No-Poach Antitrust Standard Unclear In Franchising

By **William Reiss and Matthew Geyer** (October 22, 2020)

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In recent years, regulatory agencies and courts alike have struggled to analyze no-poach agreements under the antitrust laws, particularly in the franchisor-franchisee context.

Specifically, the U.S. Department of Justice and federal courts have expressed diverging opinions as to whether no-poach agreements should be viewed as horizontal or vertical restraints of trade and, relatedly, whether such agreements should be evaluated under a per se, rule-of-reason or quick-look[1] standard.

In a public filing last year, the DOJ asserted its position that no-poach agreements between franchisors and franchisees are usually vertical agreements subject to a rule-of-reason analysis. However, federal courts have not been so quick to adopt this hard-line approach, with many recent cases holding that fact discovery is necessary before determining both the nature of the relationship at issue, and the appropriate standard under which to analyze the agreement.

This article explores the divergent approaches to analyzing no-poach agreements under the antitrust laws, and assesses the strategies plaintiffs and defendants are likely to employ in attempting to navigate ambiguities in the law.

2016 DOJ and FTC Joint Guidance

In October 2016, the DOJ and Federal Trade Commission issued joint guidance to human resources professionals explaining that "agreements among employers not to recruit certain employees or not to compete on terms of compensation are illegal."[2]

Specifically, the guidance cautioned that companies could violate the antitrust laws when they agree: (1) with other companies not to solicit or hire each other's employees (no-poach agreements); or (2) to set employee salaries or other terms of compensation at a set level or range uniformly across the companies (wage-fixing agreements).

The guidance made clear that the DOJ views both no-poach agreements and wage-fixing agreements as "per se illegal under antitrust laws," meaning that such agreements are "illegal without any inquiry into [their] competitive effects." Notably, the guidance did not distinguish no-poach agreements within the franchise context from those made in other industries.

The DOJ Refines Its Position

In 2019, the DOJ filed a statement of interest in three related litigations in which workers alleged antitrust violations stemming from no-poach agreements.[3] In its statement, the DOJ clarified that no-poach agreements are per se illegal only within the context of horizontal agreements between "rival employers within a franchise system."[4]

Further, the DOJ explained that no-poach agreements between franchisors and franchisees are usually vertical restraints, and therefore subject to the rule of reason.[5] Finally, the DOJ argued that none of the parties in the related cases alleged sufficient facts to plead a horizontal hub-and-spoke conspiracy between the franchisor and its franchisees.

But even if they had, the DOJ cautioned that because a "typical franchise relationship itself is a legitimate business collaboration in which the franchisees operate under the same brand ... [n]o-poach agreements would thus qualify as ancillary restraints" appropriately reviewed for anti-competitive effects under the rule of reason.

Federal Courts Weigh In

While one court has adopted the DOJ's approach in analyzing franchise no-poach agreements under a rule-of-reason framework, other courts confronting the issue have not been so quick to do so. Instead, those courts have applied varied, conflicting approaches for analyzing no-poach agreements in the franchise context.

In the one case that did adopt the DOJ's rule-of-reason framework, the court did not go so far as to classify such agreements as purely vertical in nature. Specifically, in Ogden v. Little Caesar Enterprises Inc. in 2019,[6] the U.S. District Court for the Eastern District of Michigan dismissed a complaint alleging that Little Caesar stifled employee mobility and suppressed wages by requiring its franchisees to adhere to a no-poaching provision in the franchise agreement.

The court credited the plaintiff's allegations that the agreement was, at least in part, horizontal because the franchisees were alleged to have agreed among themselves to the restraint. Nonetheless, it concluded that the restraint should be analyzed under the rule of reason because the plaintiff failed to plausibly allege an "explicit agreement [between the franchisees] either to fix wages or to divide the labor market into any discernable exclusive territories."

The court further observed that because the no-poach agreement "explicitly prohibit[ed] only intrabrand hiring," it was conceivable that, like vertical agreements that are appropriately analyzed under the rule of reason, the no-poach agreement at issue possessed "redeeming virtues" that enabled Little Caesar to "achieve certain efficiencies in the distribution of [its] products." The court did not, however, elaborate on what, if any redeeming virtues no-poach agreements possess.

