April 17, 2023

Via Electronic Filing

April Tabor
Secretary
Federal Trade Commission
600 Pennsylvania Avenue, NW
Suite CC-5610 (Annex C)
Washington, DC 20580

Re: Notice of Proposed Rulemaking, Federal Trade Commission; Non-Compete Clause Rule; 88 Fed. Reg. 3482 (RIN: 3084-AB74)

Dear Secretary Tabor:

The Investment Adviser Association (**IAA**)[1] appreciates the opportunity to comment on the Commission's proposed Non-Compete Clause Rule.[2] The Proposal would prohibit an employer from entering or attempting to enter into a non-compete clause with an employee, maintaining a non-compete clause with an employee, or representing to an employee that the employee is subject to a non-compete clause where the employer does not have a reasonable basis to believe that the employee is subject to an enforceable non-compete clause.

While we support the Commission's objective of protecting the interests of employees and their ability to continue to work in their field after leaving their employment, we are concerned that the potential impacts of the Proposal would extend well beyond this objective and result in unintended consequences for employers and employees, particularly in the case of investment advisers, which manage money as fiduciaries for their clients subject to a robust investor-protective regulatory framework. We are also concerned that the Proposal overlooks the important and legitimate business purpose that reasonable non-compete clauses play in the financial services industry broadly, and that by eliminating their use, our members' legitimate business interests will be significantly harmed from a competition standpoint because they would

[1] The IAA is the leading organization dedicated to advancing the interests of investment advisers. For more than 85 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. Our members range from global asset managers to the medium- and small-sized firms that make up the core of our industry. Together, the IAA's member firms manage more than $35 trillion in assets for a wide variety of clients, including individuals, trusts, investment companies, private funds, pension plans, state and local governments, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *Non-Compete Clause Rule*, 88 Fed. Reg. 3482 (Jan. 19, 2023), available at https://www.govinfo.gov/content/pkg/FR-2023-01-19/pdf/2023-00414.pdf (**Proposal**).

have inadequate protections for their trade secrets, intellectual property, and other proprietary information.

We provide additional background below to assist the Commission in understanding why we believe that the broad Proposal would have significant negative consequences for investment advisory firms, their employees, and their clients. We also offer several recommendations that we believe would better achieve the Commission's goals that we urge the Commission to take into account should a final rule (**Final Rule**) be promulgated. Our comments are limited to the Proposal's impact on investment advisers.[3]

I. Executive Summary

We make the following recommendations in this letter:

1. **The Final Rule Text Should Expressly Permit Non-Solicitation Agreements, Non-Disclosure Agreements, and Similar Provisions.** We appreciate and share the Commission's view that non-solicitation provisions and non-disclosure agreements (**NDAs**) – and certain other types of restrictive clauses – generally do not prevent an employee from seeking or accepting employment and would not be prohibited by the Proposal. We recommend that, in addition to the preamble, the text of the Final Rule contain clear language that these provisions are generally permitted.

2. **Certain Limited Non-Compete Clauses Should be Allowed.** When appropriately used, non-compete clauses serve a valid purpose. The Proposal's sale-of-business exception is too narrow as a practical matter because it fails to recognize these appropriate uses and will harm the legitimate needs of investment advisers to reasonably protect the value of their businesses, client relationships, and relationships with employees. The IAA recommends that investment advisers be allowed to use non-compete clauses: (i) with senior staff who have been directly and materially involved in developing proprietary strategies for the employer; (ii) in partnership, shareholder/equity holder, or similar agreements with the firm's principals; and (iii) in connection with sale-of-business transactions when the person restricted by the non-compete clause is, at the time the person enters into the non-compete clause, an owner, member, or partner of the selling entity.

3. **The Final Rule Should Only Apply Prospectively.** We recommend that the proposed requirement that employers rescind existing non-compete clauses and advise employees that those provisions are no longer in force not apply retroactively to agreements entered into before the effective date of the Final

[3] We are not presuming the Commission has the authority to promulgate this extremely broad rule. However, we focus in this letter on ways to better tailor the Proposal to meet the Commission's objective of ensuring employees can continue to work in their field after leaving an employer.

