



31 May 2024

Competition Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

By email: CompetitionTaskforce@treasury.gov.au

Dear Sir/Madam

**Non-Competes and Other Restraints
Understanding the Impacts on Jobs, Business and Productivity**

The Australian Financial Markets Association (AFMA) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets.

We are pleased to provide a submission to the Issues Paper "Non-competes and other restraints: understanding the impacts on jobs, business and productivity" (**the Issues Paper**). The structure of our submission will be to highlight the positive impacts that non-compete clauses have on productivity and employee outcomes for organisations within our membership and then to address some specific discussion questions in the Issues Paper.

Executive Summary

AFMA notes the following by way of executive summary:

- Financial services firms hold significant intellectual property, confidential information and customer relationships. Non-compete clauses and other forms of restrictive covenant are the most effective tools for such firms to be able to protect this information being transferred to competitors;

- Non-compete clauses in financial services employment contracts benefit employees through providing confidence to employers to invest in employees and provide access to confidential information/intellectual property at early stages of their careers;
- Employees in financial services may be distinguished from those in other industries insofar as non-compete clauses should result in higher overall remuneration and less deferral of remuneration as a means to protect confidential information/intellectual property;
- Employees in financial services firms generally hold significant bargaining power and are able to negotiate the terms of the employment contract, including the inclusion of non-compete clauses;
- Non-compete clauses are especially valuable, and should be presumed valid, for employees who earn over a certain remuneration threshold or those that are remunerated during the non-compete period;
- The policy approaches to regulating non-compete clauses in other jurisdictions are not particularly suitable in the Australian context; and
- Financial services firms have chosen Australia as a jurisdiction to operate their Asia-Pacific business, in part, due to the protections to intellectual property/confidential information afforded by current laws and regulations. Any restrictions on the ability to use non-compete and non-solicitation clauses to protect such interests would undermine Australia's position as a regional financial centre.

General Comments on Non-Compete Clauses

Noting the ABS data regarding the prevalence of non-compete clauses in the financial services sector, AFMA's view is that financial services firms generally have a legitimate interest to protect by relying on these clauses and use non-compete arrangements in ways that are mutually beneficial for the employers and their employees.

The reasons why non-compete clauses are important for financial services firms may be distinguished from clauses used in other industries. The basis for this distinction is that financial services firms generate and hold valuable confidential information and intellectual property, which they need to protect in order to ensure their ongoing competitiveness. This is the result of significant investment in systems and strategies both inside and outside Australia. This confidential information and intellectual property is a key way in which financial services firms provide services to their customers, enhancing customer outcomes and the efficiency of financial markets.

Further, in the financial services industry, maintaining client relationships is vital to remaining competitive and delivering quality customer service. The employer invests time and resources in its employees to ensure they can establish, grow and uphold those connections. As such, it is in the legitimate interests of the employer to seek to protect and solidify those relationships when an employee who was previously charged with carriage of the relationship departs the firm. Non-competes are a key tool for doing so as the employee is prevented, for a finite and reasonable period of time, from taking such relationships with them across to a competitor. The employer thereby has an opportunity to connect the client with another employee of the firm and to start building that relationship.

In addition to protecting legitimate interests of the employer with respect to client relationships, AFMA considers that non-competes deliver wider benefits in the form of economic productivity, innovation and opportunities for employees.

From an employer perspective, having contractual protections of confidential information and intellectual property encourages and incentivises financial services firms to innovate, including investing in highly confidential trading strategies without the concern that these processes will be taken by a departing employee to a competitor firm. In the absence of adequate protections, the incentives to innovate will be reduced, thereby diminishing customer outcomes and also productivity and innovation in the broader Australian economy. This is acknowledged by our members who each invest and operate in Australia with the benefit of a legal framework which supports this. A number of our members have global operations and have chosen Australia to establish their Asia-Pacific offices based on the protections available.