The Ogden decision followed on the heels of a decision last year from the Eastern District of Michigan, which, like Ogden, rejected the DOJ's premise that no-poach agreements between franchisors and their franchisees are vertical restraints.[7] Specifically, the district court in Blanton v. Domino's Pizza Franchising LLC[8] held that the plaintiff plausibly alleged a horizontal agreement among competing franchisees to restrain competition despite the fact that the express no-poach agreements at issue were signed separately by Domino's and each of its franchisees.

In so holding, the court explained that not all horizontal restraints are naked restraints of trade, and that a restraint that is ancillary to a pro-competitive agreement such as a franchise agreement is appropriately examined under the rule of reason.[9] However, unlike in Ogden, the court refused to decide which approach to apply until "all facts [had] become known" after fact discovery because the plaintiff had plausibly alleged an unlawful agreement under both a per se and rule-of-reason theory.

A handful of recent decisions have followed the Blanton court's reasoning and likewise held that no-poach agreements among a franchisor and its franchisees can be horizontal restraints of trade, and that fact discovery is necessary before determining the appropriate standard under which to analyze the no-poach agreement at issue.

For example, in Robinson v. Jackson Hewitt Inc. last year,[10] the U.S. District Court for the District of New Jersey held that plaintiffs plausibly alleged that the no-poach agreements entered into between Jackson Hewitt and its franchisees were unreasonable restraints of trade, but that determining which standard of review applied was premature at the motion to dismiss stage before fact discovery.

Similarly, in In re: Papa John's Employee and Franchisee Employee Antitrust Litigation last year,[11] the U.S. District Court for the Western District of Kentucky held that similar no-poach agreements were plausibly alleged to be horizontal restraints of trade, and that "more factual development [was] necessary before a standard of review [could be] selected."[12]

Finally, an outlier opinion issued this year by the U.S. District Court for the Southern District of Florida in Arrington v. Burger King Worldwide Inc.[13] did not even get to the question of whether the no-poach agreement constituted a horizontal or vertical restraint. Instead, the court in March found that franchisors and franchisees were not "separate economic actors for antitrust purposes" and therefore were incapable of entering into an unlawful agreement.

In so holding, the court considered the fact that the defendant franchisor imposed the following requirements on all of its franchisees:

- Payment of royalties;
- Payment toward joint advertising budget;
- Use of a uniform operations manual;
- Uniform appearance and image;
- Uniform menu;
- Uniform service and manner of food preparation;
- Standardized equipment;
- Uniform training standards; and
- Uniform hours of operation.

The court concluded that the mere fact that a franchisee retains some economic autonomy to make employment decisions does not render it a separate economic actor for antitrust purposes. On Aug. 24, the court doubled down on its holding when it denied the plaintiffs' motion for leave to amend its complaint, noting that the plaintiffs' amended pleadings were "predicated on the same theory [the] [c]ourt already rejected ... that micro-competition in the realm of labor is sufficient to classify two entities as independent source[s] of economic power for Section 1 purposes without taking stock of the broader relationship between [] parties."[14]

As the cases above reflect, courts have adopted varied and sometimes conflicting approaches in addressing which standard of review to apply, and whether no-poach agreements between franchisors and franchisees should be subject to antitrust scrutiny at all.

Assessing Various Strategies Moving Forward

Given the hostility that some courts have demonstrated to treating no-poach agreements as per se unlawful restraints, plaintiffs are likely to be vigilant in pleading alternative theories of liability under the per se, quick-look and rule-of-reason approaches moving forward. The court's decision in Ogden is instructive on this point.

There, the court felt compelled to dismiss the complaint in full because the plaintiff "tethered the viability of his pleading to the application of either the per se or 'quick look' rules of decision," and did "not even attempt to advance allegations or arguments supporting any claim under the rule-of-reason standard." As the cases above suggest, most courts appear predisposed to allow the case to proceed to discovery if at least one theory is adequately pleaded.

As such, plaintiffs bringing these cases will likely make every effort to ensure their complaint, to the extent practicable, contains robust factual allegations reflecting that:

- The franchisees had knowledge or belief that their fellow franchisees entered into similar agreements and acted on that knowledge or belief, thereby giving rise to an inference of a horizontal agreement among franchisees in restraint of trade.

- Output and/or wages were restricted or depressed as a result of the no-poach agreement such that the plaintiffs can plausibly make out a claim under the rule of reason.

- The plaintiffs were harmed by the restraint.

With respect to the latter point, the court's decision in Ogden serves as a cautionary tale. There, the court dismissed the plaintiff's complaint in part because the plaintiff failed to allege antitrust injury.