Rule. If the Commission nevertheless determines to apply this provision retroactively, the Commission should clearly define when an employee's information is "readily available." Additionally, as an alternative to sending individual notices, the Commission should permit investment advisers to post a notice on their public-facing websites.

4. **The Commission Should Provide a Reasonable Transition Period.** We recommend that the Commission provide a transition period of 18 months for employers to come into compliance with the Final Rule.

II. Background

The IAA provides the following background to give the Commission context for our recommendations.

What are Investment Advisers? Investment advisory firms provide a critically important service, helping individuals, businesses, local governments, endowments, trusts, and many other types of investors meet their financial goals. Most investment advisers are small businesses, part of and serving Main Street communities.[4] While investment advisers represent a wide variety of clients and business models, what they all have in common is that they manage money for others as fiduciaries and are legally bound to a special relationship of trust and confidence with their clients.[5]

Investment advisers are subject to robust regulation, either by the federal Securities and Exchange Commission (**SEC**) or the various states. For convenience, we focus our discussion on SEC-registered investment advisers, which are regulated under the Investment Advisers Act of 1940 (**Advisers Act**), which provides a strong investor-protective regulatory framework and a flexible, evergreen approach that has been adaptable to changes in the industry over the years.[6]

As fiduciaries, investment advisers have an affirmative duty to act in the best interests of their clients with care, loyalty, honesty, and good faith. Their fiduciary duty is overarching, broad, and applies to the entire agreed-upon investment adviser-client relationship. An investment adviser's duty of care includes the duty to provide advice that is in the best interest of the client, seek best execution of a client's transactions, and provide advice and monitoring over

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[4] For example, the median number of non-clerical employees of federally registered investment advisers was eight at the end of 2021, with 58 percent of these advisers having fewer than 10 non-clerical employees and 88.1 percent having fewer than 50 non-clerical employees. Advisers are also most likely to serve individual, rather than institutional, clients. *See IAA-NRS Investment Adviser Industry Snapshot 2022* (June 2022), available at https://investmentadviser.org/wp-content/uploads/2022/06/Snapshot2022.pdf.

[5] In fact, investors cite "trust" as the most important determinant in seeking a financial service professional for advice. Angela A. Hung, Noreen Clancy, Jeff Emmett Dominitz, Eric Talley, Claude Berrebi, Farrukh Suvankulov, *Technical Report: Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, Rand Corporation (Mar. 12, 2008), available at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

[6] States impose a similarly robust fiduciary regulatory framework on investment advisers that they regulate.

the course of the relationship. The duty of loyalty requires that an investment adviser must not place its own interest ahead of its client's interest.

Investment advisers have other obligations under the Advisers Act as well, including, but not limited to, having a comprehensive compliance program that must be reasonably designed to prevent violations of the Advisers Act and the rules thereunder.[7] An investment adviser may also have additional obligations under relevant federal and state law, including obligations related to safeguarding clients' personally identifiable information (**PII**) and other confidential information.

How Investment Advisers Use Certain Contract Provisions. Investment advisers may have non-solicitation agreements, NDAs, and non-compete clauses in their employment agreements for several important reasons. For example, investment advisers often have policies and agreements that require employees to maintain the confidentiality of proprietary and client information and restrict the use of such information for a wide range of purposes to meet their regulatory obligations and protect their businesses, employees, and clients. These uses are consistent with the Commission's public policy goal to ensure competition policy is aligned with the current economic evidence about the consequences of non-compete clauses.

Non-compete clauses can also benefit both the investment adviser and the employee. In fact, the absence of these agreements is likely to result in an impediment to the free flow of information and idea generation that is the hallmark of most investment advisers. Non-compete clauses are also used by investment advisers in M&A transactions as a critically important tool for investment adviser succession planning. Employees will also lose the economic benefit afforded by the non-compete agreement, as the employee is typically compensated for entering into the agreement and those agreements generally provide that the employee continues to receive salary and benefits through the garden leave period.

