April 19, 2023

Via Electronic Submission: https://www.regulations.gov

April J. Tabor
Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue NW
Suite 1 CC-5610 (Annex C)
Washington, D.C. 20580

Re: Non-Compete Clause Rulemaking, Matter No. P201200

Dear Ms. Tabor,

Managed Funds Association[1] (**"MFA"**) submits these comments to the Federal Trade Commission (the **"Commission"** or **"FTC"**) in response to the Commission's proposed rule to ban non-compete agreements ("**NCAs**") between employers and employees (the **"Proposed Rule"**).[2] While MFA understands the Commission's objective of protecting American workers and ensuring their mobility, particularly in farming and manufacturing industries, we believe that the Proposed Rule, as drafted, is too broad for this objective.[3] The Proposed Rule would significantly increase the burdens on organizations while impeding their ability and legitimate need to protect their intellectual property and proprietary interests. The Proposed Rule would have a significant negative impact on MFA members, which include hedge funds, crossover funds, and credit funds. The beneficiaries of these funds are pensions, foundations, and endowments, and their investment returns help secure retirements, fund medical research, and provide college scholarships, among other things.

Accordingly, we urge the Commission to reconsider the Proposed Rule as it would significantly harm MFA members with respect to research, investment, and competitiveness in the United States. To the extent that the Commission determines to move forward with the Proposed

[1] Managed Funds Association ("**MFA**") represents the global hedge fund and alternative asset management industry and its investors by advocating for regulatory, tax, and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 member firms collectively manage nearly $2.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, Brussels, London, and Asia. www.managedfunds.org.

[2] Non-Compete Clause Rule, 88 Fed. Reg. 3482 (proposed Jan. 19, 2023).

[3] The Commission's own recent enforcement actions taken a single day before announcing the Proposed Rule do not prohibit non-compete provisions for senior executives and employees involved in research and development. *See* O-I Glass, Inc., File No. 211-0182, https://www.ftc.gov/system/files/ftc_gov/pdf/2110182o-iglassdraftorderappxa.pdf (Jan. 4, 2023) (Decision and Order Appendix A); Ardagh Glass Group S.A., File No. 211-0182, https://www.ftc.gov/system/files/ftc_gov/pdf/2110182ardaghdraftorderappxa.pdf (Jan. 4, 2023) (Decision and Order Appendix A). This fact is a clear indication that there are legitimate business justifications for such non-compete provisions and is a recognition by a majority of the Commission that a blanket ban on non-compete provisions goes too far.

Rule, we would urge the Commission to provide a carveout[4] to allow for the use of NCAs where the following conditions are satisfied:

(1) The NCA has terms reasonably related to the protection of the firm's business interests, including intellectual property, trade secrets, and confidential and proprietary information, for the purpose of competitive advantage;

(2) The NCA is in effect for no more than two years after termination of employment or the maximum term allowed under state law applicable to the NCA, whichever is shorter;

(3) The NCA applies only to employees earning at least $100,000 per year or the highest wage floor amount in the states that impose wage floors, whichever is higher;

(4) The NCA provides for payment of no less than the ex-employee's base salary[5] during the post-employment period in which the ex-employee's subsequent employment is restricted by the NCA; and

(5) The NCA is otherwise in accord with applicable state law(s).

I. MFA Members Rely on Non-Compete Agreements to Protect Their Proprietary Information

MFA members frequently use NCAs with other contractual safeguards to protect some of their most valuable investment assets and proprietary information. Typically, the secrecy of MFA members' proprietary information is an inherent part of its value because such information would have little value if it were widely known and, therefore, priced into the markets. Accordingly, MFA members limit the use of NCAs only to employees whose departure would run the risk of exposing such proprietary information and result in competitive harm. In such cases, NCAs are used to protect proprietary strategies and processes that result from research and development. Indeed, MFA members often file for patent protection (or otherwise rely on trade secret law) in respect of their proprietary technologies, processes, and formulae. However, as explained in further detail below, NCAs afford MFA members unique protection against cases where departing employees misappropriate their proprietary information.

Importantly, NCAs foster the free flow of information within a firm that results in the innovation that is so critical to the competitive process in the investment management industry. Restricting MFA members' use of NCAs would impede the sharing of information within a given firm and limit the number of employees who have access to each firm's proprietary information. Currently, MFA members use NCAs to safely allow covered employees to access a firm's strategies

[4] The only exception currently in the Proposed Rule is inadequate because individuals who own less than 25% of a firm, including those with no ownership interests, often have access to the same proprietary information as those who own at least 25% of a given firm.

