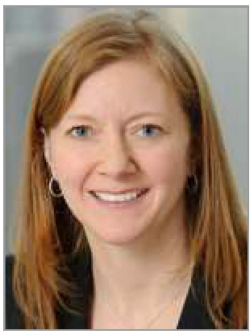
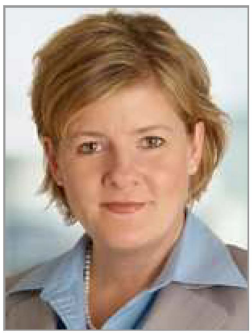
DOJ Is Trying To Rein In Franchise No-Poach Suits

By **Boris Bershteyn, Karen Hoffman Lent, Tara Reinhart and Zachary Siegler** (February 19, 2019, 4:21 PM EST)

Boris Bershteyn



Karen Hoffman Lent



Tara Reinhart

When we **last wrote** about evolving antitrust treatment of so-called "no-poach" agreements in October, Washington state Attorney General Bob Ferguson had recently expanded his investigation into the use of such agreements by franchise-based companies outside of the fast food industry, and private plaintiffs around the country were continuing to file class actions challenging various fast food companies' use of such agreements.

Since then, Ferguson has secured additional settlements with franchise-based businesses in a variety of different industries (e.g., hotel chains, tax preparation services, home cleaning services) to end their use of no-poach agreements; as of January 2019, his office has settled with 50 companies. Private plaintiffs have also continued filing class actions targeting such agreements, with lawsuits pending against several fast-food restaurant chains, tax preparation services (e.g., H&R Block), car repair services (e.g., Jiffy Lube) and other businesses that include broad no-poach clauses in their franchise agreements.

But the biggest no-poach development over the past few months has been the U.S. Department of Justice's targeted advocacy in several ongoing lawsuits.

DOJ's Statement of Interest

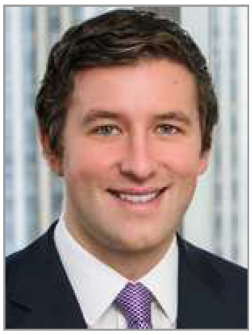
In recent weeks, the DOJ has endeavored to clarify how such agreements should be analyzed under the federal antitrust laws. On Jan. 25, 2019, the DOJ filed notices of intent to file statements of interest in three related fast-food franchise no-poach suits pending in the U.S. District Court for the Eastern District of Washington — Stigar v. Dough Dough (Auntie Anne's), Richmond v. Bergey Pullman (Arby's) and Harris v. CJ Star (Carl's Jr./Hardee's) — less than two weeks before scheduled hearings on the defendants' motions to dismiss.

Citing the government shutdown as the reason for its inability to file full statements of interest prior to the hearing, the DOJ's last-minute notices offered a preview of the arguments it intends to make regarding franchise no-poach agreements going forward.

The DOJ emphasized that no-poach agreements between franchisees and a franchisor within the same franchise system should be evaluated under the rule of reason because such agreements likely constitute a vertical restraint (between franchisor and franchisee) and a horizontal restraint (between competing franchises and franchisor-owned stores) that are reasonably necessary to a separate legitimate business transaction.

The DOJ also indicated that the "rarely applicable" quick-look analysis likely does not apply to vertical franchisor-franchisee agreements and that, in and of itself, the franchise model cannot provide the basis for allegations of a hub-and-spoke conspiracy that would warrant per se treatment or quick-look analysis. As a result of the DOJ's submissions, the court rescheduled the

hearings to March 20, 2019, allowing the DOJ to prepare a full statement of interest now that the government shutdown has ended.


Zachary Siegler

Sending a Message?

Beyond signaling its interest in the instant cases, the DOJ's notices appear to respond to the three other federal court decisions that have denied fast-food franchises' motions to dismiss in recent months. In fact, the three primary arguments the DOJ asserted in its notices (the franchise model does not constitute a hub-and-spoke conspiracy, quick-look analysis is inappropriate, rule of reason is appropriate) arguably contradict the conclusions reached in those district court decisions.

In two of the cases, Deslandes v. McDon-ald's (Northern District of Illinois) and Yi v. SK Bakeries LLC (Eastern District of Washington) (Cinnabon), the courts held that the plaintiff employees plausibly alleged that the franchises' no-poach restraints could be found unlawful under quick-look analysis.

