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Protecting Confidential Information

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"The most valuable commodity I know of is information."
-Gordon Gekko, Wall Street

While Gordon Gekko may have been referring to illegal inside information, the larger point is that "information" is the most valuable asset for the investment management industry. Ever since Nathan Mayer Rothschild arranged to receive advance notice of Wellington's victory at Waterloo via carrier pigeon, the acquisition, development and protection of valuable, exclusive and actionable information has been essential to successful investing.

The investment management industry is extremely competitive. Investment managers expend great resources to develop, enhance and maintain differentiated investment strategies and assemble teams of pedigreed professionals to successfully execute these investment strategies. Managers also routinely have to balance sharing information with their investors to manage investor expectations, and to comply with their legal obligations, with the potential risk to their businesses should such information become public. With the advancement of technology, protecting information is not only more critical, but also more complicated, than in the past.

Managers share information either in the ordinary course of business or in response to a crisis. Managers routinely disseminate quarterly investor letters in the ordinary course of business. Investor letters often include discussion regarding the fund's major investments, as well as the manager's perspective regarding the global environment. At other times, due to material negative developments, such as the departure of a key person, the decision to shutter the fund or an action threatened by a regulator, a manager can be compelled to communicate information to investors on an expedited basis. While the degree of actionable proprietary information contained in these investor letters varies, managers have gone to great lengths to prevent the public dissemination of these communications.

Occasionally a letter is leaked to the media and its contents become public. Although the media's right to publish information is generally constitutionally protected, this has not prevented managers from bringing actions to enjoin the publication of their letters' contents or attempting to compel the media to reveal the source of the leaked information.

In 2010, Elliot Management filed a "motion to compel" against Institutional Investor to reveal its source following the publication of the manager's quarterly letter. After brief legal wrangling, Elliot ultimately withdrew its motion. Other managers have also commenced legal action to prevent the public dissemination of proprietary information. In 2014, Greenlight Capital brought suit against Seeking Alpha for revealing Greenlight's previously undisclosed stake in Micron Technology. Greenlight claimed that by publicizing the position it was building in Micron, Seeking Alpha had made it more expensive for Greenlight to accumulate the position. Greenlight ultimately withdrew the lawsuit.

In response to these and other unauthorized disclosures, managers have begun employing new technologies to prevent the dissemination of the information contained in investor letters. These technologies include digital watermarking, technologies which prevent printing or downloading letters or which permit readers to view only a few lines of the letter at a time, password protected emails and secured investor portals. While these technologies make it more difficult to disseminate the content of investor letters, they do not prevent someone using a digital camera or smart phone from taking screenshots. However, there are expensive software options that render screenshots unreadable.

Investor letters are not the only source of confidential information. Employees are the greatest potential threat to leak or misappropriate actionable confidential information. This is especially true with regard to portfolio managers and software developers responsible for developing the investment strategy and portfolio positions. If these employees leave to join a competitor, they can expropriate the manager's most actionable confidential information. To address this potential threat, managers usually include certain provisions in their employment agreements, such as confidentiality clauses, provisions for "gardening leave", non-competition and non-solicitation provisions and technology assignment clauses.

Confidentiality agreements are essential for almost any employment contract. They are often broad in scope and seek to prevent employees from disclosing confidential information regarding the manager, investment strategy, investors, portfolio construction and counter parties. Nonetheless, courts have declined to enforce confidentiality agreements to the extent that the confidentiality obligation applies to communications with the U.S. Securities and Exchange Commission ("SEC"). Such provisions were often found to be a violation of laws intended to protect whistleblowers or impede individuals from communicating with the SEC about possible securities law violations.

Non-competition clauses also serve to protect confidential information by prohibiting a departing employee from joining a competitor employing a similar investment strategy. Although a few states, such as California, are reluctant to enforce employment related non-competition restrictions, most state courts will enforce restrictions which are reasonable in geography, scope and duration. The scope should specifically relate to the particular investment strategy. A one year term is common for duration, however, some restrictions extend up to two years or more. A 2016 National Labor Relations Board ("NLRB") inquiry revealed that a Bridgewater Associates' employee was subject to a two year non-competition agreement. The NLRB ultimately withdrew its complaint following a confidential settlement between the employee and the company. In addition, when Chris Rokos, the former Brevan Howard star trader left his employer to launch his own hedge fund, Brevan Howard attempted to enforce the terms of his five year non-compete under UK law. The matter eventually settled out of court.

As managers continue to seek to acquire, develop and secure information which enables them to outperform their competitors and benchmarks, software developers and attorneys will continue to devise increasing sophisticated technology and legal devices to help protect manager's confidential information.

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