relationships between Merrill Lynch and its customers by Mr. Schwartz and/or J.C. Bradford & Co.;*

5. Unfair competition by Mr. Schwartz and/or J.C. Bradford & Co.;
6. Conspiracy by Mr. Schwartz and J.C. Bradford & Co.;
7. Unjust enrichment by Mr. Schwartz and J.C. Bradford & Co.; and,
8. Violation of the Code Rule 10335(g) by Mr. Schwartz and J.C. Bradford & Co.

On March 25, 1998, Claimants filed a Supplement to Statement of Claim and Affirmative Defenses to Claim of Merrill Lynch. In its Claim Supplement, Claimants alleged:

1. False and misleading statements about Mr. Schwartz;
2. Intentional and tortious interference with Mr. Schwartz's business relationships with his clients;
3. Disregard, circumvention and, in general, abuse of NASD arbitration process;
4. Willful misconduct, malice, fraud, wantonness, oppression, or that entire want of care which would warrant punitive damages.

Its stated Affirmative Defenses were:

1. Contract unenforceable as a matter of law;
2. Information used by Mr. Schwartz for his initial announcement are not "trade secrets";
3. Promissory estoppel and quasi-new agreement;
4. Constructive discharge; and,
5. No damages to Merrill Lynch.

In addition to matters raised in their pleadings, at the hearing, J.C. Bradford & Co. sought a referral for NASD disciplinary action for alleged violation of the Code Rule 10106. Merrill Lynch denied any violation and both parties submitted materials they had previously filed with the NASD Regulation, Inc., Office of Dispute Resolution on this subject; Mr. Schwartz specified monetary damages of approximately \$45,000.00 in lost commission income which he sought as well as attorney's fees of \$14,053.00; and Merrill Lynch sought monetary damages as the Panel deemed appropriate.

RELIEF REQUESTED

Claimants requested immediate relief from the Federal District Court's preliminary injunction and further requested an award in their favor for compensatory damages in the amount of \$45,000.00 and punitive damages of an unspecified amount for lost commissions due to interference with Schwartz's business relationship with his customers, for wrongfully prosecuting Schwartz on a contract which is unenforceable and void as a matter of Georgia law and which had been waived, and for flagrant violation of the Code of Arbitration Procedure and its contractual obligations under the arbitration agreement. Claimants renewed their request for referral of Respondent for disciplinary proceedings.

Respondent requested a permanent injunction order pursuant to NASD Code Rule 10335(g) enjoining Claimants Schwartz and J.C. Bradford & Co. from (1) soliciting any account formerly serviced or learned by Schwartz at Merrill Lynch for the remaining four month duration of the non-solicitation clause contained within Schwartz's employment agreement, (2) from the use, disclosure and/or transmission of any information contained in Respondent's business records, and (3) from accepting business from any such customer Claimants had improperly solicited prior to the U.S. District Court's entry of the Preliminary Injunction Order on February 5, 1998. Respondent further requested compensatory damages, costs and forum fees for Claimants' pre-injunction breaches in an amount to be determined by the arbitration panel. Respondent also requested that Claimants' claims be dismissed in their entirety.

OTHER ISSUES CONSIDERED & DECIDED

The parties have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered. In either case, the parties have agreed to receive conformed copies of the Award while the originals remain on file with NASD Regulation, Inc.

At the arbitration hearing before the full panel on March 30, 1998, the Chairperson recused himself from the proposed panel of arbitrators and the parties each agreed to proceed before two arbitrators.

Respondent Merrill did not file with the NASD Regulation, Inc., Office of Dispute Resolution a properly executed submission to arbitration but is required to submit to arbitration pursuant to Rule 10301 of the Code and having answered the claim, appeared and testified at the hearing is bound by the determination of the arbitration panel on all issues submitted.

FINDINGS AND AWARD

Except as provided below, the Arbitrators dismiss the alleged causes of action enumerated in Merrill Lynch's Temporary Statement of Claim and Answer and Counterclaims. The Arbitrators dismiss the alleged causes of action enumerated in J.C. Bradford & Co.'s and Mr. Schwartz's Statement of Claim and Supplement to Statement of Claim. The aforementioned dismissals relate only to a ruling thereon by this Panel as to matters which constitute private rights of action and do not preclude the possibility of a referral of the allegations by both sides of violations of the NASD's Code of Arbitration Procedure to the NASD for a disciplinary investigation where the Panel has reason to believe they may constitute a violation of the NASD's rules.