[5] Provided that the ex-employee's base salary is not less than $100,000, consistent with the third condition.

and proprietary information. Having access to such information enables employees to gain valuable experience to progress in their careers, and many often go on to start their own firms, increasing competition in this industry. Without the protection of NCAs, firms would be forced to severely limit the number of employees with access to their proprietary information, and the employees without access would be relegated to working on discrete projects without understanding the broader implications of their work. As a result, employees would likely lose out on career-advancing learning opportunities.

This is not a hypothetical concern. Employees of MFA members already recognize that employees who enter NCAs with their employer receive increased access to the firm's proprietary information, which allows them to have a greater impact within the firm. Because of this fact, there have been instances where the ***employees*** of MFA members have requested to enter NCAs with their employers. The Proposed Rule would prevent employees from making such a choice.

In turn, the use of NCAs allow MFA members to utilize the unique perspectives of each covered employee, which is needed to develop and implement investment strategies for pension plans, university endowments, charitable foundations, and other institutional investors. These investors depend on the innovation that allows MFA members to diversify their investments, manage risk, and generate attractive returns over time.

Significantly, NCAs limit harm to employees in the investment management industry, as such employees are typically compensated during the non-compete period. The net result is that the use of NCAs by MFA members fosters investments in employees and creates the prospect of more competition once the post-term non-compete period ends. Not only do new firms started by former employees benefit from the use of NCAs, but other new entrants do too. Both benefit from knowing that their startup investment in their own proprietary information will be protected. A blanket ban on the use of NCAs would not only harm former employees and new entrants looking to compete, but it would result in less competition overall, which would have a negative effect on investors.

NCAs play a crucial role in allowing MFA members to protect their proprietary information, investment strategy, and investors while balancing the interests of employees.

II. A Blanket Ban on Non-Competes Would Harm MFA Members and Their Employees

As discussed in more detail below, NCAs are one of the most effective ways MFA members can ensure protection of their proprietary information, know-how, and investment strategies after their employees with access to such information leave. As noted above, much of the value in MFA members' proprietary information comes from its secrecy, which makes preventative measures, particularly NCAs, necessary. A recent study published on the Commission's website found that "[w]hen NCAs are relaxed, firms become less willing to fire advisers for misconduct and advisers' propensities to engage in misconduct and client fees increase."[6] In the investment management industry, NCAs serve to reduce costs and foster new market entry and competition. As noted above,

[6] Amit G. Gurun, Noah Stoffman & Scott E. Yonker, *Unlocking Clients: The Importance of Relationships in the Financial Advisory Industry*, 141 J. Fin. Econ. 1218 (2021).

employees in this industry need to have access to proprietary information and strategies to develop their skills and knowledge, which also allows them to deliver better results and client service for investors.

For example, MFA members often create and market new funds centered around specific portfolio managers, generally one or more individuals, who develop and implement the investment strategies of that fund. Before developing a new fund centered around one or more portfolio managers, to justify the substantial financial commitment required to launch and market a new offering, firms typically require assurances that the individual(s) will not misappropriate the firm's existing or future proprietary information and strategies. The Proposed Rule's ban on NCAs would likely dampen the market for new fund launches and, accordingly, put downward pressure on innovation and competition.

The Commission recites two reasons why the Proposed Rule may in fact increase new firm formation: first, workers would be free to launch new firms to compete with their former employer, and second, firms would be more willing to enter markets in which potential sources of labor are not restricted by NCAs. However, these rationales are largely inapposite in the investment management industry.[7] Often, it is the employee's former employer that seeds the new fund launch in return for an economic interest in the general partner entity, as well as the typical exposure of a limited partner and additional, preferential fund-level rights. Further contrary to the Commission's rationales, firms in this industry are generally unwilling to enter the market unless they can reach a sufficient comfort-level that their highly compensated, highly skilled workforce cannot immediately take the firm's proprietary information and strategies to a competitor.

To be sure, strategies employed by private funds vary widely and are highly proprietary. In fact, investors in funds are subject to confidentiality and non-disclosure agreements when they receive confidential information from these funds. It often takes a considerable investment of time, effort, and resources to develop and refine a strategy, and to develop a track record and sufficient reputation, to market that strategy to potential investors. NCAs protect this investment by MFA members. Accordingly, a complete ban on NCAs would have a chilling effect on new fund formations and investments in the investment management industry, which would harm investors.

