Non-Compete Obligations of Departing Star Partners and the Right of Clients to Their Continued Services

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The interests of advisers and their clients may conflict in unexpected ways. One such situation arises when the adviser's partners or managers (portfolio managers) sign a non-compete agreement with the adviser and later, when they leave, are sought after by clients who wish to continue the relationship. The case is clear if the departing portfolio manager solicits the clients of the adviser in violation of its non-compete undertaking. The case is less clear when the clients wish to follow the departing portfolio manager and press to engage her in violation of the non-compete undertaking. The conflict here is between the adviser's right to protect itself against unfair competition by disloyal portfolio managers and to enforce its rights against breach of contract by portfolio managers, and the right of clients to have a portfolio manager of their choice.

The clients' right requires some elaboration. Manager-client relationships are fiduciary relationships based on trust and confidence. If clients for any reason wish to terminate the relationships, the assumption is that their trust and confidence in the portfolio managers have weakened. Therefore, clients should be allowed to sever the relationships on short notice and without penalty. The Investment Company Act of 1940 (1940 Act) provides explicitly that the advisory contract should provide for termination of the relationship upon a notice of sixty days without penalty. Most advisory contracts have adopted a thirty-day notice, or termination without notice.

The position of dominance between advisers and clients shifts significantly after the establishment of the relationship. Advisers court clients; clients have choices and therefore bargaining power. That is so before the advisory contract is signed. Once the contract is signed, however, and once the assets of the client are transferred to the adviser, the bargaining power shifts dramatically. The client is in the adviser's hands, regardless of the terms of the agreement. This bargaining power shift is not the same for all advisers, and depends on the situation. If the client retains the function of executing the portfolio transactions and capability of day-to-day operations of the portfolio, an adviser serves essentially as a consultant -- an independent contractor -- who is close to a professional employee. Such an adviser has far weaker bargaining power compared to an adviser to whom the entire operation of the portfolio has been transferred to a competitor. In the latter situation a client

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[1] *See* Investment Company Act of 1940 § 15(a)(3), 15 U.S.C. § 80a-15(a)(3) (1994) (stating "that [the contract] may be terminated at any time . . . on not more than sixty days' written notice to the investment adviser").

[2] *See* CLIFFORD E. KIRSCH, INVESTMENT ADVISER REGULATION § 7:8 (1997), *available in* LEXIS, PLI Library, Allpli File (suggesting that advisory contract spell out terms with respect to termination, e.g., "Either party may terminate this agreement upon 30 days' written notice to the other party.").

who wishes to terminate the relationship needs the terminated adviser to help transition the operations of the portfolio to another adviser or to the client. If the client does not have the means to manage the portfolio and has only a skeleton part-time staff to oversee the adviser, termination depends on the full cooperation of the terminated adviser in transferring the operations to a competitor. That is awkward in the best of cases, and may even be impossible without enforcement in other cases. One story demonstrates the legal questions that this situation raises.

Frank Russell Co. v. Wellington Management Co.

The story is well told in *Frank Russell Co. v. Wellington Management Co.* It begins when Arnold Schneider (The Manager) joined Wellington Management Company (The Adviser) in 1983. When he became a partner, The Manager signed a non-compete agreement with The Adviser. When he left in 1996, however, The Manager continued to serve some of The Adviser's existing clients, whom he had served as partner. Being a stellar performer, the clients sought The Manager's service. These clients included Frank Russell Co. (Russell) and RJR Nabisco (RJR).

After Russell cancelled its contract with The Adviser and immediately moved its assets to The Manager, The Adviser brought suit in a Massachusetts court against The Manager for an injunction enforcing the non-compete agreement. The court upheld the five-year ban on doing business with The Adviser's clients (striking down other provisions of the agreement as being in restraint of trade). Russell filed an amicus brief and was well aware of the proceedings.