III. Recommendations

A. The Final Rule Text Should Expressly Permit Non-Solicitation Agreements, Non-Disclosure Agreements, and Similar Provisions.

The IAA appreciates and supports the Commission's position that non-solicitation agreements and NDAs would continue to be allowed under the Proposal. The Preamble makes clear that "the definition of non-compete clause would generally not include other types of restrictive employment covenants – such as [NDAs] and client or customer non-solicitation

[7]At a minimum, the investment adviser's policies should address: portfolio management processes; trading practices; proprietary trading of the investment adviser and personal trading activities of staff; accuracy of disclosures made to investors, clients, and regulators; safeguarding of client assets; accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction; the marketing of investment advisory services; processes to value client holdings and assess fees based on those valuations; safeguards for the privacy protection of client records and information; and business continuity plans. *See Compliance Programs of Investment Companies and Investment Advisers*, 68 Fed. Reg. 74714 (Dec. 24, 2003), available at https://www.sec.gov/rules/final/ia-2204.pdf.

agreements – because these covenants generally do not prevent an employee from seeking or accepting employment with a person or operating a business after the conclusion of the employee's employment with the employer."[8] We agree with this position and ask that the Commission include this position in the text of the Final Rule rather than just in the Preamble, so that it is clear that these contractual terms are presumptively permissible. We thus recommend that the Final Rule explicitly provide that non-solicitation agreements, NDAs, and other restrictive covenants that do not prevent an employee from seeking or accepting employment are permitted.

Non-solicitation agreements in the investment advisory industry are contracts that govern an employee's right to solicit clients of the employer after the employee's employment ends. These agreements are meant to protect an investment adviser from losing clients to former employees (including other financial advisory firms that may employ them). The investment adviser does not seek to prohibit the employee from accepting employment in the same or similar industry. Rather, it generally seeks to prohibit the employee from soliciting the investment adviser's clients for a specified period of time following the termination of employment.

These contracts are particularly important in the investment advisory industry, where the investment adviser's relationship with the client is its primary asset. Investment advisers hire professionals to service and nurture the investment adviser's fiduciary relationships with its clients. If employees are able to move to a competing firm and, immediately after termination, solicit the investment adviser's clients, they would essentially be allowed to take the investment adviser's assets with them.[9] Investment advisers use their brand and invest substantial time and money to attract clients and provide their resources, support, and operations to serve those clients. Additionally, many investment advisers serve clients in a team-based environment, where the employee is only one of several individuals who directly support the client relationship. Non-solicit agreements are thus used to protect an investment adviser from the harm caused by a former employee being able to leave and immediately take clients to a competitor. This includes initial harm, including the loss of the current relationship with the client and harm to the remaining team members, and future harm, including potential additional business opportunities with the client.

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[8] *Proposal*, 88 Fed. Reg. at 3482 (citing *MAI Basic Four, Inc.* v. *Basis, Inc.,* 880 F.2d 286, 287-88 (10th Cir. 1989) (stating that employees subject to NDAs—unlike employees subject to non-compete clauses—"remain free to work for whomever they wish, wherever they wish, and at whatever they wish, subject only to the terms that prohibit them from disclosing or using certain information.").

[9] It is important to note that clients sign an investment advisory agreement with the investment adviser entity, not the individual. Individuals are investment adviser representatives (**IARs**) of their investment adviser, which means they are the representative for the investment adviser. The client is a client of the firm's, even if the individual is assigned as the client's primary point of contact as the relationship manager. This is especially true when the individual is working as part of a team, and that individual leaves, but the rest of the team remains at the investment adviser. Prohibiting the investment adviser from using a non-solicit agreement in these cases would also harm these remaining employees.

