The Fight Against No-Poach Agreements Is Expanding

By **Paul Eckles, Karen Hoffman Lent, Matthew Martino and Tara Reinhart** (October 23, 2018, 1:09 PM EDT)

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In recent weeks, Washington state Attorney General Bob Ferguson has continued to expand his efforts to eradicate the use of no-poach agreements by employers. The targets of his investigation are companies that have included "no-poach" clauses in their franchise operating agreements. Such clauses typically prohibit franchisees from hiring employees directly from the franchisor or other franchisees for up to six months following the end of their employment. Ferguson has been touting the ongoing success of his investigation with respect to fast food chains, and franchise-based chains in other industries appear to be his next target.

Ferguson's efforts date back to January 2018, when his office opened an investigation into the use of no-poach agreements by franchise-based fast food chains operating in Washington state. According to Ferguson's office, the investigation was prompted in part by stagnating wages in the industry as reported by news outlets and an economic study by Alan B. Krueger and Orley Ashenfelter.

As of Oct. 15, 2018, Ferguson's office reportedly had reached "assurance of discontinuance" agreements with 30 national chains to remove no-poach clauses from their standard U.S. franchise contracts. The agreements also require the companies to (1) refuse to enforce the clauses in any existing U.S. franchise agreements; (2) ensure that franchisees do not attempt to enforce the clauses; (3) amend all existing agreements in Washington state to remove the clauses within 120 days; and (4) remove the clauses from existing franchise agreements in other states as they come up for renewal.

The agreements do not, however, provide for any monetary penalties so long as the companies comply with the terms. Ferguson's office announced a third wave of settlements with eight fast food chains in September 2018, following first and second waves of settlements in July and August. In the September announcement, Ferguson's office simultaneously indicated that it was expanding the investigation to industries beyond restaurants and fast food, including:

- Hotels.
- Car repair services.
- Home health care services.
- Cleaning services.
- Convenience stores.
- Tax preparation.
- Parcel services.
- Electronic repair services.
- Child care.
- Custom window covering services.
- Travel services.
- Insurance adjuster services.


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Less than a month later, on Oct. 15, 2018, a fourth wave of settlements was announced, including with three chains that are not in the fast food industry (gyms and a car repair service). According to the attorney general's office, only two major fast food chains operating in Washington state continue to include no-poach clauses in their franchise agreements: Quiznos and Jersey Mike's Subs. In the Oct. 15 settlement press release, Ferguson's office also announced that it had filed a lawsuit against Jersey Mike's in Washington state court because the company refused to remove the no-poach clause from its franchise agreements. The complaint alleges that the company's use of no-poach clauses constitutes a per se violation of the antitrust provisions contained in Washington state consumer protection laws. Beyond the Jersey Mike's lawsuit, the attorney general now appears to be focusing his investigation on chains in the above-mentioned industries.

Outside of Washington, other states are beginning to follow Ferguson's lead. On July 9, 2018, a coalition of attorneys general from 10 states — New York, California, Illinois, Massachusetts, Maryland, Minnesota, New Jersey, Oregon, Pennsylvania and Rhode Island — and the District of Columbia sent a letter to eight national franchise-based fast food chains requesting information related to their franchise agreements and no-poach clauses. The press release announcing the letters also indicated that the group was interviewing fast food workers who had been impacted by their employer's use of no-poach agreements. Six of the eight fast food chains subsequently settled with the Washington state attorney general. There have not been any major public developments in the investigation since the letters were sent, but it seems likely that this is just the beginning of the states' efforts.

The U.S. Department of Justice has also recently been focused on the elimination of no-poach agreements. In 2016, the DOJ and Federal Trade Commission issued a guidance paper arguing that no-poach agreements among employers are per se illegal under the antitrust laws and signaled an intent to seek criminal penalties for companies engaged in naked no-poach agreements. It was not until April 2018, however, that the DOJ announced that it was actively investigating and prosecuting no-poach agreements, most notably by entering into settlements with several companies in the rail industry that had previously entered into employee no-poaching agreements. The 2016 DOJ guidance noted that no-poach agreements that are ancillary to pro-competitive agreements could be pro-competitive, so it is unsurprising that the DOJ does not appear to be investigating agreements such as those among franchisees.

A third mode of attack on no-poach agreements has come from former employees, who have filed private lawsuits against several of the fast food companies targeted in the Washington state probe — including major chains such as Burger King, Jimmy John's and Domino's. These suits typically allege that the inclusion of no-poach clauses in franchise agreements constitutes an anti-competitive restraint of trade in violation of Section 1 of the Sherman Act. Thus far, at least one case — Deslandes v. McDonald's — has received a decision on a motion to dismiss.

On June 25, 2018, Judge Jorge L. Alonso of the U.S. District Court for the Northern District of Illinois denied McDonald's motion to dismiss, concluding that the plaintiff plausibly alleged a restraint that could be found unlawful under "quick-look" analysis — in part because the no-poach clause effectively restricted horizontal competition for potential employees between franchisees and company-owned stores. But Judge Alonso concluded that the restraint did not constitute a per se unlawful restraint because it was ancillary to otherwise pro-competitive franchise agreements. This means that the restraint appears to be facially anti-competitive, but the court will nevertheless review potential pro-competitive justifications offered by the defendant in determining whether the restraint ultimately violates the Sherman Act.

Given the success of Ferguson's investigation thus far, the flurry of private lawsuits that have followed, the initial victory by the plaintiffs in the McDonald's case and the DOJ's signaled interest in no-poach agreements, companies that engage in no-poach agreements should be prepared for governmental scrutiny as well as private litigation from former employees.

Franchises may have good legal arguments to defend the use of such clauses, particularly if such arguments are reasonably tailored to pro-competitive justifications as to why such clauses are

important to the franchising process. Potential pro-competitive justifications include promoting interbrand competition among competing chains and encouraging investment in employee training. Although Judge Alonso rejected both arguments in the McDonald's decision, he also indicated that narrowly tailored no-poach clauses could serve the pro-competitive purpose of improving franchise investment in employee training by, for example, limiting the clause's applicability to only those employees who receive additional training. Consequently, no-poach clauses that do not apply all employees, but instead are limited in duration, geography and/or the category of employees to whom the clauses apply appear less likely to face antitrust scrutiny compared to no-poach clauses that apply to all employees across the board.

Ultimately, any employers that currently utilize no-poach agreements or are considering doing so should be sure to examine whether there are valid pro-competitive justifications for the agreement that outweigh any anti-competitive effect and whether the benefits of the no-poach agreement are worth the risk of the potential governmental or private challenge that is likely to occur.

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