From an employee perspective, there are unique benefits arising from non-compete clauses. Firstly, in the absence of non-compete clauses to protect confidential information and intellectual property, employers will be significantly less inclined to provide employees with exposure to such information, which will hinder the employees' development and ability to advance to more senior roles and remuneration levels. This will also see a reduction in collaboration across teams, and resultant loss of productivity, where employers seek to reduce employees' knowledge of the confidential information and intellectual property outside of the employee's own department. The same can be said of an employer's willingness to give meaningful opportunities to employees to grow their own customer connections, out of fear that if the relationship is concentrated with one individual the customer's business would be lost to a competitor if the individual leaves.

Secondly, the absence of adequate protections for intellectual property and confidential information may also give rise to a free-rider problem, whereby firms are disincentivised to train their own staff, with the path of lesser resistance being to hire an employee from a competing firm who is able to bring another firm's training and knowledge with them. The likely consequence would be an intensified 'war for talent' between competitor firms rather than a focus on investment in their own staff. While some highly trained employees may benefit from this in terms of securing higher remuneration from a competitor, the bulk of the workforce loses out as a result of less investment in their learning and development, especially impacting graduate intakes. Eventually this will mean that all firms have less access to skilled resources.

Third, although employers may not always allocate a specific payment for the non-compete period, the non-compete is a term agreed to by an employee in their employment contract in consideration for their remuneration during employment. In other words, at least in the financial services industry, the fact that the employee is agreeing to a constraint on their conduct post-termination should be reflected in their overall compensation package. If non-competes were to be regulated or prohibited, AFMA expects that this could have a detrimental impact on employee remuneration outcomes rather than boosting wages. This is because from an employer's perspective, the value of the employee is somewhat discounted if they are able to freely join a competitor at any time, potentially taking with them (either advertently or inadvertently) confidential information, intellectual property and/or customer connections. In the absence of non-compete clauses to protect those interests, it is likely that financial services firms will look to implementing employment contracts with significant amounts of deferred compensation that is "at-risk" to mitigate the risk of

an employee transferring valuable intellectual property to a competitor. This would clearly be less beneficial for an employee's remuneration outcomes and would also hinder job mobility.

It is also likely that employers will need to rely on other mechanisms in the employment contract to achieve similar outcomes as a non-compete, for example, by extending the duration of the notice period and/or placing the employee on garden leave. Instead of facilitating job mobility, as is a stated aim of the Treasury, this would have a similar impact as a non-compete in terms of preventing employees from moving jobs freely, and may last for a longer period of time.

The Issues Paper queries whether the employer's legitimate interests can be protected in ways other than a non-compete, for example, via a non-disclosure clause in the employment contract or relying on statutory protections to protect confidential information. However, enforcing such obligations is burdensome for employers and requires incurring significant legal costs and management time on litigating to protect the firm's rights. This is a costly and inefficient alternative for the existing employer, the future employer and employee. In contrast, by using a non-compete, the employee being kept out of the market for a reasonable period of time will in most cases allay an employer's concerns around taking valuable information to a competitor without needing to resort to any legal action.

Courts in Australia and overseas have long accepted that the use of non-disclosure agreements alone are insufficient to protect an employer's legitimate interests. The reason is because it is too difficult to draw the line between information which is confidential and information which is not; and it is very difficult to prove a breach when the information is of such a character that an employee can carry this away in their head. These difficulties are such that the Courts accept that the only practicable solution is to take a covenant from the employee not to work for a competitor for a reasonable time.

The common law starts from the position that restraints cannot be enforced, except for where they are reasonable. The common law position already accounts for the potential impacts of these obligations on employees and the labour market (including worker mobility). The common law position appropriately balances interests by placing the onus and burden on employers to make the case to enforce these obligations. This is part of the test applied by the Courts which the Issues Paper itself describes as a pragmatic reflection of the limitations these obligations can place on an employee's freedom of trade. Our members agree with that description. An employee's individual circumstances, including whether they are paid during the restraint, are always relevant to the Courts' analysis.

