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INSIGHT: Intra-Franchise No-Poach Agreements: Recent Developments and Trends



By Douglas F. Gansler, Adam Miller, and Scott T. Sakiyama

Washington Attorney General Bob Ferguson has obtained binding settlement agreements from 23 prominent franchisors in the nine months since he announced an initiative to eliminate no-poach clauses nationwide, and he has already expanded beyond the fast-food industry.

Scrutiny of the clauses, which generally prevent employees from moving from one company franchise to another, is building nationwide: A coalition of Attorneys General from 11 other states and the U.S. Department of Justice have targeted franchisors throughout 2018 on the basis that the clauses violate state and federal antitrust laws. Several of these public enforcement actions have prompted follow-on private class-action lawsuits, leading employers nationwide to re-evaluate their practices to avoid harsh civil penalties and even criminal prosecution.

Recent federal and state enforcement actions against no-poach agreements are a serious concern for franchise businesses in particular due to the unique incentives that they have to enter into such agreements and their vulnerability to class action lawsuits by former employees.

No-poach agreements are common among franchisors, who typically agree not to solicit for employment the employees of a co-franchisee, or to reject applications for employment by these employees. Because the skill sets required by one franchisee are often similar or identical to those required by its co-franchisees, no-poach provisions of franchise agreements help franchisees retain their talent, protect the investment of time and resources in employee training, and avoid the financial and reputational costs of worker turnover.

Even if any given franchise agreement does not explicitly contain the words ''no poach,'' these clauses are more common than one might think: A recent publication by economists at Princeton University reported that 58 percent of major franchise chains use clauses akin to no-poach agreements.

Enforcement authorities and other critics of no-poach agreements argue that they violate antitrust laws by reducing employees' bargaining power by restricting their job opportunities and suppress employees' wages by reducing competition in the job market. However, eliminating or outlawing no-poach agreements, while perhaps well-intentioned, would significantly damage businesses with employees whose skill sets are highly similar to one another and easily transferable to co-franchisees who are also competitors. This also creates a ''free-rider'' problem: If employers can do nothing to prevent employees from being poached by competitors, then those competitors can easily save themselves the expense of training employees by simply waiting until the employees are trained elsewhere before soliciting them.

Perhaps most worrisome, a prohibition on no-poach agreements disincentivizes employers from investing in advanced or specialized employee-development programs, because an employer's own investment into its employees' futures would simultaneously make those employees even more likely to be poached by a competitor. One unintended result of the recent enforcement actions against no-poach agreements may be a reduced number of advanced or specialized job opportunities, and an increase in low-skilled or unskilled labor.

Nevertheless, enforcement authorities at both the state and federal levels have expressed a clear intention to prosecute employers who use no-poach agreements, and this trend seems virtually certain to continue.

In addition to Ferguson's January 2018 announcement, Assistant Attorney General Makan Delrahim indicated that the Justice Department could treat no-poach or wage-fixing agreements as criminal violations of antitrust laws. Just over three months later, the Justice Department filed a civil antitrust suit against three companies, alleging that the companies' no-poach agreements were *per se* unlawful because they were not reasonably necessary for any collaboration between the firms. In July, the Attorneys General of 11 states announced investigations into several prominent fast-food franchisors for their use of no-poach agreements, and Ferguson began to announce settlements with many prominent corporate chains shortly thereafter. In October, Ferguson filed a civil action against Jersey Mike's, a nationwide fast food franchise, alleging that the company's inter-franchise no-poach agreements violated Washington state consumer protection laws for suppressing wages—a legal theory grounded in antitrust law.

We expect the state Attorneys General to continue pursuing enforcement actions against employers in a broad array of industries, including hotels, car repair services, gyms, home healthcare services, cleaning services, convenience stores, tax preparation, parcel services, electronic repair services, child care, custom window-covering services, travel services, and insurance adjuster services.

The Senate is currently considering a bill—the End Employer Collusion Act, introduced by Sen. Cory Booker (D-N.J.) in March—that would amend federal antitrust law to expressly target no-poach provisions. This legislation has serious implications for all franchise businesses because it would encourage not only regulatory enforcement actions against no-poach agreements, but also private class-action claims.