While non-solicitation agreements are used to prevent former employees from soliciting an investment adviser's clients, investment advisers also face regulatory risk if former employees are able to use confidential information of the investment adviser and its clients. NDAs and non-solicitation agreements often work in tandem to protect client relationships and client and investment adviser confidential information because departing employees may otherwise use confidential information in their attempt to solicit clients.[10]

It is thus also crucial that investment advisers' ability to use NDAs to prevent employees from disclosing confidential information – in particular relating to clients – also be explicitly preserved. As noted previously, investment advisers are subject to privacy laws both at the federal[11] and state levels.[12] Investment advisers use multiple tools to ensure compliance with these regulatory structures, including non-solicitation agreements and NDAs that serve to protect client relationships and information. Due to the scope of these privacy laws, NDAs cover a wide range of information.[13] For example, in a recently published SEC Division of Examinations "Risk Alert," SEC staff cited investment advisers for deficiencies where "former employees of firms retained access rights after their departure and therefore could access restricted customer information."[14] If investment advisers are prohibited from using non-solicitation agreements and NDAs, investment advisers will be at greater risk of former employees retaining client

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[10] We appreciate that the Commission recognizes that employers have a legitimate business interest in protecting themselves from competition by former employees who possess sensitive information. Courts have recognized this interest as well. *See, e.g., Update, Inc. v. Samilow*, 311 F.Supp. 3d 784, 788 (E.D. Va. 2018) (citing *Power Distrib. v. Emergency Power Engineering, Inc.*, 569 F.Supp. 54, 57 (E.D. Va. 1983)).

[11] *See, e.g.*, 17 C.F.R. Part 248, Subpart A, and Appendix A to Subpart A; *Privacy of Consumer Financial Information (Regulation S-P)*, Release Nos. 34-42974, IC-24543, IA-1883 (June 22, 2000) (adopting rules implementing the privacy provisions of Subtitle A of Title V of the Gramm-Leach-Bliley Act (**GLBA**) with respect to financial institutions regulated by the SEC).

[12] *See, e.g.*, California Consumer Privacy Act (**CCPA**), which was amended and expanded by the California Privacy Rights Act (**CPRA**), CAL. CIV. CODE §§ 1798.100–199 (2021); Colorado Privacy Act (**CPA**), C.R.S. §§ 6-1-1301-1313 (2021); Virginia Consumer Data Privacy Act (**VCDPA**), Va. Code Ann. §§ 59.1-575-585 (2021).

[13] NDAs may cover information including, but not limited to, PII of employees, investors, vendors and clients as well as information regarding an investment adviser's business, methods, systems of doing business, investment/trade strategies, analysis, research, specific or potential trades/investments and strategies, data and computer systems, models, business procedures, processes, policies, methods of operation, programs, forecasts, projections, financial information, innovations, technologies, techniques, terms of contracts and agreements, business knowledge, and concepts that are not generally known by others and acquired as a result of the employment.

[14] SEC, Office of Compliance Inspections and Examinations (now Division of Examinations), Risk Alert, *Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P – Privacy Notices and Safeguard Policies* (Apr. 16, 2019), available at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Regulation%20S-P.pdf.

information and may face regulatory scrutiny for failure to appropriately safeguard this information.[15]

NDAs are also critical in the context of M&A transactions, where client privacy and business confidentiality issues routinely arise. For example, both the buyer and seller in such a transaction will generally share confidential firm and client information as part of the due diligence process. If either party to the transaction is unable to place restrictions on the use of that information through an NDA, that party faces potential legal and compliance risk and clients face potential harm as their information may be unnecessarily exposed. Similarly, both parties will also use non-solicitation agreements so that neither party will be able to contact the other party's clients inappropriately. This is especially important in the M&A context because prior to the transaction's completion, one party's clients will have no relationship, legal or otherwise, with the other party.

Non-solicitation agreements and NDAs are also important for the protection of trade secrets. The IAA appreciates that the Commission cites trade secret laws that provide employers with an alternative means of protecting their investments in trade secrets. The Uniform Trade Secrets Act (**UTSA**)[16] generally defines a "trade secret" as information that (i) derives independent economic value from not being generally known to other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of reasonable efforts to maintain its secrecy.[17] Investment advisers may use several tools, including non-solicitation agreements and NDAs, to ensure that they are making reasonable efforts to maintain secrecy. Without being able to use these tools, investment advisers may be unable to meet the burden under the UTSA.