Further, if an employer was forced to rely on a non-disclosure/confidentiality clause in the employment contract rather than a non-compete, they may need to enforce their rights by bringing an action for breach of contract and damages after the damage has already been done, as opposed to proactively validly protecting the confidential information and intellectual property through a non-compete for the duration of the currency of that information. Such other restraints give rise to significantly increased costs of litigation without achieving the legitimate protection of confidential information and intellectual property, and hence are less efficient mechanisms than non-compete clauses.

The experience of our members in the industry is that their employees are highly educated and knowledgeable about the operation of post-employment restraint obligations. These are frequently

the subject of negotiation, including by employees who insist on higher remuneration packages before agreeing to obligations of this nature. The labour market in the industry means the need to secure key talent is critical. This means that employees are often successful in achieving their preferred position in these negotiations.

There are many sources that discuss in detail the wide range of legitimate interests that appropriate restraint obligations serve, including how businesses use them to prevent disclosure of confidential information, protect investment in workforce training and development, and to incentivise strong performance through high compensation.¹

Specific Discussion Questions

- 1. Does the common law restraint of trade doctrine strike an appropriate balance between the interests of businesses, workers and the wider community? If not, what alternative options are there?***

The common law restraint of trade doctrine is summarised in the Issues Paper as being that restraints of trade are presumed to be against the public interest “unless they are reasonably necessary to protect the legitimate interest of the employer.” As such, the presumption of unenforceability is in favour of the employee and the employer bears the onus of proving that it has a legitimate interest and the restraint is reasonably necessary to protect it. The courts have developed jurisprudence in this space which ensures that restraints are adequately limited in scope or are otherwise held to be unenforceable. Employers in financial services draft non-competes in light of these rules, being careful to only preclude the employee undertaking a similar role for a competitor and to appropriately limit the restraint in duration, geography and types of prohibited conduct to maximise the prospect enforceability.

In AFMA’s view, the common law doctrine already imposes a high threshold test on employers in favour of the interests of employees and the broader public interest. The common law test already seeks to balance a range of interests and AFMA considers that any variation of this test that further subordinates the employer’s interests would risk those interests not being adequately taken into account.

In a financial services context, generally the most important interest that non-compete clauses seek to safeguard is the protection of valuable confidential information and intellectual property, and financial services firms will generally only look to enforce non-compete clauses where there is a legitimate risk that the employee holds, and will be able to transfer, such information. It is always open to an employer to waive any non-compete that is considered unnecessary to enforce at the point when the employee departs the firm and in members’ experience, employers take a reasonable approach in requiring a period out of the market only when it is legitimately considered reasonable and necessary.

¹ Jonathan Barnett & Ted Sichelman, *The Case for Noncompetes*, 87 U. Chi. L. Rev. 953 (2020); Geoffrey A. Manne & Dirk Auer, *Comments of the International Center for Law & Economics Regarding Contract Terms that May Harm Fair Competition* 10 (September 30, 2021); Evan P. Starr, et al., *Noncompete Agreements in the US Labor Force*, 64 J. L. & Econ. 53, 53 (2021); see also U.S. Chamber of Commerce, *Comment Letter on Non-Compete Clause Rule* (April 17, 2023), <https://www.regulations.gov/comment/FTC-2023-0007-19345>; Business Roundtable, *Comment Letter on Non-Compete Clause Rule* (April 17, 2023), <https://www.regulations.gov/comment/FTC-2023-0007-19341>.

2. Do you think that the *Restraints of Trade Act 1976 (NSW)* strikes the right balance between the interest of businesses, workers and the wider community?

The approach adopted in the *Restraints of Trade Act 1976 (NSW)* differs from the common law restraint of trade doctrine as it positively presumes that a restraint of trade is valid to the extent that it is not against the public interest. AFMA considers this strikes the right balance between the interests of businesses, workers and the wider community. This is because the presumption in favour of validity is appropriate given the restraint is entered into consensually by the employee as a term of their employment contract and in consideration for their remuneration (or sometimes, additional remuneration). However, there are still reasonable limits on enforceability in order to ensure the interests of the employee and wider community are taken into account. A court is able to balance each of these interests and 'read down' the clause to achieve a fair outcome overall.