Three weeks before the effective date of the injunction, Russell brought action in the Eastern District of Pennsylvania, seeking to enjoin The Adviser from enforcing the non-compete agreement. The Adviser sought a declaratory judgment against RJR in Massachusetts, asking that the injunction be declared enforceable. The District Court enjoined The Adviser from enforcing the petition. On appeal from that denial the court of appeals reversed. Russell's arguments were that the enforcement of the injunction would be a breach of its fiduciary duties to Russell, and that when it signed Russell as a client, The Adviser should have informed Russell of the non-compete agreement. The Appeals court found no authority in state law for these propositions, especially the duty to disclose the non-compete agreement; it found no implied private right of action for

[3] 154 F.3d 97 (3d Cir. 1998) [hereinafter *Russell* II].

[4] *See* McFarland v. Schneider, No. 96-7097, 1998 Mass. Super. LEXIS 711, at *165 (Super. Ct. Feb. 17, 1998).

[5] *See* Frank Russell Co. v. Wellington Mgmt. Co., No. 98-1703, 1998 U.S. Dist. LEXIS 5520, at *3 (E.D. Pa. Apr. 13, 1998), *rev'd*, 154 F.3d 97 (3d Cir. 1998) [hereinafter *Russell* I].

[6] *See* Wellington Mgmt. Co. v. RJR Nabisco, Inc., No. 98-10916 (D. Mass. filed May 5, 1998), *cited in Russell* II, at 100-01.

[7] *See Russell* I, at *6-7.

damages under the Advisers Act, and no cause of action under ERISA. The court distinguished between those facts which the client needs to know and those facts which constitute internal business arrangements of The Adviser, and determined that the non-compete agreement related to the internal business of The Adviser. To be sure, if the client had asked about the existence of such an agreement a truthful answer was required under contract law, but not under fiduciary law. In sum, the court refused to create a new client right of action absent authority to that effect.

Wellington Management Co. v. RJR Nabisco, Inc.

The other client whom The Manager continued to serve was RJR. The Adviser entered into an advisory contract with RJR to manage a portion of RJR's large pension fund. Unlike the Russell contract, RJR's contract contained a provision that required Wellington to transfer RJR's portfolio upon RJR's termination of the contract (by 30 days notice) to whomever RJR would direct. Wellington did not disclose to RJR the existence of the non-compete provisions in the agreement between Wellington and The Manager. After Wellington sued The Manager and obtained an injunction prohibiting The Manager from servicing Wellington's clients for five years, as provided in the contract, Wellington sued RJR seeking to enforce its injunction.

RJR counter-claimed seeking damages for breach of contract. RJR argued that Wellington's actions to deprive RJR of The Manager's services resulted in significant damage to RJR. RJR argued that another portfolio manager, who managed an identical portfolio to that of the Wellington Manager, had performed far worse. Therefore, RJR sought damages measured by the difference in performance between the two portfolio managers. On a motion to dismiss, the court followed the holding in *Russell* and dismissed the claims based on the same causes of action.[13] However, the court distinguished this case on the factual grounds that RJR's contract contained an express provision requiring Wellington, upon termination, to transfer the portfolio "as directed" by RJR. Because Wellington transferred the portfolio to RJR rather than to the portfolio manager of its choice, and in fact precluded RJR by its actions and injunction from using the portfolio manager of RJR's choice, the court allowed RJR's claim on breach of contract to continue.

The Advisory Contract Issues

This case then raised questions of contract interpretation. First, should the contract between a client and an adviser be interpreted literally, or is there a "vagueness door" through which evidence of the parties' intentions can be proven? Second, what is the meaning of "transfer of a portfolio"? Third, what is the meaning of "as directed"? Fourth, how can damages be shown in this case or similar cases? Finally, outside the four corners of this decision, the larger question is, how should the conflict between the adviser's rights against a portfolio manager and the client's rights to the portfolio

[8] *See Russell* II, at 106 (finding "a weak . . . likelihood of success" on merits).