We are also concerned that, without clear protection of provisions like non-solicitation agreements and NDAs, investment advisers would have little incentive to invest time, capital and provide valuable experience to develop new employees and will be less likely to share know-how and trade secrets or introduce those new team members to clients and prospects. This will ultimately hurt those professionals and the next generation of investment advisers and may also competitively harm the investment adviser's business and its clients, today and in the future.

To ensure that these tools remain clearly available for investment advisers, we recommend that both non-solicitation agreements and NDAs be expressly permitted in the text of

[15] We note that, while NDAs are used by investment advisers to ensure that client and other confidential information is kept private, they would not prevent employees from contacting regulators. 17 CFR § 240.21F-17 ("[n]o person shall take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications.").

[16] Uniform Law Commission, *Trade Secrets Act with 1985 Amendments*, https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=e58f19a0-6a5e-c90f-67c1-ac1f747ad47b&forceDialog=0.

[17] *Id.* at Sec. 1(4).

the Final Rule, rather than just discussed in the Preamble, which is not legally binding.[18] We believe this is consistent with the Commission's intent. We are concerned that the absence of a clear presumption permitting these types of contractual provisions would create confusion for investment advisers and may chill their use of valid non-solicitation agreements and NDAs. We also appreciate the Commission's view that in some cases, these types of provisions could effectively preclude an employee from working in the same field and would thus be prohibited.

We therefore recommend that the Commission add the following language to the proposed definition of "Non-compete clause" in proposed Rule 910.1(b):

> (3) Restrictive employment covenants—such as non-disclosure agreements ("NDAs") and client or customer non-solicitation agreements —are permitted unless they function to prevent an employee from seeking or accepting employment with a person or operating a business after the conclusion of the employee's employment with the employer, in which case they would be considered a de facto non-compete clause.

B. Certain Limited Non-Compete Clauses Should be Allowed.

We appreciate that the Commission recognizes the role M&A plays in business succession. However, we believe that the proposed 25 percent equity ownership threshold exception for non-compete clauses is too narrow to be of a practical benefit to investment advisers that use such clauses in reasonable and limited ways. The Commission suggests that there may be merit to and invites comment on an alternative approach that would apply different rules to different categories of employees based on an employee's job function, occupation, earnings, another factor, or some combination of factors.[19] Because there are other circumstances in which non-compete clauses are reasonable and consistent with the Commission's policy objectives, we strongly agree with this approach.

While we support the Commission's statements allowing NDAs and non-solicitation agreements to be used by investment advisers, these agreements may not be fully adequate to

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[18] Under well-established principles of administrative law, the Preamble is the public justification for the rules in judicial review; as a result, that justification has an authoritative status for guiding the courts and the public about the rule's application. *See*, *e.g.*, SEC v. Chenery Corp., 318 U.S. 80, 87 (1943). A Preamble is not legally enforceable, but it is an important aid in understanding why an agency is acting or refusing to act. Preamble language operates as the agency's contemporaneous interpretation of the regulatory requirements and is not part of the enforceable regulatory requirements themselves. As such, the agency interpretation of the substantive regulatory requirements may change from what a Preamble indicated.

[19] *Proposal*, 88 Fed. Reg. at 3518. We note that only three states (California, North Dakota, and Oklahoma) have adopted laws rendering non-compete clauses void for nearly all employees, while the rest of the states do not place any restrictions on the use of non-compete clauses or will only render non-compete clauses void based on an employee's earnings, consideration, notice, or other factors.

prevent immediate and irreparable damage to an investment adviser.[20] Non-compete clauses used in a limited manner, with reasonable temporal, scope, and geographic restrictions, in conjunction with NDAs and non-solicitation clauses can provide adequate protection for an investment adviser's specific intellectual property, proprietary information and methods, and other confidential information.[21]

