Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York | Brussels | London

August 1, 2023

The Honorable Kathy Hochul
Governor of the State of New York
Executive Chamber
New York State Capitol Building
Albany, NY 12224

Re: New York Senate Bill S03100-A, 2023-2024 Legislative Session

Dear Governor Hochul,

Managed Funds Association[1] ("**MFA**") appreciates the opportunity to submit these comments for your consideration in response to the New York State Legislature's (the "**Legislature**") passage of New York Senate Bill S03100-A (the "**Act**"), an act to amend the labor law, in relation to prohibiting non-compete agreements and certain restrictive covenants ("**NCAs**").

Across New York State, the alternative asset management industry delivers for retirement security, college education, and the important work done by nonprofits and charities through $221.7 billion in investments.[2] New York State-based investment managers, in total, manage over $3.3 trillion in gross assets.[3] Institutional investors – like pensions, university endowments, and nonprofits – rely on MFA members to meet financial obligations, diversify their investment portfolios, and manage risk. Moreover, New York State-based investment managers are substantial employers in their own right, numbering over 900 firms.

While MFA understands the Legislature's objective of protecting the labor market and economy of New York State, particularly in the medical field, we believe that the Act, as passed by the Legislature, is too broad for this objective. The Act would significantly increase the burdens on organizations while impeding their ability and legitimate need to protect their intellectual property and proprietary interests. The Act 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.

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[1] Managed Funds Association ("**MFA**"), based in Washington, D.C., New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 170 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly $2.2 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.

[2] *New York*, INVESTING IN OPPORTUNITY, https://investinginopportunity.org/state/new-york/ (last visited June 20, 2023).

[3] *Number of Hedge Fund and Fund-of-Funds Firms by State or US Territory*, HEDGE FUND ALERT (June 28, 2023).

Accordingly, we urge you to endorse certain chapter amendments to alleviate the significant harm to MFA members and their employees with respect to research, investment, and competitiveness in New York State. Specifically, we urge you to work with the Legislature and private sector stakeholders to develop chapter amendments that modify the Act as follows:

(1) **Exclude from the prohibition on NCAs covered individuals compensated for services and/or exclusivity to the relevant employer or its affiliates at an annualized rate of *total* cash compensation (including all wages, incentives, bonuses, vested restricted stock shares or units, commissions, and other remuneration) equivalent to or greater than $200,000 per year, or otherwise holds a bona-fide officer position or is a board member.** Highly compensated investment professionals are much more likely to have the power to effectively bargain on their own behalf and are able to obtain higher compensation in exchange for the agreement to not compete. These professionals are not unfairly restricted from deciding which employer is the best fit for them or pursuing other economic opportunities that are available to them.

(2) **Exclude from the definition of "non-compete agreement" forfeiture-for-competition agreements under which an employee agrees to forfeit (or repay) specified post-employment compensation per the terms of that agreement if they voluntarily elect to take employment with a competitor.** Forfeiture-for-competition agreements have the same benefits as NCAs but, by their plain terms, do not prevent workers from accepting new employment, even with competitors. This distinction, among others, frequently makes forfeiture-for-competition agreements a reasonable compromise between employers and employees.

(3) **Exclude from the prohibition on NCAs (i) a partner in a partnership (or, similarly, a member in a limited liability company) in such partner's (or member's) capacity as a partner (or member), and (ii) a person who is selling a business entity or otherwise disposing of the person's ownership interest in the business entity, or a person who is selling substantially all of a business entity's operating assets.** The protection of the value of a business for current partners (or members) following the departure of a former partner (or member) and potential buyers following the sale or other change in control of a business is paramount. These exceptions recognize that a former owner conveys the full value of a business on its sale and may be required to contract not to destroy the goodwill of that business by immediate competition.

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

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. 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.

A. A Blanket Ban on Non-Competes Would Harm Employees

NCAs foster the free flow of information within a firm that results in innovation that is critical to competition in our 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 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.

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. Because of this fact, there have been instances where the *employees* of MFA members have requested to enter NCAs with their employers. The Act would prevent employees from making such a choice.

Significantly, NCAs limit harm to employees in our industry, as such employees are typically compensated during the non-compete period. The Act's ban on NCAs could harm employees by eliminating the consideration employees are paid during the non-compete period, as well as the consideration employees are paid initially 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,[4] and in such cases, departing employees receive neither the compensation associated with an NCA nor unvested awards of deferred compensation.[5]

B. A Blanket Ban on Non-Competes Would Harm MFA Members

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 Federal Trade 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 our industry, NCAs serve to reduce costs and foster new market entry and competition.

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[4] *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 replacement for NCAs for purposes of retaining employees).

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

[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).

For example, MFA members often 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 Act's ban on NCAs would likely dampen the market for new fund launches and, accordingly, put downward pressure on innovation and competition.

To be sure, strategies employed by private funds vary widely and are highly proprietary. In fact, even 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, which would harm investors.

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 the 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.

C. Confidentiality, Non-Disclosure, and Non-Solicitation Agreements Do Not Provide the Same Level of Protection as Non-Competes

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 our industry as a whole. 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 law enforcement, etc.

Consequently, contrary to the objective of the Act, a ban on NCAs would likely have a chilling effect on firms hiring their competitors' former employees.