3. Are current approaches suitable for all workers, or only certain types of workers? For example, senior management, low-income workers or care workers?

AFMA's response to this question is limited to financial services firms. AFMA acknowledges that the principal benefit arising from non-compete clauses is the protection of valuable confidential information and intellectual property; accordingly, there should be no need to apply a non-compete clause for those employees that are sufficiently junior that they do not have access to the sensitive information and cannot transfer it to a competitor. However, this will be role-dependent and employers should assess on a case by case basis when entering into a contract whether or not the specific role and circumstances justifies the use of a non-compete. The risk with prohibiting non-competes from being used for certain types of workers or income levels is that this blanket approach does not permit a case-by-case analysis of whether or not the employer has a legitimate interest that needs to be protected. Employers are best placed to make that assessment.

If a blanket rule must be imposed, then AFMA would support an employee's total remuneration as a threshold as a proxy for seniority in terms of the ability to retain non-compete clauses in employment contracts. Our position is that it can be safely and fairly assumed that employees with remuneration over a certain threshold have sufficient bargaining power to be able to understand and negotiate the existence of a non-compete clause in an employment contract. As noted above, AFMA would support a position whereby non-compete clauses for financial services firms are presumptively valid if the employee's total remuneration is above a specific monetary threshold or if the employee receives his or her remuneration during the period of the non-compete.

We suggest that the high income threshold, as indexed annually, may be a sensible threshold for this purpose. However, our position is that other types of restrictive covenants like employee and customer non-solicitation clauses should be able to apply to any employee regardless of remuneration, as such restraints do not prevent an employee from starting work in a new job as soon as they finish with their employer. As such, in most industries they impose no detriment to the employee in terms of job mobility or ability to earn an income, and they are also generally simple to understand and comply with.

As a final comment on non-competes, AFMA notes that the Issues Paper is silent on how any reform to or restriction on their use might interact with or impact non-competition obligations in a sale of business context. This is a type of restraint that arises regularly in financial services and is an issue that should be considered and addressed. For example, non-competes are often imposed on sellers

of businesses who have bargaining power to negotiate these arrangements and factor them into transaction costs, but may also have a dual capacity as employee of the company. AFMA's view is that this situation should be exempt from any restrictions placed on the use of non-competes in an employment contract.

4. *Would the policy approaches of other countries be suitable in the Australian context? Please provide reasons.*

Our members include those who operate in the jurisdictions referred to in the Issues Paper. This experience means that they have perspectives on the approaches referred to in other jurisdictions that are not captured in the Issues Paper.

AFMA has members who operate in the United States of America and have a detailed understanding of the Federal Trade Commission's Clause Rule (**Rule**). The Rule needs to be understood in its context and its current status.

The Rule was not the result of a detailed legislative analysis. There were a number of unsuccessful attempts to introduce Bills at the congressional level to regulate restraint obligations in the United States of America. It was only after attempts to formally legislate were rejected that an Executive Order was made directing the Federal Trade Commission to use certain powers available to it to restrict the operation of these obligations.² The making of the Executive Order was the result of, amongst other things, perceived impacts of competition in farming and telecommunications in the United States of America. The Rule itself was then only adopted in a split 3-2 decision of the Federal Trade Commission.

Our members who have experience in the United States of America have emphasised caution on placing much weight on reforms in that jurisdiction which are essentially the result of a highly political process, as opposed to a reasoned analysis of the interests served by post-employment obligations.

It is also significant that the making of the Rule is currently the subject of extensive litigation³ with the vast majority of commentators and practitioners strongly of the belief that it will be struck down and never go into effect.⁴ The Australian context should not be influenced by the Rule in circumstances where it is likely it will never meaningfully operate.

Our members also have experiences in the United Kingdom. The Issues Paper correctly notes that there was a high level proposal to regulate post-employment obligations in that jurisdiction. That proposal was made in May 2023. Despite more than a year passing, it has not advanced and is understood it will not be revisited until at least after the upcoming election. Plainly, it is not a legislative priority in that jurisdiction.