Therefore, we recommend expanding the scope of allowable non-compete clauses in a way that will benefit employers, employees, and clients during certain ordinary business relationships and in the context of M&A transactions. Specifically, we recommend that non-compete clauses be allowed in the following circumstances: (i) with senior investment staff who are directly and materially involved in developing proprietary investment strategies; (ii) in partnership, shareholder/equity holder, or other similar agreements with the firm's principals; and (iii) in sale-of-business transactions.[22]

Certain Senior Staff. Investment advisers may make limited use of non-compete clauses for their senior investment or other senior professionals who are directly and materially involved in proprietary investment strategy and model development and execution. Due to the nature of their position, these senior professionals develop highly sensitive, proprietary, and confidential information relating to the investment strategy, models, or other approaches used by the investment adviser and have access to confidential information relating to proprietary investment strategies as well as their employer's proprietary methods and systems of investing.[23] These employees are at the core of an investment adviser's business to the extent that the investment adviser develops its own proprietary investment strategies. The employer's interest may not be adequately protected by a non-solicitation agreement or NDA because neither may directly capture a former senior staff member's use of the employer's proprietary intellectual property. We thus believe that narrowly tailored restrictions to protect an investment adviser's legitimate business interest in these cases are reasonable and should be allowed under the Final Rule.[24]

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[20] *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1055 (4th Cir. 1985) (finding preliminary injunction appropriate where firm "faced irreparable, noncompensable harm in the loss of its customers.").

[21] *See Zambelli Fireworks Mfg. Co., Inc. v. Wood*, 592 F.3d 412, 424 (3rd Cir. 2010) ("legitimate business interests include trade secrets, confidential information, goodwill, unique or extraordinary skills, and specialized training that would benefit competitors.").

[22] We note that a non-compete clause in the sale of a business is legal in all 50 states, even in states that generally prohibit non-compete clauses. *See, e.g.*, Cal. Bus. & Prof. Code § 16601. The purpose of these exceptions is to protect the goodwill, ownership interest, and staff acquired by the buyer.

[23] *See Harrison v. Albright*, 577 P.2d 302, 304 (Colo. App. 1977) (the employee "was the only person who possessed the knowledge, skills, and the licenses to make the business a possible success. This made him the key man and very heart of the business.").

[24] *See Morgan's Home Equip. Corp. v. Martucci*, 390 Pa. 618, 136 A.2d 838, 846 (1957) ("not allowing competitors to profit from an employee's 'specialized training and skills' is a legitimate use of a covenant."); *see also Hess v. Gebhard Co. Inc.*, 808 A.2d 912, 918 (Pa. 2002) (quoting *Miller Mech., Inc. v. Ruth*, 300 So.2d 11, 12 (Fla. 1974))

Shareholders, Partners, and Other Equity Holders. Shareholders, partners or other equity holders of an investment adviser will also generally have detailed knowledge of the firm's intellectual property, trade secrets, business plans, and relationships with key stakeholders, and will also have access to client lists and client information. Non-compete clauses in partnership, shareholder/equity holder or similar agreements with a firm's principals are designed to protect and benefit all shareholders, partners or other equity holders of a firm by preventing them from using that insider information to start a rival business or contribute to a direct competitor. NDAs may not provide adequate protection in these situations because the former partner, shareholder or other equity holder may use confidential information in their work with the new employer, without directly taking it from the former investment adviser or disclosing it to anyone at the new firm, and the former investment adviser may face an uphill battle to show that its confidential information has been misappropriated, which is generally accomplished through expensive and time-consuming litigation.[25] Lacking a non-compete clause, the former investment adviser's options for prohibiting the shareholder, partner or other equity holder from using sensitive information for a direct competitor are limited.

Sale of Business/M&A. Non-compete clauses, which are generally entered into between a buyer and a seller (including its partners or owners), are a material element of the negotiation between the parties and focus on restricting the seller from engaging in a business that competes with the buyer and/or the acquired business for a specified period of time and within the boundaries of a designated geographic area. It is important to note that non-compete clauses are relevant to M&A transactions because the investment adviser generally desires to retain the goodwill and certain employees of the acquired firm who have special talents, knowledge, and experience with business operations to help develop the acquired firm post-acquisition.