The Proposed Rule's ban on NCAs could also harm employees in the investment management industry by eliminating the consideration employees are paid for signing NCAs, thereby potentially decreasing wages. Employees who are subject to NCAs are typically sophisticated, highly compensated investment professionals who can negotiate higher wages based, in part, on the requirement that they execute NCAs. The same is also true when NCAs are added or extended while such professionals are employed by MFA members. If NCAs are no longer permitted, the result could be downward pressure on the wages paid to such employees. Indeed, increased weighting toward deferred compensation may be substituted for NCAs,[8] and in such cases, departing employees receive

[7] To note, none of the academic studies on which the Commission relies dealt specifically with the investment management industry.

[8] *See* Richard A. Booth, *Give Me Equity or Give Me Death—the Role of Competition and Compensation in Building Silicon Valley*, 1 Entrepreneurial Bus. L. J. 265, 271 (2006) (arguing that deferred equity compensation is used as a

neither the compensation associated with an NCA nor unvested awards of deferred compensation.[9] We urge the Commission to consider the potential impact on such wages.

Further, many funds rely heavily on their traders' and developers' knowledge and innovation in developing algorithms for quantitative trading. If a developer were to leave and join another firm, they would be taking that key asset with them, thereby exposing, and immediately devaluing, their former employer's trading strategy and harming its competitive position. Consequently, investors, as the clients of those firms, ultimately bear the costs resulting from firms' loss of intellectual property and the increased costs of doing business. More broadly, absent NCAs, firms would be forced to keep proprietary information limited to only a very select group of employees, stifling the flow of valuable information and ideas that support innovation and bring value to investors.

Contrary to the Commission's view, in practice, confidentiality, non-disclosure, and non-solicitation agreements do not afford MFA members the same level of protection as NCAs. Putting aside the difficulties with detecting misuse of proprietary information, even if detected, it is often too late to do anything meaningful about it. After-the-fact litigation is often an inadequate alternative because the harm has already occurred once the information has been divulged. Moreover, complicated assessments of ownership of investment algorithms can be costly, lengthy, and potentially result in disclosure of proprietary information as part of the litigation process.

Further, the cost and business disruption that engaging in litigation would bring hurts the firm and has a negative impact on the investment management industry as a whole.[10] To the extent that MFA members cannot rely on NCAs, they would be forced to litigate alleged confidentiality breaches much more frequently to protect their proprietary information. There have been many well-publicized cases of such trade secret litigation and the great expense at which the firms involved enforced their rights, including both core litigation expenses (which may be incurred over many years) and collateral expenses, such as those associated with internal investigations, cooperation with federal law enforcement, etc. Consequently, contrary to the objective of the Proposed Rule, a ban on NCAs would likely have a chilling effect on firms hiring their competitors' former employees. Accordingly, a blanket ban on NCAs would harm MFA members and their employees.

III. The Proposed Rule Should Carve-Out and Permit Certain NCAs

If the Commission decides to proceed with the Proposed Rule, the Commission should provide a carveout in the Proposed Rule and explicitly allow NCAs that meet the following conditions:

First, the NCA has terms reasonably related to the protection of the firm's business interests, including intellectual property, trade secrets, and confidential and proprietary information, for the purpose of competitive advantage. Most states currently employ a reasonableness standard when

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replacement for NCAs for purposes of retaining employees).

[9] *See* Jonathan M. Barnett & Ted Sichelman, *The Case for Noncompetes*, 87 U Chi. L. Rev. 953, 991 (2020).

[10] A blanket ban may well harm smaller, budding firms and new entrants as they may not be able to keep their teams together or keep their own proprietary information internal.

examining NCAs.[11] This nearly ubiquitous standard reflects a balance between an employer's legitimate interest in protecting its proprietary information, an employee's mobility (and, more broadly, competitive conditions in labor markets), and the public interest.

Second, the NCA is in effect for no more than two years[12] after termination of employment or the maximum term allowed under state law applicable to the NCA, whichever is shorter. Generally speaking, the terms of NCAs in the investment management industry are variable and tailored to the business interests of the particular firm. Anecdotally, we understand that firms may employ NCAs with terms ranging from 12 to 36 months. In consideration of the variability of NCA terms and the business purposes for which they are suited, we urge the Commission to consider an NCA in effect for no more than two years after termination of employment to be presumptively valid. NCAs with a longer term may be valid to the extent reasonably related to the protection of the firm's business interests and not applied on a firm-wide, one-size-fits-all basis.

