

Hedge Funds Urged to Prepare for a Non-Compete Clause Ban

A pending rule change may not survive court challenges in an era of weak deference to new policy, but managers must be ready regardless.

By **Chris Larson** | June 12, 2024

The noncompete clause in employment contracts that bars staffers from immediately joining a rival firm – criticized by such strange bedfellows as **Millennium Management's Izzy Englander** and the **Federal Trade Commission** – could be going away as soon as this summer, banned by federal fiat. Or, if the courts say hold on there, it could stick around and be a standard feature of hedge fund contracts for the foreseeable future.

Regardless, hedge fund managers need to be thinking now about how they would tweak their employment practices if the new rules were to come online, say market consultants. It's not clear many are doing so, however – and that's as a hiring spree continues for technology and distribution roles.

The looming noncompete ban stems from a 3-2 FTC vote in April, with the new rule slated to take effect in late August, a move that would cut deep in the hedge fund market, where such clauses are common in employment contracts. But several lawsuits immediately attacked the rule, arguing that it goes beyond the FTC's authority.

Several of those cases have since consolidated into coordinated litigation, with a court decision expected by early July on whether the rule will be put on hold while the lawsuits play out. Some legal observers say the matter could end up before the Supreme Court before its fate is final.

"Most legal experts in the U.S. don't expect" the rule will survive the court challenges, said **Eric Rumbaugh**, partner at law firm **Michael Best**. "But we don't know for sure."

Opponents, including the two commissioners who voted against the rule, assert the new rule goes beyond the outer limits of the FTC's authority. And there are worries that it might backfire: in a note to clients about the new rule, the **Wagner Law Group** noted that

while the rule is ostensibly meant to eliminate unfair competition, "there is substantial concern that the new rule will actually have the opposite effect and limit businesses' ability to protect their legitimate trade secrets and confidential data."

Some business owners, though, see non-competes as the cause of rising compensation costs overall. That includes Englander, founder of Millennium, a \$67.7 billion multi-strategy hedge fund, who said at a conference last fall that the lengthy non-competes hedge funds use to deter staff from working for rivals have created a "talent bubble" that's helped to drive up overall compensation, according to a Business Insider article.

Many large funds routinely use noncompete clauses to prevent their staff from joining competitors for long periods of time, with Englander specifically calling out rivals like **Citadel**, **ExodusPoint** and **Point72** for using such restrictive covenants, the report said. For top traders and other high-ranking hedge fund officials, non-competes can last for a year or even two.

Sometimes they're even longer: **Chris Rokos** had a five-year non-compete with **Brevan Howard**, the hedge fund he cofounded but left in 2012. He sued to have it overturned, though he and Brevan Howard settled in 2015, clearing the way for Rokos to launch his namesake firm, with backing from his former firm.

While the lawsuits wend their way through the courts, there hasn't been much impact so far, some market watchers say.

"I have not seen firms modifying offer letters or contracts yet," said executive recruiter **George Wilbanks**.

That's in part because many say the rule's chances of taking effect are slim.

"Many colleagues feel that the rule is going to be delayed," Brustowicz said. "As a result, some companies have been reluctant to make significant changes to their agreements if it ends up being unnecessary."

But experts are advising hedge fund managers to take steps now to be ready if the rule survives the legal challenge, as its stipulations would take effect almost immediately.

If at the July 3 hearing the court says the rule can indeed go into effect in August, even with the lawsuits pending, "I think that's too late for you to start thinking about what you're going to do with comp after the rule," Rumbaugh said.

"The most prudent action for businesses to take now is to begin the shift away from non-competes and instead augment non-solicitation and confidentiality provisions," said **Katherine Brustowicz**, associate attorney at Wagner.

Managers should also be reviewing their existing non-competes to determine if any of them fall into a handful of exceptions written into the rule, such as contracts for certain highly paid senior executives.

"We're telling our clients now to take an inventory of the agreements they've got," Rumbaugh said. "Decide which ones count as non-solicitation agreements, which we think you'll still be allowed to have, and which ones are going to count as non-competes."

For agreements that fall under the new rule's umbrella, firms that have current noncompete contracts would be required to inform employees, both current and former, that the provisions are no longer in effect. They would need to be ready to send out such notices just as the rule takes effect.

The Wagner note urged managers to go beyond the basics and be very thorough in reviewing non-solicitation clauses as well as other restrictive covenants.

And hedge funds could start to tweak their compensation plans, regardless of the rule's outcome, Brustowicz said.

"I would not be surprised to see more employers create incentives for key employees to remain with their company through the compensation plans," she said.

With or without non-competes, hedge funds have still been actively hiring, with an ongoing focus on tech roles.

"Firms continue to build out quantitative and technology capabilities around machine learning in large data sets, often non-financial in nature, and the implementation of large language models on the same front," Wilbanks said.

Sales and marketing roles are in demand, too, especially outside of the large firm.

"Distribution remains a weak point for many of the small to midsize firms, and they are mostly starting from scratch, usually with only a couple of investor relations professionals," Wilbanks added.

These trend lines in hiring are likely to not be deflected whether the FTC rule takes effect or is thrown out by other courts.

"I don't foresee a change in the types of positions [in demand] for the remainder of the year and certainly not as a result of the non-compete rule," Brustowicz said.

FundFire is a copyrighted publication. FundFire has agreed to make available its content for the sole use of the employees of the subscriber company. Accordingly, it is a violation of the copyright law for anyone to duplicate the content of FundFire for the use of any person, other than the employees of the subscriber company.