[9] *See id.* at 103-04 (analyzing Russell's arguments). Presumably a new manager would require the sale of the whole portfolio to avoid responsibility for the performance of the existing portfolio, and that sale would involve significant taxation.

[10] No. 98-10916 (D. Mass. filed May 5, 1998).

[11] *See* McFarland v. Schneider, No. 96-7097, 1998 Mass. Super. LEXIS 711, at *165 (Super. Ct. Feb. 17, 1998).

manager's services be resolved? In this connection, can we draw analogies from similar issues that arise in the context of law firms, their partners and their clients?

Even though the case did not go to trial because the parties settled, one can speculate as to the answers to the above questions. To reach the main interesting issues in this case, I will assume that the contract is vague under contract law. Second, I will assume that industry practice governs the interpretation of such a contract. This practice takes into consideration the policies of the Securities and Exchange Commission that would not allow advisers to impose an onerous condition or a limitation that has a chilling effect on the client's freedom of contract termination.

The next question is the meaning of "transfer of a portfolio." Wellington argued that because it explicitly contracted not to have custody of the portfolio, it had no portfolio to transfer. It interpreted the term "portfolio" literally to mean the assets under custody. Therefore, if the assets were in the hands of a custodian, as they were, and the custodian remains the same institution, Wellington has nothing to transfer. The weakness of this argument is that the parties agreed that Wellington would not have custody of the portfolio. Therefore the provision requiring Wellington to transfer the portfolio is rendered meaningless and superfluous. A rule of interpretation does not favor such an outcome if another interpretation would give the words a clear meaning.

Alternatively, Wellington argued that it did whatever was necessary to transfer the portfolio. It passed to RJR all the necessary documents to enable someone else to continue managing the portfolio. The problem with this interpretation was twofold. First, shortly after the transfer Wellington brought suit to undo the transfer and prevent the transferee (The Manager) from managing the portfolio. Second, the provision is far more meaningful than it appeared in this case because the transfer was easier in comparison to other cases. This is because the person who managed the portfolio under the Wellington contract was The Manager who left Wellington. It would have been far more complex to transfer the functions of management to someone else.

Wellington further argued that its function under the advisory contract was not that of an operational portfolio manager to whom all operations of the portfolio were "outsourced," but rather that of a consultant-employee who merely gave discretionary investment advice. However, in light of the skeleton staff of RJR dealing with its pension funds, it is clear that if Wellington transferred its functions to RJR, the RJR staff could not manage the portfolio. Someone had to perform the functions that Wellington had performed through its portfolio manager and its other facilities.

To be sure, there are pension funds that outsource fewer operational functions than investment companies with external portfolio managers, such as Fidelity. Nonetheless, the issue in any particular case is the importance and weight of the transfer that must occur for there to be a smooth continued operation of the fund in a transitional mode. It is clear that a break in the operation and management of the pension fund can result in significant damage even if the fund does not engage in trading. If part of the portfolio is devoted to active trading, then the damage from a break in the operation can indeed be substantial.

[12] *See Wellington*, No. 98-10916 (D. Mass. filed May 5, 1998).

[13] *See id*.

What is the meaning of "as directed"?

May a terminated adviser transfer the management of the portfolio to anyone as directed except to a portfolio manager whom the terminated adviser can legally prevent from serving a particular client? If the contract provides unambiguously that the transfer should be effected as directed, may the adviser, after the transfer, immediately block the continued service by seeking a court order? Does seeking that court order constitute a breach of the adviser's contractual obligation?

The last question can be answered first, because the judge hearing the case seemed to believe that a transfer, which is followed closely by legal roadblocks raised by the transferor, is less than the transfer envisioned in this case.