² See Executive Order No. 14,036, 86 Fed. Reg. 36987.

³ See, for example, Ryan LLC v Federal Trade Commission, United States District Court of Northern District of Texas, Dallas Division, No. 3:24-v-00986-E.

⁴ See Dissenting Statement of Commissioner Christine S. Wilson Regarding the "Policy Statement Regarding the Scope of Unfair Methods of Competition," 7-8 (Nov. 10, 2022); Chamber of Commerce for the United States of America et al. v. Federal Trade Commission et al., 6:24-cv-00148, United States District Court for the Eastern District of Texas, Complaint, filed April 24, 2024; <https://www.forbes.com/sites/aldenabbott/2024/04/23/ftc-rule-barring-non-compete-agreements-likely-will-fail/?sh=777d43886193>; <https://www.yalejreg.com/nc/predicting-the-fate-of-the-ftcs-non-compete-ban/>

In any event, the analysis which does appear to have been undertaken is highly localised to that jurisdiction. The most recent 25 January 2024 report of the Competition & Markets Authority about the perceived impact of non-compete agreements has regard to specific trends in labour markets in the United Kingdom, such as the geographical concentration of those markets inside and outside of London and the South-East. That close analysis of market factors in the United Kingdom does not make the case for change in Australia.

5. *Are there other experiences or relevant policy options that the Competition Review should be aware of?*

The financial services industry is unique. It is highly competitive and the labour market is comprised of workers with specialised skills. We note additional matters for consideration below.

Negotiated arrangements

The need to protect confidential and market sensitive information weighs heavily in this industry. The investment by market participants (such as our members) is significant. This is often known and accepted by employees, many of whom are directly involved in the development of bespoke technologies and investment strategies that are easily portable in the unaided memory of departing employees.

In our members' experience, the level of worker understanding of these arrangements in its industry is far greater than that summarised in the Issues Paper.

Post-employment obligations are often the subject of negotiations between our financial services firms and prospective employees and are the basis upon which prospective employees advocate for higher remuneration packages.

Labour mobility in the financial services industry

The potential concerns expressed about labour mobility do not apply to the same degree in the financial services industry.

A number of our members continue to pay former employees for the period of their post-employment restraints through a monthly payment equivalent to, at a minimum, their annual base salary. This ensures that individuals continue to be financially supported through the period in which they are prevented from working for a competitor.

The post-employment obligations used by our members are frequently drafted to allow the employer to waive the enforcement of post-employment obligations. This recognises that there can be occasions where it is not necessary to enforce the obligations in some way because of an employee's particular circumstances. This includes where there is unlikely to be a risk of transfer of confidential information to a competitor. This drafting also assists employees in the industry to approach their employer to have a discussion about the obligations and how they may be enforced.

Interests of business not fully reflected in Issues Paper

AFMA's members who have global operations have identified further interests of business which are not fully reflected in the Issues Paper.

There are AFMA members who develop proprietary and confidential information on a worldwide scale. In light of the sensitivity of this material and the considerable investment to produce it, these members only elect to operate in jurisdictions where there are safeguards in place to protect against the transfer of material to a competitor. These members have relied on the protections currently available under Australian law being in place when establishing local offices and would need to revisit the way in which they operate in Australia if there are fundamental changes to these protections.

If these members do decide to retain a presence in Australia where there are changes to the protections available, they would have to rely more heavily on service conditions for the vesting of benefits such as deferred compensation to protect trade secrets and confidential information. The ultimate result would be that employees would be paid less. There would also likely be a stratification of the workforce of these members globally with those involved in the development and use of sensitive information being located in jurisdictions outside Australia, with less specialised roles (if any) being retained locally.

There are limited alternative options which meaningfully protect business interests in the financial services industry where the use of non-competition and, to a lesser extent, non-solicitation obligations are not available. AFMA does not believe the potential flow-on impacts of scenarios where there is further regulation of these obligations has been captured in the Issues Paper.