II. The Act Should Carve-Out and Permit Certain NCAs

We urge you to endorse the following carveouts to alleviate the significant harm to MFA members and their employees:

First, exclude from the prohibition on NCAs covered individuals compensated for services and/or exclusivity to the relevant employer or its affiliates at an annualized rate of *total* cash compensation (including all wages, incentives, bonuses, vested restricted stock shares or units, commissions, and other remuneration) equivalent to or greater than $200,000 per year, or otherwise holds a bona-fide officer position or is a board member. Such a threshold would place New York State atop the jurisdictions with the highest wage floors below which NCAs are prohibited.[7] Indeed, under such a threshold, NCAs would have only been permitted with respect to workers with annual wages in *at least the 90th percentile* in New York State according to data published by the U.S. Bureau of Labor Statistics.[8]

Second, exclude from the definition of "non-compete agreement" forfeiture-for-competition agreements under which an employee agrees to forfeit (or repay) specified post-employment compensation per the terms of that agreement if they voluntarily elect to take employment with a competitor. New York State has a long history of finding such agreements inherently reasonable. As stated by the New York Court of Appeals, this finding "rests on the premise that if the employee is given the choice of preserving his rights under his contract by refraining from competition or risking forfeiture of such rights by exercising his right to compete, there is no unreasonable restraint upon an employee's liberty to earning a living."[9] Moreover, employees frequently negotiate with new employers to backfill the forfeited, unvested compensation, thereby eliminating any concern that such agreements depress compensation.

Third, exclude from the prohibition on NCAs (i) a partner in a partnership (or, similarly, a member in a limited liability company) in such partner's (or member's) capacity as a partner (or member), and (ii) a person who is selling a business entity or otherwise disposing of the person's ownership interest in the business entity, or a person who is selling substantially all of a business entity's operating assets. These exclusions are present in virtually every jurisdiction with statutory restrictions on NCAs. Indeed, even the four states that have enacted broad statutory bans on NCAs

[7] *See, e.g.*, D.C. Code Ann. § 32-581.01(6), (10), (13) (at least $150,000, adjusted annually for inflation); 820 Ill. Comp. Stat. Ann. 90/10(a) (at least $75,000); Me. Rev. Stat. Ann. tit. 26 § 599-A(3) (at or below 400% of the federal poverty level); Md. Code Ann., Lab. & Empl. § 3-716(a) (at least either $15 per hour or $31,200 annually); Or. Rev. Stat. § 653.295(1)(e) (exceeds $100,533, adjusted annually for inflation); Wash. Rev. Code Ann. § 49.62.020(1)(b) (exceeds $100,000, adjusted annually for inflation).

[8] U.S. Bureau of Labor Statistics, *May 2022 State Occupational Employment and Wage Estimates: New York*, https://www.bls.gov/oes/special.requests/oesm22st.zip (last modified April 25, 2023) (reflecting annual wages in excess of $136,080 as the 90th percentile in New York State).

[9] *Morris v. Schroder Capital Mgmt. Int'l*, 7 N.Y. 616, 621 (2006) (citing *Post v. Merrill Lynch, Pierce, Fenner & Smith*, 48 N.Y.2d 84, 88-89 (1979)).

provide similar exclusions.[10] One of those state's courts have described the purpose of the exceptions as "prevent[ing] the seller from depriving the buyer of the full value of its acquisition, including the sold company's goodwill."[11] Likewise, the New York Supreme Court has endorsed this rationale.[12]

These narrowly tailored carveouts to the Act are in fact necessary to achieve the Legislature's goal of protecting the labor market and economy of New York State, 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. We urge you to incorporate these carveouts into the Act to preserve the benefits derived from NCAs while balancing employers' need to protect their information and the Legislature's goal of promoting competition and mobility.

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We appreciate the opportunity to submit our comments for your consideration in response to the Legislature's passage of the Act, and we would be pleased to meet with your staff to discuss our comments. If your 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/ Jillien Flores

Jillien Flores
Executive Vice President & Managing Director
Head of Global Government Affairs
Managed Funds Association

cc: Elizabeth Fine, Counsel to the Governor of the State of New York
Darren Cohen, Senior Counsel to the Governor of the State of New York

[10] Cal. Bus. & Prof. Code § 16601 (sale of a business or of the goodwill of a business); Cal. Bus. & Prof. Code § 16602 (dissolution of a partnership or dissociation of a partner from the partnership); Cal. Bus. & Prof. Code § 16602.5 (dissolution or termination of interest in an LLC); Minn. Stat. § 181.988, Subd. 2(b) (sale of a business and dissolution of a business); Okla. Stat. tit. 15 § 218 (sale of the goodwill of a business); Okla. Stat. tit. 15 § 219 (dissolution of a partnership); N.D. Cent. Code § 9-08-06 (sale of the goodwill of a business and dissolution of a partnership, LLC, or corporation; dissociation of a partner or a member).

[11] *Alliant Ins. Servs., Inc. v. Gaddy*, 72 Cal. Rptr. 3d 259, 267 (Cal. Ct. App. 2008); *see also Strategix, Ltd. v. Infocrossing West, Inc.*, 142 Cal. App. 4th 1068, 1072-73 (Cal. Ct. App. 2006) (citations omitted) ("Section 16601's [sale-of-a-business] exception serves an important commercial purpose by protecting the value of the business acquired by the buyer. In the case of the sale of the goodwill of a business it is 'unfair' for the seller to engage in competition which diminishes the value of the asset he sold.").

[12] *See Shearson Lehman Bros. Holdings v. Schmertzler,* 500 N.Y.S.2d 512, 516 (1986) ("[C]ovenants not to compete incident to the sale of a business are more liberally enforced 'on the premise that a buyer of a business should be permitted to restrict his seller's freedom of trade so as to prevent the latter from recapturing and utilizing, by his competition, the good will of the very business which he transferred for value…'").