To date there have been at least eight class-action lawsuits against employers using no-poach agreements. And more are on the way: a proposed class action lawsuit against Dunkin' Donuts is currently awaiting class certification in New York federal court. Because private antitrust plaintiffs may obtain treble damages and attorney's fees, class actions pose a serious threat to potential defendants. Moreover, employers' potential liability does not end with no-poach agreements: Authorities and class-action plaintiffs alike have demonstrated increased scrutiny of contracts between employers and their employees. For example, non-competition clauses—that is, agreements by employees not to work for any businesses in competition with their employers upon the employees' termination—have also been the subject of recent civil litigation brought by private litigants and Attorneys General, as well as state legislation.

Ferguson was unequivocal: his goal is to eliminate no-poach clauses nationwide, and he will continue to enforce the antitrust provisions of Washington state law against all franchises in Washington with a nationwide presence. In light of his recent successes, the private class actions that followed, the ongoing investigations by other Attorneys General, and the pending legislation in the Senate, the takeaway is clear: Employers nationwide must take steps to assess and reduce their risk of civil liability, regulatory pressure, and even criminal prosecution.

Employers can take some general steps to reduce their potential exposure. For one, employers should avoid using ''naked'' no-poach agreements—that is, those that are ''not reasonably necessary to any separate, legitimate business collaboration between the employers''—because these most clearly run afoul of antitrust law. Generally, no-poach agreements are more likely to pass muster if they are (1) ancillary to a larger, legitimate collaboration; (2) reasonable in scope and duration; and (3) reasonably necessary to further procompetitive interests. This means that employers should ensure that any no-poach agreements are narrowly-tailored to advance pro-competitive interests, such as increasing output, improving products or services, protecting trade secrets, and ensuring quality control. Further, because the focus of federal antitrust law is on agreements between competitors, no-poach provisions in joint venture agreements, parent-subsidiary contracts, merger agreements, or purely internal hiring policies are more likely to be lawful.

We also note that, despite Ferguson's stance that no-poach agreements are *per se* illegal, this position lacked judicial backing until very recently and remains a relatively unrecognized interpretation of antitrust law. Conduct is *per se* unlawful under the antitrust laws only if it has ''such predictable and pernicious anticompetitive effect[s], and such limited potential for procompetitive benefit'' that it is obvious they are unreasonable restraints of trade.

Application of the *per se* standard is very unfavorable to defendants because it is automatically illegal, without regard to defendants' intent or legitimate interests. Conduct that does not reach the *per se* standard is assessed under the ''rule of reason,'' which enables defendants to justify the conduct by demonstrating that it serves legitimate business interests and generates procompetitive effects.

Experienced counsel will ensure that clients' contracts and communications are carefully drafted so that the legitimate and procompetitive goals of any no-poach-type restrictions are prominent and clear. In the franchise context, no-poach provisions can be carefully drafted to evince that any anticompetitive effects are ancillary to legitimate, output-enhancing interests of the franchise, meaning that plaintiffs or authorities bringing antitrust lawsuits against franchise employers will face an uphill battle when those franchises are represented by counsel familiar with this developing area of law.

Clients concerned about antitrust liability from no-poach provisions should have their attorneys tailor agreements and pursue litigation strategies that encourage courts to apply the rule-of-reason standard rather than the *per se* standard in any action.

The rule-of-reason standard is preferable for defendants because it generally requires plaintiffs to show that the defendant has ''market power—that is, the ability to raise prices significantly without going out of business—without which the defendant could not cause anticompetitive effects on market pricing.'' Where the allegedly anticompetitive behavior is the use of no-poach (or similar) agreements, the ''market power'' in question is the power to suppress wages.

Depending on the nature of the franchise, plaintiffs may be hard-pressed to show that a particular defendant has the power to suppress wages across the entire relevant market, and skilled counsel will advocate to broaden or narrow the scope of the market in question as most benefits their client's position. One way to do

that, for example, is to show that the client's no-poach provisions only apply to skilled employees who have received expensive or time-consuming training, and therefore, the no-poach provisions have a narrowly tailored, procompetitive purpose without substantially burdening a broader labor market.

Given the rapid developments in this area of law, however, and Ferguson's ongoing investigations, avoiding and defending against antitrust suits over no-poach agreements requires a delicate touch.

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