Because M&A non-compete clauses are generally bargained for in the sale of the business, it is reasonable for an investment adviser to be allowed to safeguard its value in the acquired firm.[26] Without such an agreement in place, the owner(s) of the acquired firm could form a new firm and utilize their knowledge to compete with the buyer and/or acquired firm, significantly reducing the value of the acquired firm. The loss of clients and/or critical staff could

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("covenants have developed into important business tools to 'allow employers to prevent their employees and agents from learning their trade secrets, befriending their customers and then moving into competition with them.'").

[25] Courts have found that certain employees' access to confidential information regarding the employer's customers, products, technical details, and marketing strategies may make it less likely that they would be able to not use that information in their new position. *See, e.g., National Business Services Inc. v. Wright*, 2 F.Supp.2d 701, 708 (E.D. Pa. 1998) (the court concluded that it was "virtually inconceivable that [the former employee] would be able to avoid utilizing the confidential information . . . and exploiting [the employer's] customer goodwill.").

[26] *See Strategix, Ltd. v. Infocrossing West, Inc.*, 142 Cal. App. 4th 1068, 1072-73 (Cal. Ct. App. 2006) (citations omitted) (non-compete agreements used in the sale of a business "serve[] 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."); *see also Shearson Lehman Bros. Holdings v. Schmertzler*, 500 N.Y.S.2d 512, 516 (1986) (covenants not to compete relating to a sale of a business are more liberally enforced, on the premise that the buyer of a business should be permitted to restrict the seller's ability to take back the goodwill that was just sold).

undermine the value for both firms in the transaction. Sudden staff transition can also lead to material negative impacts on clients. Therefore, investment advisers often require that these owners enter into non-compete clauses.

Non-compete clauses may have important tax implications.[27] For example, investment advisers are currently allowed to pay a percentage of the purchase price for the departing owner's stock in exchange for the non-compete clause.[28] This facilitates succession planning (particularly in firms where there are multiple smaller owners), accelerates payments to departing sellers, helps firms spread equity ownership more broadly, and helps smaller investment advisers maintain independence.[29]

For all these reasons, a broad restriction that does not carve out certain employees is too narrow because it fails to recognize the legitimate needs of investment advisers to protect the value of their businesses and clients. The IAA believes that appropriately tailored non-compete clauses in these circumstances can produce stability and value for both employers and employees and promote long-term planning.

We therefore recommend that the Commission replace the language of the "Exception" in proposed Rule 910.3 with the following:

> The requirements of this part 910 shall not apply to a non-compete clause that is entered into by a person who is: (i) a senior executive of a business entity; (ii) selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity; or (iii) selling all or substantially all of a business entity's operating assets, when the person restricted by the non-compete clause is an owner of, or member or partner in, the business entity at the time the person enters into the non-compete

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[27] For example, the rule, if finalized as proposed, would have a significant impact on the calculation of amounts subject to the golden parachute rules of Internal Revenue Code (**IRC**) § 280G, which impose a 20 percent employee-paid excise tax and disallows a corporate tax deduction for certain compensation payments made in connection with a change in control event. Currently, the value of payments associated with an enforceable non-compete are excluded from Section 280G.

[28] This creates a material discount to the individual buyer/existing owners of the firm through tax shifting to the entity (and deductions against passive income). Because the firm is paying part of the purchase price, this reduces the firm's overall revenues and tax burden. Certain employers also treat non-compete clauses as a "substantial risk of forfeiture" under IRC § 83 in order to delay the imposition of income and/or FICA taxes on certain compensation awards. This position would be unavailable if the Proposal is finalized as proposed, resulting in accelerated taxation of outstanding awards.