Suggested Guidelines

This was a case of first impression because rarely do advisers or any other fiduciaries sue their clients (except for payment of fees). The paucity of cases against clients suggests that market actors do not consider it wise to take such a step. A reputation for suing clients does not endear an adviser to clients and potential clients. It may also be the case that clients rarely insist on following a departing portfolio manager when they find other portfolio managers of the adviser satisfactory and when they have a strong bond with the adviser. Therefore, cases like the one discussed are unusual. However, apart from the wisdom of such a suit, the question remains whether the rights of the adviser and those of the client fully conflict, and under what circumstances one or the other should prevail.

The issues in such a case must be resolved by evaluating numerous factors. A number of guiding principles may be helpful. First, the easiest case is if the portfolio manager solicits the clients rather than the other way around. There is no conflict in this case and the adviser should win against the portfolio manager. It is doubtful whether clients will be involved at all.

Second, even if it seems that the clients solicit the portfolio manager, the adviser may still win. An objective test can be made by measuring the performance of a portfolio manager in comparison to other managers with similar portfolios. In this case it seems that the portfolio manager is "fungible." The question will focus on whether the quality of the portfolio manager's services is unique and whether the portfolio manager's performance is fungible. In today's environment and especially in the area of financial markets, the trust and confidence that clients bestow on their portfolio managers need not be personal. Clients may not know the portfolio managers personally nor have exchanged words with them. Trust and confidence may be impersonal within the boundaries of the services that the portfolio managers perform for their clients. Even so, trust and confidence must exist between the portfolio manager and their clients. In contrast, there are services which clients accept from anyone who is chosen by the trusted portfolio manager. These service providers may be changed, sometimes without the clients' consent or even knowledge. Hence, we must establish the clients' preferences as to the choice of the portfolio managers or other service providers. These choices may determine whether the adviser or the portfolio manager wins. In such situations, the client should always win (either by lack of care or by getting what he cares about).

Furthermore, clients may seek the portfolio manager's services, not because they strongly prefer that portfolio manager but because of other extraneous (e.g., personal) reasons. Arguably, in the merits. This argument, however, may be hard to prove. The rationales are similar to the rationales for efficient breach, but in the reverse. There is no reason not to enforce a non-compete condition, which the portfolio manager signed voluntarily, and to ignore the courts' edict of injunction if the client is not harmed by the exchange of portfolio managers.

The Nature of an Advisory Contract

Unlike the sale of widgets (and the basis for efficient breach), the sale of services, and especially advisory services, involves confidence and trust, which is generally less fungible. Rather, the confidence and trust is unique to the particular relationship of the service provider and the client. In such a case, it seems that the adviser should lose and the client should continue to enjoy the services of the portfolio manager of his choice. The manager-client relationship is a personal trusting relationship. The custom and usage against which the term "as directed" is understood involves the trusting aspect of the manager-client relationship.

The nature of the relationship provides the term "as directed" a meaning that the industry and regulators adopt and understand. Investment management contracts are considered personal contracts in which confidence is reposed in the portfolio manager by the client.[14] Such contracts will not be specifically enforced.[15] Also, an interpretation of an investment management contract that limits the clients' freedom and ability to choose any other portfolio manager is detrimental to our system generally and to clients in particular. Such an interpretation conflicts with the public policy of encouraging competition among portfolio managers.[16] It is not surprising that research has not uncov-

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[14] *See* Robert D. Brown Inv. Counsel, Inc., SEC No-Action Letter, 1984 SEC No-Act. LEXIS 2661, at *3 (July 19, 1984) (defining "investment supervisory services" as "the giving of continuous advice . . . on the basis of the individual need of each client."). The SEC staff notes specifically that:

> For an adviser to provide investment supervisory services, there must be effective communication between a client and the adviser; the client informing the adviser of his needs, and the adviser providing the client with advice based on these needs. If the client does not continue to have confidence in the adviser and is unable to communicate effectively with him or rely on the adviser's advise (sic), the basis of their relationship has effectively ended. We believe that generally the continued performance of an adviser's services is dependent upon the client's having trust and confidence in the adviser and a willingness to continue the advisory relation ship. Where the basis for the relationship is ended, and the adviser, accordingly, is unable to continue to perform services under the contract, in our view the adviser's fiduciary duties preclude its receipt of compensation for service it is not able to perform.
> . . . .
> . . . RDBIC would breach its fiduciary duty and violate section 206(2) of the [Advisers] Act by entering into a contract for the provision of investment supervisory services which purports to bar a client from terminating the relationship except annually.