The Arbitrators specifically find that as it pertains to this case only based on the particular facts and circumstances of this case, the non-solicitation clause in Mr. Schwartz's employment contract with Merrill Lynch is void and unenforceable as a matter of Georgia law after applying all of the factors and tests enumerated in *W.R. Grace & Co. v. Mays*, 262 Ga. 464 (Ga. Supreme Ct. 1992). The Arbitrators also find, as it pertains to this case only based on the particular facts and circumstances of this case, after considering applicable law, that the confidentiality clause in Mr. Schwartz's employment contract with Merrill Lynch is void and unenforceable as a matter of Georgia law. Finally, as it pertains to this case only based on the particular facts and circumstances of this case, after considering applicable law, the Arbitrators find that the Georgia Trade Secrets Act was violated by J. C. Bradford & Co. and Mr. Schwartz. Although the list was created by Mr. Schwartz, the information was derived directly from Mr. Schwartz's holding pages which are a trade secret of Merrill Lynch and the Arbitrators believe it contains information which was not generally known to and not readily ascertainable by proper means to a competitor and it was subject to a reasonable, but not perfect, system to maintain its security. As to J. C. Bradford & Co., the Arbitrators find that while it did not use improper means to obtain the customer list, it did misappropriate it, albeit not willfully or with malice. As to Mr. Schwartz, the arbitrators find that while he used improper means to obtain and transmit the customer list and did, misappropriate it, he in good faith did not believe there was any contractual or statutory prohibition against doing so and, therefore, his actions were not wilful or malicious. Regardless, damages are appropriate.

After considering the pleadings, the testimony and the evidence presented at the hearing, the undersigned arbitrators have decided in full and final resolution of the issues submitted for determination as follows:

The court's preliminary injunction which has been in effect is by its own terms automatically dissolved upon the issuance of this final decision in arbitration, and accordingly it is not necessary for this Panel to formally do so.

For the period from January 31, 1998 through the date of this decision, J.C. Bradford & Co. and Mr. Schwartz shall, jointly and severally, pay damages to Merrill Lynch in the amount of \$20,441.00. However, except as provided below, all the parties may immediately freely compete for all customers. All of the accounts of Mr. Schwartz which had previously been customers of his while at Merrill Lynch and which may already have been transferred to J.C. Bradford & Co. or are pending to be processed, and those which subsequently hereto are submitted for processing, through the ACATS system to J.C. Bradford & Co., may, for the period of time from the date of this decision through and including August 1, 1998, be received and serviced by J.C. Bradford & Co. and Mr. Schwartz, but two-thirds of all gross commissions earned thereon during that period of time (as defined by trade date) shall be promptly (i.e. within 30 calendar days of each transaction) remitted by J.C. Bradford & Co. to Merrill Lynch. All such account transfer applications shall be processed promptly as provided by applicable NASD rules and all parties shall cooperate in that process. Further, J.C. Bradford & Co. shall provide Merrill Lynch with a duplicate confirmation of each transaction at the same time it is provided to the customer. After August 1, 1998, all parties may retain commissions as they would in the normal course of business, except for any continuing obligation of J.C. Bradford & Co to transmit to Merrill Lynch gross commissions generated on or before August 1, 1998. Each party shall pay its own attorneys' fees and costs of litigation.

FORUM FEES

Pursuant to Rule 10205(c) of the Code of Arbitration Procedure, forum fees in the sum of \$3,000.00 (injunctive relief hearing two sessions \$600.00 plus four sessions x \$600.00) are assessed as follows:

Bradford and Schwartz are assessed, jointly and severally, the sum of \$1,500.00 less the \$600.00 on deposit in partial satisfaction thereof leaving a balance due in the sum of \$900.00.

Merrill Lynch is assessed the sum of \$1,500.00.

Merrill Lynch is assessed the sums of \$500.00 and \$1,200.00 representing the outstanding claim filing fee and member surcharge in NASD Arbitration Number 98-00451. In addition, Merrill Lynch is assessed the sum of \$500.00 representing the outstanding claim filing fee in NASD Arbitration Number 98-00439.

Fees are payable to the NASD Regulation, Inc., Office of Dispute Resolution.

Concurring Arbitrators' Signatures

Name

Public/Industry

/s/

Industry

Marshall H. Lichtenstein, Esq.

/s/

Public

A. Duncan McFarlane

Date of Decision: April 8, 1998