Registered Rep. The Source for Investment Professionals

UNBREAKABLE PROMISES

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Question:

On March 2, 2001, my partner and I left our firm for a national wirehouse where I was promised in writing that I would be the manager of a satellite office to be built in the suburbs. I was also promised:

- satellite manager pay;
- a 35 percent flat-rate payout on the accounts of 25 clients;
- a payout on transactions in my own account; and
- the ability to do low-priced arbitrage situations, in which I specialize.

Of these promises, I was only granted the satellite manager's pay, and then just for three years. The wirehouse used the 2001-2003 bear market as defense for not building the new office.

My partner and I left in October 2004 so I could take a manager's job with the suburban office of a regional firm. We had a 60-month promissory note from the wirehouse, which claims that since we left after 42 months, and not on the anniversary of the note signing (March 2), we lost six months of forgiveness on our loans; they want us to pay back 24 months of the note instead of the 18 months that were left when we departed. This amount was significant — around $12,000 per month.

In a recent arbitration, we alleged damage (fraud, failure to compensate, breach of contract of approximately $520,000). They responded that we owed approximately $500,000 for the time left on the note (their interpretation), attorney fees, slander, etc.

The three-judge arbitration panel awarded us a token amount (under $50,000) and ruled we owed $291,000 on the promissory note, plus 10 percent interest with no credit for the aforementioned six months.

Isn't it standard in the industry to prorate notes over the entire period employed? Do we have any recourse?

Answer:

Your question focuses on two primary concerns of most registered reps: will my outstanding promissory note be pro-rated if I leave the firm before the term of the note is satisfied and, is there any recourse after an unfavorable arbitration award?

Not knowing what jurisdiction you are in or where the arbitration award was rendered, the answer provided here will use New York law for reference. The short answer to your question is yes, there is recourse after an unfavorable arbitration award. However,

the practical reality is that arbitration awards are binding and the ability to vacate is severely limited to very narrow circumstances.

Most states have procedural rules governing arbitration. In New York, Article 75 of the Civil Practice Law and Rules (CPLR) provides that a party to an arbitration may make an application [to the court] to vacate or modify an award within 90 days after delivery of the award to a party to the arbitration. Assuming that you are still within the statutory time for petitioning to vacate the award, you must consider the available grounds for vacating the award.

The grounds that provide the basis for a petition to vacate are narrowly defined and often difficult to prove. Under New York State Law, the following are grounds for vacating an arbitration award:

- corruption, fraud or misconduct in procuring the award,
- partiality of an arbitrator, or
- an arbitrator exceeding his authority [the Federal Arbitration Act provides for similar grounds].

One difficulty in vacating an arbitration award lies in the fact that most awards provide very little, if any, explanation of legal reasoning by the arbitration panel. It's also rare that parties to an arbitration will have been willing to bear the expense of having a court reporter in attendance. This means there is often no written transcript of the hearings. Without detailed awards and transcripts of the proceedings, the grounds cited above are extremely difficult to prove.

There is a fourth basis for vacating an arbitration award. In 1953, the U.S. Supreme Court in *Wilko v. Swan* introduced the doctrine of "manifest disregard of the law" as grounds for vacating an arbitration award. The doctrine does not apply if the arbitration panel simply misapplies the law or makes a decision that is in contradiction with the established law. Rather, a showing must be made that the arbitrators were made aware of a law that is well defined, explicit and clearly applicable to the case, and either refused to apply it or ignored its existence.

Regarding your question as to whether proration on a promissory note is "standard in the industry," the answer is not always. A promissory note is a contract between two parties, generally a broker and a member firm, in which one party "lends" the other money in exchange for a specified term of employment. Generally the note provides for repayment with an annual "forgiveness" of such payments for each full year of completed employment. While I have not seen the promissory note in your case, all the ones that I have reviewed do not contain any language regarding proration of the forgiveness if the broker leaves prior to an anniversary date. Although member firms have generally applied the doctrine of proration, more recently these firms are taking a hard line in demanding repayment — perhaps as a result of higher broker turnover.

Recently, my partner and I represented a broker in an arbitration in which his former firm was seeking repayment in full for the entire outstanding term of a promissory

note. During cross examination, the branch manager admitted that, in some cases, his firm had prorated an outstanding promissory note. Here, however, the firm referred to the terms of the contract [that is the promissory note] and told the panel that they were not willing to prorate the amount due. The panel awarded the firm the entire amount outstanding, plus interest. This should be taken as a cautionary tale by registered reps: Proration is not automatic and is dependent on the goodwill and largess of the former firm.

Finally, although you did not ask this question, you and your partner are now subject to an arbitral award. Section 10330(h) of the NASD Code of Arbitration Procedure states: All monetary awards shall be paid within 30 days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction. An award shall bear interest from the date of the award: (1) if not paid within 30 days of receipt, (2) if the award is the subject of a motion to vacate which is denied or (3) as specified by the arbitrator(s) in the award. Interest shall be assessed at the legal rate, if any, then prevailing in the state where the award was rendered, or at a rate set by the arbitrator(s). Furthermore, failure to comply with an arbitration award can result in a suspension or cancellation of membership or a suspension or bar from associating with any member.

Time is of the essence in your case, and you should consult with an attorney as soon as possible.

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