Id. at *4; *see generally* Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983) (suggesting rationale for imposition of fiduciary duties).

[15] *See* 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.7 (2d ed. 1998) (citing Fitzpatrick v. Michael, 9 A.2d 639, 641 (Md. 1939)) (stating "court will not grant specific performance of a contract to provide a service that is personal in nature").

[16] This is especially important as between advisers and their employee portfolio managers. The staff of the Securities and Exchange Commission has permitted such employees to establish their own business by allowing them to advertise the performance of funds which they managed while employed, to demonstrate their past experience. *See* 3 TAMAR FRANKEL, THE REGULATION OF MONEY MANAGERS ch. XXV § 8 (Supp. 2000) (noting that SEC granted no-action letters allowing related performance information in sales materials and prospectuses).

such a case the adviser should win because it does not seem that the clients prefer the portfolio manager on the merits. This argument, however, may be hard to prove. The rationales are similar to the rationales for efficient breach, but in the reverse. There is no reason not to enforce a non-compete condition, which the portfolio manager signed voluntarily, and to ignore the courts' edict of injunction if the client is not harmed by the exchange of portfolio managers.

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The nature of the relationship provides the term "as directed" a meaning that the industry and regulators adopt and understand. Investment management contracts are considered personal contracts in which confidence is reposed in the portfolio manager by the client. Such contracts will not be specifically enforced. Also, an interpretation of an investment management contract that limits the clients' freedom and ability to choose any other portfolio manager is detrimental to our system generally and to clients in particular. Such an interpretation conflicts with the public policy of encouraging competition among portfolio managers. It is not surprising that research has not uncovered a single case in which an adviser sued a client for breaching his contract by seeking the services of another portfolio manager. I have not discovered such a case either under the common law or under the federal regulatory law.

To perform his functions efficiently, a portfolio manager must exercise significant powers over the client's portfolio. Such powers put investors at risk from the potential of the portfolio manager's abuse of power. The powers will not be granted unless the client has confidence in his portfolio manager. If the client's confidence is lost, the client will withdraw these powers. To encourage investors to risk putting their money and liquid assets in the hands of others, public policy has long mandated that a client should not be required to continue its relationship with a portfolio manager against his wishes. The marketplace accepts the proposition that a client may choose its portfolio manager and can terminate the relationship on short notice.[17]

Portfolio managers are not always happy with this freedom of clients to move to competitors. Therefore, portfolio managers seek ways to impose costs on clients who might wish to change portfolio managers. Unregulated portfolio managers may require a contract for a minimum (in reality

[17] Advisory contracts usually entitle the client to terminate the relationship by a 30-day notice. *See* Investment Company Act of 1940 § 15(a)(3), 15 U.S.C. § 80a-15(a)(3) (1994) (stating explicitly that advisory contract should provide for termination of relationship upon notice of sixty days without penalty); KIRSCH, *supra* note 2, at § 7:8 (suggesting that advisory contract spell out terms with respect to termination, e.g., "Either party may terminate this agreement upon 30 days' written notice to the other party").

long) period or a fee forfeiture. But regulated advisers (which nearly all portfolio managers are) may not. "[T]he SEC staff has expressed the view that an adviser's fiduciary duty would preclude an adviser from enforcing a contract that unreasonably limits a client's right of termination."[18]

The staff of the Securities and Exchange Commission has long interpreted federal law to prohibit advisers from entering into a long-term advisory contract (e.g., a year) or impose upon termination of the contract a penalty or fee forfeiture. The staff explained that in a client-manager confidential relationship a client should be permitted to terminate the relationship on short notice without penalty.[19]

What signals would establish the clients' preferences to retain the departing portfolio manager's services?