The court found that the plaintiff did not offer "any facts to show the agreement precipitated any specific wage or opportunity lost to him," and that it was not enough for the plaintiff to claim that the no-poach provision in his contract depressed his wages or suppressed his employment mobility without providing specific examples of such harm. With this in mind, plaintiffs are likely to allege specific examples of their inability to gain comparable employment in order to bolster allegations of antitrust injury.

Conversely, parties defending against no-poach franchise cases are likely to emphasize the court's holding in Burger King that franchisors and franchisees are not "separate economic actors for antitrust purposes" and thus, are incapable of conspiring and entering into unlawful agreements altogether. Alternatively, defendants will likely argue that no-poach provisions in franchise agreements are merely ancillary restraints to otherwise procompetitive agreements that, if anything, should be subject to a rule of reason analysis, not a per se analysis.

Conclusion

Despite the divergent approaches taken by federal courts around the country in tackling this thorny issue, courts have been consistent, at least, in their rejection of the DOJ's near categorical position that no-poach agreements between franchisors and franchisees are, by definition, vertical restraints of trade subject to a rule-of-reason analysis.

Recent cases show that the more factual detail a plaintiff can provide to support its claims of a per se unlawful horizontal agreement or, alternatively, an anti-competitive agreement under the rule of reason, the more likely a plaintiff will be able to successfully navigate through the haze of conflicting precedent and survive a motion to dismiss.

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[1] The "quick look" standard is an abbreviated form of the rule of reason standard in which "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and [the] market." See In re Papa John's Employee and Franchisee Employ Antitrust Litigation, No. 3:18-cv-00825, 2019 WL 5386484 (W.D. Ky. Oct. 21, 2019) (quoting Cal. Dental Ass'n v. FTC, 526 U.S. 756, 770 (1999)) (internal quotation marks omitted).

[2] Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidance for Human Resource Professionals at 3 (Oct. 2016), https://www.justice.gov/atr/file/903511/download.

[3] Harris v. CJ Starr, LLC, No. 2:18-cv-00247 (E.D. Wash. Mar. 8, 2019) at ECF No. 38; Richmond v. Bergey Pullman Inc., No. 2:18-cv-00246 (E.D. Wash. Mar. 8, 2019) at ECF No. 45; Stigar v. Dough, Inc., 2:18-cv-00244 (E.D. Wash. Mar. 8, 2019) at ECF No. 34.

[4] Dep't of Justice, No Poach Approach (Spring 2019), https://www.justice.gov/atr/division-operations/division-update-spring-2019/no-poach-approach.

[5] The DOJ noted, however, that a typical no-poach agreement between a franchisor and franchisees could be horizontal in nature — and subject to a per se analysis — when the franchisor owns and operates one or more franchises and competes in the same market as its franchisee in which the relevant employees are hired.

[6] 393 F.Supp.3d 622 (E.D. Mich. 2019).

[7] Curiously, the court in Ogden made no mention or reference to its sister court's holding in Blanton issued just months earlier.

[8] No. 18-13207, 2019 WL 2247731 (E.D. Mich. May 24, 2019).

[9] The court aptly described an "ancillary agreement" as follows: "If A hires B as a salesman and passes customer lists to B, then B's reciprocal covenant not to compete with A is 'ancillary.' At the time A and B strike their bargain, the enterprise (viewed as a whole) expands output and competition by putting B to work ... Covenants of this type are evaluated under the Rule of Reason as ancillary restraints, and unless they bring a large market share under a single firm's control they are lawful." Id. at *3 (quoting Polk Bros., Inc. v. Forest City Enterprises, Inc., 776 F.2d 185, 188-89 (7th Cir. 1985)).

[10] No. 19-cv-9066, 2019 WL 5617512 (D.N.J. Oct. 31, 2019).

[11] No. 3:18-cv-00825, 2019 WL 5386484 (W.D. Ky. Oct. 21, 2019).

[12] See also Fuentes v. Royal Dutch Shell PLC, No. 18-cv-5174, 2019 WL 7584654, at *1 (E.D. Pa. Nov. 25, 2019) (holding that plaintiff plausibly alleged that no-poach agreement was horizontal in nature, and declining to announce the appropriate standard of review prior to fact discovery).

[13] 448 F.Supp.3d 1322 (S.D. Fla. 2020).

[14] Arrington v. Burger King Worldwide, Inc., No. 18-24128-CIV, 2020 WL 6021420, at *1 (S.D. Fla. Aug. 24, 2020).