Other litigation (such as the enforcement of confidentiality obligations and intellectual property disputes) is highly adversarial, costly and can become easily protracted. This litigation is increasingly complex (with forensic expert witnesses needing to be briefed where there are information technology systems used by an employee) and can have the unintended consequence of signalling to a competitor the information which is believed to be significant and in their possession.

Proving actual trade secret misappropriation is also extremely difficult, and often requires turning over the very intellectual property that the employer wants to remain secret.

Without the ability to use existing post-employment restrictions, employers would be required to resort to this type of litigation at a much higher rate, creating more financial and opportunity costs for both employers and employees and increasing the litigation burden on the judicial system. This has been observed in overseas jurisdictions, such as California which has completely prohibited non-compete agreements.

Summary

If there was a view to regulate the enforcement of post-employment non-compete obligations in particular industries, any policy response should be targeted to the specific circumstances of those industries. AFMA's view is that the financial services industry is not an industry in which a policy response is required.

8. What considerations lead businesses to include co-worker non-solicitation in employment contracts? Are there alternative protections available?

In financial services, it is relatively common for employment contracts to include a co-worker non-solicitation clause. This does not preclude the departing employee from commencing employment with another company, but it does require the employee to refrain from poaching their former colleagues for a period of time. The considerations that lead businesses to include co-worker non-solicitation provisions in employment contracts largely relate to protecting businesses from

competitors poaching key talent. The particular behaviour that financial services firms are seeking to prevent is having a competitor provide significant incentives to one incumbent employee to transfer employment on the basis that that employee is able to identify and entice other key personnel. AFMA's view is that this places no real burden on the departing employee and is simple to comply with. It also should not hamper job mobility to any significant extent, given the non-solicitation is time limited and employees are still able to independently apply for and be hired for advertised jobs, provided that they are not solicited by the former colleague.

Non-solicitation clauses also allow financial services firms a period of time to reallocate responsibilities, ensure adequate coverage and protect business interests in circumstances where a key employee leaves.

As above, AFMA does not support any restriction on an employer's ability to include non-solicitation provisions in employment contracts. There are no real alternatives available to employers except relying on other restraints in the employment contract to delay the departing employee's commencement with a new employer (for example, increasing the notice period or using garden leave). This would stifle job mobility more than the use of non-solicitation clauses, which do not prevent the person from moving jobs but rather require a period of time for the business to recover before others can be recruited by the departed employee.

9. What considerations drive businesses to include non-disclosure clauses in employment contracts? Are there alternative protections, such as Section 183 of the Corporations Act 2001 available?

Non-disclosure clauses are standard terms in employment contracts, which normally survive termination of the employment relationship, and are essential for providing protection of the employer's confidential information and trade secrets. Such clauses already normally include appropriate carve outs, for example, for disclosure required by law or to a regulator, whistleblowing and (since the introduction of Australia's pay secrecy laws) remuneration information. The non-disclosure obligation does not extend to the skills, knowledge and experience the employee has naturally acquired in the course of their employment. Therefore, the material protected is only that which is confidential information and intellectual property belonging to the employer. It is appropriate that this is not distributed more broadly by former employees as the information is not their property and wider dissemination may harm the employer.

Further, permitting contractual non-disclosure clauses has the benefit of alerting the employee to obligations that they would have under statute and general law anyway, but may not be aware of necessarily. By setting out this requirement in the contract, all parties are aware of these obligations and can readily comply. The alternative would be that the employer needs to resort to legal claims to protect confidentiality and AFMA would expect to see an uptick in claims by employers under section 183 of the *Corporations Act 2001* (C'th) for breach of officer and employee duties. This would carry unnecessary litigation costs for employers and employees alike.

* * * * *

Please contact me on (02) 9776 7996 or rcolquhoun@afma.com.au if you have any queries about this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Rob Colquhoun', written in a cursive style.

Rob Colquhoun
Chief Operating Officer