In the *RJR Nabisco* case the signal was clear and, at the outset, stated in the contract. However, if advisory contracts do not contain the specific statutory language but merely provide for the right of termination with a short notice and without penalty, the answer is more complex. One possible answer is to look at the statutory interpretation by courts and regulators and the legislative history. After all, the parties' contracts follow the statute, to which they consider themselves, and are, bound. But this argument is circular because the interpretation of the statute is affected by the parties' expectations and behavior. Therefore, in advisory contracts that do not specifically provide for the client's choice of the portfolio manager, other signals may be helpful, such as the insistence of the clients on continued services of the portfolio manager, the objective dependence of the client on the portfolio manager's services, the previous relationships between the parties and as mentioned before, the performance of the portfolio manager as compared to others who offer the same type of services, which would justify a rational client's insistence.

A second answer would be based on the adviser's approach to the termination. In many cases, but not all, an adviser may wish to prevent termination by disqualifying its competitor. The adviser may say to the client: I will indeed transfer the portfolio to whomever you direct, except this competitor of mine, who enticed you to transfer the business to her. No adviser or other fiduciary should be allowed to do that. Therefore, the adviser's attempts to disqualify a competitor are circumspect. If the adviser must transfer the portfolio notwithstanding the fact that the competitor is a

[18] KIRSCH, *supra* note 2, at § 8.2 n.1 (citing National Deferred Compensation, Inc., SEC No-Action Letter, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,543, at 77,764 (Aug. 31, 1987)); *see* Robert D. Brown Inv. Counsel, *supra* note 14, at *2 (noting that once a year termination is too restrictive of client's right to terminate advisory contract). The SEC further notes that a fee schedule based on the assumption that client relationship would extend from year to year denies clients' right to terminate the contract, and constitute adviser's breach of fiduciary duty. *See* Robert D. Brown Inv. Counsel, *supra* note 14, at *19 (believing these restrictions obligated clients to accept and pay for advisory services whether or not such services were satisfactory).

[19] Such a specific requirement is imposed on advisers that serve investment companies. *See* 15 U.S.C. § 80a-15(a)(3) (1994); *cf.* Steven Lubet, *The Rush to Remedies: Some Conceptual Questions About Nonrefundable Retainers*, 73 N.C. L. REV. 271, 284-85 (1994) (citing *In re* Cooperman, 633 N.E.2d 1069, 1072-73 (N.Y. 1994)) (discussing fiduciary duties in context of attorney-client relationship and noting court's concern that penalty would render clients "hostage to an unwanted fiduciary relationship" and inhibit clients' right to discharge their lawyers, but arguing against absolute right in certain cases); Lisa Estrada, Note, *An Assessment of* Qui Tam *Suits by Corporate Counsel Under the False Claims Act:* United States *ex rel.* Doe v. X Corp., 7 GEO. MASON L. REV. 163, 175-77 (1998) (analyzing incentives for lawyers in light of their client relationships which require trust to ensure effectiveness).

person who signed a non-compete agreement, and is under a duty and a court order not to provide the services, the situation does not change. We can assume that the adviser will try to prevent the transfer and should not be permitted to impede it by selecting or disqualifying the client's choice. Such an action is detrimental to healthy competition and the client's interests. In addition, allowing a terminated adviser to disqualify its successor may enable the terminated adviser to extract payments from the designated successor or even stay as a silent partner to that successor.

A more difficult question arises, for example, if the client requires the terminated adviser to transfer the management of the portfolio to an adviser whose registration was revoked, and who is therefore prohibited from serving. A similar question would arise if the client insists on resorting to a disbarred lawyer.