Third, the NCA applies only to employees earning at least $100,000 per year or the highest wage floor amount in the states that impose wage floors, whichever is higher.[13] By the Commission's own admission, this threshold is "relatively high."[14] Indeed, under such a threshold, NCAs would not have been permitted with respect to roughly 84% of workers with wage or salary income in 2021.[15]

Fourth, the NCA provides for payment of no less than the ex-employee's base salary[16] during the post-employment period in which the ex-employee's subsequent employment is restricted by the NCA. Crucially, such a requirement, currently only present in two states,[17] ensures that there would not be any economic harm to employees who enter NCAs.

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[11] Non-Compete Clause Rule, 88 Fed. Reg. at 3494 ("In the 47 states where at least some non-compete clauses may be enforced, courts use a reasonableness inquiry…"); *see*, *e.g.*, *Data Mgmt., Inc. v. Greene*, 757 P.2d 62, 65 (Alaska 1988); *Valley Med. Specialists v. Farber*, 982 P.2d 1277, 1283 (Ariz. 1999).

[12] Post-term NCAs of up to two years are permitted in many states. *See* Ala. Code § 8-1-190 (Alabama); Ark. Code Ann. § 4-75-101(d) (Arkansas); Fla. Stat. § 542.335(1)(d)(1) (Florida); Ga. Code Ann. § 13-8-57(b) (Georgia); La. Stat. Ann. § 23:921(C) (Louisiana); S.D. Codified Laws § 53-9-11 (South Dakota).

[13] Only a limited number of states have a wage floor requirement for employee NCAs. *See, e.g.*, D.C. Code Ann. § 32-581.01(6), (10), (13) (Washington, D.C. – at least $150,000, adjusted annually for inflation); 820 Ill. Comp. Stat. Ann. 90/10(a) (Illinois – at least $75,000)); Me. Rev. Stat. Ann. tit. 26 § 599-A(3) (Maine – at or below 400% of the federal poverty level); Md. Code Ann., Lab. & Empl. § 3-716(a) (Maryland – at least either $15 per hour or $31,200 annually); Or. Rev. Stat. § 653.295(1) (Oregon – exceeds $108,575.64 in 2023, adjusted annually for inflation); Wash. Rev. Code Ann. § 49.62.020(1)(b) (Washington – exceeds $100,000, adjusted annually for inflation ($116,593.18 in 2023)).

[14] Non-Compete Clause Rule, 88 Fed. Reg. at 3518 ("An earnings threshold could be relatively high (as in, *e.g.*, the State of Washington, where a non-compete clause is void unless the worker's annual earnings exceed $100,000 for employees…").

[15] U.S. Census Bureau, *PINC-10. Wage and Salary Workers--People 15 Years Old and Over by Total Wage and Salary Income, Work Experience, Race, Hispanic Origin, and Sex*, https://www2.census.gov/programs-surveys/cps/tables/pinc-10/2022/pinc10_1.xlsx (last revised Aug. 17, 2022).

[16] Provided that the ex-employee's base salary is not less than $100,000, consistent with the third condition.

[17] Mass. Gen. Laws Ann. ch. 149, § 24L(b)(vii) (Massachusetts – arrangement must provide for the payment of at least 50% of the employee's highest annualized base salary paid by the employer within the preceding 2 years); Or. Rev. Stat. § 653.295(7) (Oregon – arrangement must provide for the payment of (a) compensation equal to at least 50% of the

Finally, the NCA is otherwise in accord with applicable state law(s).[18]

This narrowly tailored carveout to the Proposed Rule is in fact necessary to achieve the Commission's goal of increasing competition in the labor market, particularly in the financial sector. As discussed at length above, NCAs provide firms with protection—and consequently, comfort—to share their proprietary information with employees, which in turn allows the employees to gain the necessary know-how. The Commission should incorporate this carveout into the Proposed Rule to preserve the benefits derived from NCAs while balancing employers' need to protect their information and the Commission's goal of promoting competition.

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We appreciate the opportunity to provide our comments to the Commission regarding the Proposed Rule, and we would be pleased to meet with the Commission or its staff to discuss our comments. If the Commission or its staff have questions or comments, please do not hesitate to call Joseph Schwartz, Director and Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Global Regulatory Affairs
Managed Funds Association

cc: The Hon. Lina M. Khan, Chair, Federal Trade Commission
The Hon. Rebecca Kelly Slaughter, Commissioner, Federal Trade Commission
The Hon. Alvaro Bedoya, Commissioner, Federal Trade Commission
Elizabeth Wilkins, Director, Office of Policy and Planning, Federal Trade Commission

employee's annual gross base salary and commissions at the time of the employee's termination or (b) 50% of $100,533, adjusted annually for inflation, whichever is greater).

[18] For clarity, MFA does not believe that its proposed carveout of the Proposed Rule should alter or otherwise preempt any state laws.