

No-Poach Update: DOJ Seeks to Rein In Franchise Suits

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Evolving antitrust treatment of so-called “no-poach” agreements continues to offer important guidance for company counsel and human resources professionals. Over the past two years, the Department of Justice (DOJ) has increasingly ramped up enforcement efforts regarding employee “no-poach” or “no-hire” restraints, whereby two or more companies agree not to hire or solicit each other’s employees. In 2016, the DOJ and the Federal Trade Commission (FTC) issued guidance making clear that the agencies consider “naked” no-poach agreements among employers to be *per se* illegal under the federal antitrust laws and stating that, in the future, the DOJ may seek criminal penalties against companies that use such agreements. However, the guidance made equally clear that no-poach agreements that are ancillary or reasonably related to otherwise pro-competitive agreements (such as a joint venture or other business collaboration) would be subject to review under a more permissive mode of analysis (*i.e.*, rule-of-reason or quick-look analysis). In April 2018, the DOJ announced that it was actively investigating and prosecuting companies that entered no-poach agreements. It subsequently disclosed consent decree with several companies in the railway industry. The DOJ treated those companies’ conduct as a civil violation because it occurred before the 2016 guidance was issued.

Since the 2016 guidance, additional aggressive enforcement activity against no-poach agreements has occurred at the state level. In particular, Washington State Attorney General Bob Ferguson has been investigating the use of no-poach agreements among franchises (such as fast-food restaurants) since January 2018, reaching agreements with more than 50 companies to eliminate the use of no-poach agreements nationwide and suing one — Jersey Mike’s Subs — in Washington state court after it refused to remove the provision from its franchise agreements. Initially focused on such fast-food franchises as McDonald’s and Jimmy John’s, Ferguson recently expanded his investigation to target tax preparation services and hotels. In July 2018, a coalition of attorneys general from 10 states and the District of Columbia also opened an investigation into the use of no-poach agreements by fast-food franchises.

On the heels of these investigations, franchise employees have filed a number of private class actions in federal courts across the country. The complaints challenge the use of no-poach agreements in franchise 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 franchise-based businesses that include broad no-poach clauses in their franchise agreements. The private actions typically allege that agreements among the franchisor and franchisees to avoid poaching employees violate Section 1 of the Sherman Act and call for *per se* treatment or, in the alternative, quick-look review of the alleged conduct.

DOJ’s Statement of Interest

Following this recent wave of state investigations and private lawsuits targeting franchise no-poach restraints, the DOJ has endeavored to clarify how such restraints should be analyzed under the federal antitrust laws. On January 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

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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.

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. McDonald's* (N.D. Ill.) and *Yi v. SK Bakeries LLC* (E.D. Wash.) (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: Filings Are Welcome Clarification From DOJ, 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*, FTC 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."

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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* (W.D. Pa.), 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 February 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.