Analysis of the Issue

The issue involves a conflict between the client's rights to choose an adviser and the legal prohibitions for the adviser to serve. Presumably, the client's rights should be subject to legal prohibitions. But that is not the issue in our context. The question is whether the adviser can use the disqualification of the transferee adviser as a defense for preventing the transfer. I believe that the adviser should not be permitted to use legal limitations as protection from his contract violation.

The one exception may be if the adviser would be liable as aider and abettor to a violation of the law. Further, the adviser may have a duty to notify the client of the successor's disqualification. But if the client persists, the adviser should transfer the portfolio nonetheless. Otherwise, the illegality of involving another adviser should not provide the terminated adviser with a reason to avoid transfer.

In the *RJR Nabisco* case The Adviser's arguments based on legal constraints to the transfer seem weak because, but for The Adviser's actions, the transferee adviser (The Manager) would not be prevented from serving the client.

However, as the *Russell* court has noted, the adviser has a legal right to prevent the disloyal portfolio manager from serving its clients. The conflict is therefore between the rights of the client and those of the adviser. The reason it feels uncomfortable to allow the terminated adviser to do anything but what the client orders it to do is that the terminated adviser has a sharp conflict of interest with the client. In the conflict with the portfolio manager the law is on the side of the adviser. However, in the conflict with the client, the court's order does not apply to the client.

I would prefer that courts avoid this vicious circular argumentation, and provide a straightforward argument. I suggest that if the client truly wants the portfolio manager to continue to serve, the adviser should not be permitted to invoke the court's injunction to prevent the service. However, even if the injunction does not apply to the client, what other remedies does the adviser have against the portfolio manager?

First, the adviser can seek the remedy of accounting for the portfolio manager's profits. Such a remedy is likely to prevent the portfolio manager from serving in violation of the injunction, because he would be required to serve without compensation. This prevention may raise the same questions that an injunction raises: is this prevention violating the client's rights to the portfolio manager of its choice? If it does, then under certain conditions, the adviser cannot exercise his rights.

Second, the adviser may claim damages from the portfolio manager. These damages would reduce, but not eliminate, the portfolio manager's compensation, and keeping good clients for some time with low fees may be attractive to the portfolio manager.

Third, and this may be the best answer, the adviser should be protected by extra-legal remedies. Protections of the adviser must derive from behavioral patterns, market reputation and business relationships rather than from the law.

Against this background, I conclude that an obligation to transfer the portfolio as provided in the contract provision means the transfer of the portfolio management operation to another portfolio manager. It is a crucial and important obligation of the portfolio manager in light of the difficulties that the portfolio manager can create and the damages and losses it can inflict. Whether or not the assets are moved to another custodian is irrelevant.

How should advisers and clients prepare for such a situation in the future? After all, most advisers impose non-compete obligations on their partners and their portfolio managers. Clients, however, may not necessarily insist on the services of a particular portfolio manager, yet on other occasions may wish to retain the services of a favored manager even if she leaves the adviser. A number of scenarios are possible to imagine. The adviser has the option of notifying the client of the non-compete condition. The adviser, however, risks the possibility that, in light of this disclosure, the client will insist on the freedom to follow the manager, and bargain for a specific contract provision to that effect.

Another possibility is that the client will raise the issue before the service knot is tied. At that stage, the client has a strong bargaining position vis-à-vis the adviser, and the adviser may concede. There is also a possibility that if the parties agree on all other terms they will decide not to raise the issue in the hope that it will not arise. The probability that such an issue will arise may be indeed quite low. However, if such a situation does arise, a client may have a far weaker position after the relationship has been established than at the bargaining stage, and unless it "costs" the client some other bargaining advantages, the issue is best resolved in advance of establishing this relationship. These speculations lead me to the conclusion that negotiations on specific contract terms may not be the solution, and are not an effective way to start the relationship. The way advisers' behave in the marketplace seems to be the wisest one: refrain from raising the issue. But if the issue arises, cut your losses. Allow (even help) clients to depart and follow the disloyal partner or portfolio manager with as little emotion as is humanly possible, and without much ado.