[29] The U.S. Small Business Administration Office of Advocacy has submitted a letter voicing its concerns about the Proposal's impact on small businesses. *See* Letter from Major L. Clark, Deputy Chief Counsel, Office of Advocacy U.S. Small Business Administration, to the Commission re: *Federal Trade Commission's Non-Compete Clause Rule* (Mar. 20, 2023), available at https://advocacy.sba.gov/wp-content/uploads/2023/03/FTC-Noncompete-Clause-Comment-Letter-Filed.pdf ("[The Office of] Advocacy encourages the [Commission] to adopt an approach that addresses the different concerns of small entities in the marketplace. Alternative approaches should be considered, analyzed, and tailored to the size and type of entity to minimize adverse impacts to small entities.").

> clause. For purposes of this part 910, a senior executive is a person who is a partner, shareholder, other equity holder or owner of the employer or an employee who is directly and materially involved in proprietary strategy development for the employer. Non-compete clauses covered by this exception would remain subject to Federal antitrust law as well as all other applicable law.

C. The Final Rule Should Only Apply Prospectively.

The IAA recommends that the Final Rule not apply retroactively to agreements entered into before its effective date. We have significant concerns about a rule provision that would apply retroactively to existing contractual arrangements without exemption or accommodation. This approach is inconsistent with the view that "[r]etroactivity is not favored in the law."[30]

The IAA believes that it will be difficult for investment advisers to implement that requirement, due to the potential legal issues arising from rescinding agreements previously negotiated in good faith. For example, while investment advisers are required to retain the names of former employees, they are not likely to have retained updated contact information for former employees.[31]

We are also concerned how retroactive application will impact M&A transactions, should the Commission not accept our recommendation regarding expansion of the exception for non-compete clauses, discussed above. The Proposal's requirement that employers notify employees that their non-compete clauses are rescinded will likely apply in the context of a sale of business, requiring investment advisers to make such notifications to individual sellers who held less than the proposed 25 percent equity ownership of the sold business. Not only will this requirement be unfair because it will negatively impact the bargained-for value of the transaction, but will also be legally and operationally difficult to implement, and will lead to unintended consequences, because non-compete clauses are only one element of matrixed and complex M&A transactions.

If the Commission nevertheless determines to apply this provision retroactively, it should clearly define "readily available" to mean that an employer has the employee's contact information in its current systems as of the effective date of the Final Rule, so that the employer would not need to do further research to attempt to locate former employees.

As an alternative, the Commission should eliminate the requirement for investment advisers to locate and notify each individual currently subject to a non-compete clause,[32] and

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[30] *Bowen v. Georgetown Univ. Hosp*., 488 U.S. 204, 208 (1988). Noting that retroactivity is disfavored, the Supreme Court held that "a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms."

[31] Investment advisers have an obligation to keep records of "the names of all persons who are an investment adviser's partners, officers, directors, or employees" for a period of five years; however, there is no requirement to monitor or update the former employees' contact information. 17 C.F.R. § 275.204-2(a)(15)(iii).

[32] *Proposal*, 88 Fed. Reg. at 3513.

instead permit investment advisers to post a notice on their public-facing websites. This would allow investment advisers to inform former employees without the added time and expense of individually rescinding existing non-compete clauses.

D. The Commission Should Provide a Reasonable Transition Period.

The Proposal states that an employer could comply with the rule by rescinding prior non-compete clauses no later than the compliance date, which would be 180 days after the effective date of the Final Rule.[33] The IAA believes that the proposed timeline is unrealistic.

Due to the difficulty investment advisers will face when implementing the requirements of the Proposal, including potentially locating and contacting former employees and having to rescind and/or re-negotiate agreements previously negotiated in good faith as described in the preceding section, the Commission should provide an adequate transition period of 18 months for employers to come into compliance.

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We appreciate the Commission's consideration of our comments on this important Proposal. Please do not hesitate to contact the undersigned at (202) 293-4222 if we can be of further assistance.

Respectfully Submitted,

/s/ Gail C. Bernstein
Gail C. Bernstein
General Counsel

/s/ William A. Nelson
William A. Nelson
Associate General Counsel

[33] *Proposal*, 88 Fed. Reg. at 3536.