In the third, Butler v. Jimmy John's, the U.S. District Court for the Southern District of Illinois concluded that the plaintiff plausibly alleged a hub-and-spoke agreement involving Jimmy John's and its franchisees to not poach each other's employees, but declined to decide which mode of analysis would apply. At the same time, however, the courts in both Butler and Deslandes indicated that it would be difficult for the cases to succeed under a rule-of-reason analysis, with the Butler court remarking, "the rule of reason may rear its head and burn this case to the ground." In light of these decisions, the DOJ notices appear to be designed to persuade other courts to remain open to defendant franchises' motions to dismiss in the coming months.

Takeaways: Welcome Clarification, But Questions Remain

Antitrust case law recognizes that franchise relationships are often pro-competitive. Franchisors impose restrictions on franchisees to ensure quality of products and services across the outlets, which helps the franchise's brand compete with other brands for consumers. The DOJ notices indicate that the DOJ also recognizes the pro-competitive benefits of franchise relationships and seeks to continue rule-of-reason treatment of them. And if the courts agree with the DOJ, plaintiffs' claims will become more difficult to advance.

Under the rule of reason, a plaintiff must plead and prove market power in a relevant market, and franchise employee plaintiffs will face significant difficulties on the questions of both a relevant market and market power. As the Deslandes court noted, the relevant geographic market would likely be confined to a small geographic area (i.e., a city or metropolitan area). It is possible, however, that courts would determine that the relevant (labor) market includes all similar employment options — not just jobs at the defendant's franchises — within the geographic market.

This broader relevant labor market would significantly weaken a plaintiff's claim that the defendants had market power sufficient to cause significant anti-competitive effects in the market by using no-poach restraints. At a minimum, defendants will argue that an alleged no-poach agreement would not foreclose a plaintiff from seeking employment at a competing franchise in the geographic market (e.g., a McDonald's employee could be poached by a nearby Burger King).

Along the same lines, in a December 2018 interview with GCR USA, Federal Trade Commission Chairman Joseph J. Simons indicated that it would be difficult for a plaintiff challenging a vertical agreement between a franchisor and franchisee to allege that franchises have market power: "If it's like a unilateral case, there's no precedent for bringing those cases without market power of some kind ... it's hard to argue they [franchise chains] have market power."

At the same time, Simons also suggested the FTC was skeptical of the need for such restraints among franchises: "The FTC doesn't see what the benefits of a non-compete agreement are when there is no highly skilled labour involved. ... There doesn't seem to be any efficiency benefit, so outlawing that would seem not to have a cost to it; actually it might have a benefit."

The DOJ has not backed off its position that naked no-poach agreements are per se unlawful. On the same day it filed notices in the franchise cases, the DOJ also filed a notice in In re Railway Industry

Employee No-Poach Antitrust Litigation (Western District of Pennsylvania), the follow-on civil litigation related to the railway industry no-poach agreements the DOJ investigated earlier this year.

In its Railway notice, DOJ challenged the defendants' position that all no-poach agreements should be evaluated under the rule of reason. Instead, the DOJ repeated from the 2016 guidance that no-poach agreements should be evaluated under the per se standard unless they are necessary to further a related, legitimate collaboration between the employers. Despite the DOJ's view, no court has yet to apply the per se rule to a no-poach agreement — such cases have typically settled before courts have had the opportunity to decide which standard applies — but this case could be the first.

On Feb. 6, 2019, the DOJ filed yet another notice in a no-poach case — Seaman v. Duke University. That case involves an alleged agreement between Duke University and University of North Carolina at Chapel Hill not to poach each other's medical school professors. The notice did not identify what standard the DOJ believes the court should apply in the case; instead, it merely previewed that the DOJ's forthcoming statement of interest would address the applicable standard as well as defendants' state action defenses.

Ultimately, it remains to be seen whether courts will follow the DOJ's guidance, which is not binding on them. But the evolving litigation landscape, in addition to the DOJ's continued advocacy, will likely offer important insights to company counsel and human resources professionals seeking to reduce the risk of investigations and litigation.

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