

31 May 2024

Via Electronic Mail: CompetitionTaskforce@treasury.gov.au

Competition Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

Re: Non-competes and other restraints: understanding the impacts on jobs, business and productivity

Dear Competition Taskforce:

MFA¹ appreciates the opportunity to submit these comments in response to the Australian Government's request for information and views to inform the Competition Review's consideration of non-compete clauses.² MFA represents the global alternative asset management industry, of which fund managers with offices in Australia, in total, manage nearly \$1 trillion in gross assets.³ Institutional investors—like pension plans, university endowments, charitable foundations, and other institutional investors—rely on MFA members to meet financial obligations, diversify their investment portfolios, and manage risk.

While MFA understands the Government's focus on protecting Australian workers and ensuring their mobility, we believe that the alternative asset management industry's use of non-compete clauses to protect intellectual property and proprietary interests is unique in context and distinguishable from the restrictive covenants that often are the focus of broad-based academic studies on the use of non-compete clauses. Accordingly, we recommend that the Government closely study market-standard practices in specific industries before reaching a policy prescription. For that purpose, our comments seek to inform the Government's study of the alternative asset management industry's use of non-compete clauses.

¹ Managed Funds Association (MFA), based in Washington, DC, 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 180 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over \$3.2 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 AUSTRALIAN GOVERNMENT, THE TREASURY, COMPETITION REVIEW, NON-COMPETES AND OTHER RESTRAINTS: UNDERSTANDING THE IMPACTS ON JOBS, BUSINESS AND PRODUCTIVITY: ISSUES PAPER (April 2024) ("**Issues Paper**").

³ *Hedge Funds and Alternative Assets in Australia*, FUNDComb, <https://fundcomb.com/overview/hedge-funds-alternatives/australia-region> (last visited May 21, 2024).

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I. MFA Members' Use of Non-Compete Clauses Inures to the Benefit of Employees

MFA members frequently use non-compete clauses 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 non-compete clauses only to employees whose departure would run the risk of exposing such proprietary information and result in competitive harm. In such cases, non-compete clauses 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, non-compete clauses afford MFA members unique protection against cases where departing employees misappropriate their proprietary information.

Importantly, non-compete clauses foster the free flow of information and training within a firm that results in the innovation that is so critical to the competitive process in the alternative asset management industry. Restricting MFA members' use of non-compete clauses would impede the sharing of information and training within a given firm and limit the number of employees who have access to each firm's proprietary information. Currently, MFA members use non-compete clauses to safely allow covered employees to access and understand 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 in this industry. Without the protection of non-compete clauses, firms would be forced to severely limit the number of employees with access to their proprietary information and investment into training and development, 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.

In turn, the use of non-compete clauses allow MFA members to utilise 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, non-compete clauses limit harm to employees in the alternative asset management industry, as such employees are typically compensated during the non-compete period. The net result is that the use of non-compete clauses 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 non-compete clauses, but other new entrants do too. Both benefit from knowing that their startup investment in their own proprietary information will be protected.

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

II. MFA Members' Use of Non-Compete Clauses is Uniquely Necessary to Protect Intellectual Property and Proprietary Interests

As discussed in more detail below, non-compete clauses 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 non-compete clauses, necessary. In the alternative asset management industry, non-compete clauses serve to reduce costs and foster new market entry and competition. As noted above, 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 Competition Review recites two reasons why non-compete clauses may in fact impede new firm formation: first, workers would be unable to launch new firms to compete with their former employer, and second, firms would be less willing to enter markets in which potential sources of labor are restricted by non-compete clauses.⁴ However, these rationales are largely inapposite in the alternative asset management industry. 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 these 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 fund managers 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

⁴ Issues Paper, at 19 ("The direct consequence of a non-compete clause is that it hinders competition among businesses: it disincentivises workers from leaving their current job, creating a barrier to the entry of new businesses and the expansion of existing businesses.").

resources to develop and refine a strategy, and to develop a track record and sufficient reputation, to market that strategy to potential investors. Non-compete clauses protect this investment by MFA members.

Non-compete clauses also benefit employees in the alternative asset management industry because non-compete clauses are frequently supported by consideration, thereby enhancing wages. Employees who are subject to non-compete clauses are typically sophisticated, highly-compensated investment professionals who can negotiate higher wages based, in part, on the requirement that they execute non-compete clauses. The same is also true when non-compete clauses are added or extended while such professionals are employed by MFA members. In the absence of non-compete clauses, a likely result would be downward pressure on the wages paid to such employees. Indeed, increased weighting toward deferred compensation may be substituted for non-compete clauses,⁵ and in such cases, departing employees receive neither the compensation associated with a non-compete clause nor unvested awards of deferred compensation.⁶ Moreover, absent non-compete clauses, employers would be likely to condition significant incentive compensation on remaining employed, which would result in individuals forfeiting significant compensation on resignation—regardless of whether they went to work at a competitor immediately after or not.

Further, many fund managers 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 non-compete clauses, 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.

In practice, confidentiality, non-disclosure, and non-solicitation agreements do not afford MFA members the same level of protection as non-compete clauses. 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

⁵ 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 non-compete clauses for purposes of retaining employees).

⁶ See Jonathan M. Barnett & Ted Sichelman, *The Case for Noncompetes*, 87 U. CHI. L. REV. 953, 991 (2020).

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 alternative asset management industry as a whole. To the extent that MFA members cannot rely on non-compete clauses, they would be forced to litigate alleged confidentiality breaches much more frequently to protect their proprietary information. There have been many well-publicised 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.

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We appreciate the opportunity to submit our comments in response to the Government's request for feedback and comments, and we would be pleased to meet with the Competition Taskforce to discuss our comments. If your staff have questions or comments, please do not hesitate to call Joseph Schwartz, Vice president and Senior Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jillien Flores

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