

## A Fresh Approach to No-Poach Provisions in Franchise Agreements

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### Key Points

- The Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC) have indicated in the past that they believe that certain agreements between employers not to poach each other's employees are "per se" illegal and, thus, do not require an examination of these agreements' net effect on competition.
- Recently, certain state Attorneys General (AG) have expanded this theory of harm by aggressively investigating and prosecuting cases against a variety of no-poach provisions, including provisions in franchise agreements preventing franchisees from poaching each other's employees.
- Following those cases, many plaintiffs' attorneys also filed class actions on behalf of the franchisee employees arguing that the agreements are per se illegal.
- Earlier this month, the DOJ filed a brief in three of those class actions stating that it believes that no-poach agreements between franchisors and franchisees are not per se illegal and should be reviewed under the rule of reason.
- Last week, the cases settled, meaning we will not have a court decision on this—yet. Regardless, we now know that no-poach agreements imposed by franchisors are likely to be analyzed under the "rule of reason" by the DOJ and could face less scrutiny in class actions in light of the DOJ's position.

### Background

On March 7, 2019, the DOJ formally weighed in on a debate percolating in the courts regarding the appropriate standard for evaluating no-poach agreements implemented by franchisors. While the DOJ was not a party to the cases, it noted that it had "a particular interest in the standard for judging the legality of 'no-poach agreements'" and had engaged in extensive recent enforcement in the area. The cases, which were all pending in the U.S. District Court for the Eastern District of Washington, involved employees who were formerly employed by three restaurant franchises (Carl's Jr., Arby's and Auntie Anne's). The cases alleged that the franchise agreements at issue prohibited franchisees from employing or seeking to employ employees of the

### Contact Information

**If you have any questions concerning this alert, please contact:**

**Corey W. Roush**

Partner  
croush@akingump.com  
Washington, D.C.  
+1 202.887.4115

**Robert G. Lian, Jr.**

Partner  
blian@akingump.com  
Washington, D.C.  
+1 202.887.4288

**Gorav Jindal**

Partner  
gjindal@akingump.com  
Washington, D.C.  
+1 202.887.4234

**Deona T. Kalala**

Counsel  
dkalala@akingump.com  
Washington, D.C.  
+1 202.887.4068

franchisor or other intrabrand franchisees and that the provision was intended “to keep their employees’ wage costs down, so that profits continued to rise or at least not be undercut by rising salaries,” and, thus, were per se illegal.

## Legal Standard

The DOJ’s brief, which was filed while a motion to dismiss was pending, focused on which legal standard should govern no-poach agreements in commercial-franchise relations. The DOJ explained that no-poach agreements are restraints of trade and should be analyzed like any other restraint. The DOJ distinguished between vertical and horizontal restraints, explaining that the former are almost always evaluated under the rule of reason and the latter are to be reviewed under the per se rule unless they are “ancillary to a separate, legitimate venture between the competitors.”

The distinction between the two is quite significant. The per se standard provides the least imposing hurdle to plaintiffs. Under this rule, a plaintiff need only show that the alleged conduct occurred in order to substantiate its claim against a defendant; no evidence of intent or effect is necessary. The rule of reason, on the other hand, requires a balancing of competitive benefits and harms to determine whether the alleged conduct unreasonably restrains trade.

The DOJ indicated in its brief that the per se rule should be limited to certain no-poach provisions that are essentially agreements to divide or allocate labor markets. To that end, the DOJ made clear that an agreement among competitors not to “compete against each other for the services of a particular employee or prospective employee ... is ‘generally unlawful *per se*.’” The DOJ mentioned that this could include an agreement (1) between or among franchisees operating under the same brand not to hire each other’s current or former employees or (2) between two competing fast-food franchisors not to hire each other’s employees.

By contrast, the DOJ noted that the typical no-poach agreement between a franchisor and its franchisees is distinguishable from a per se illegal restraint of trade because, when imposed by the franchisor, the franchisor is preventing its franchisees from hiring or soliciting other franchisees’ employees. According to the DOJ, such an arrangement is a vertical restriction between firms at different levels of distribution (not a horizontal agreement between direct competitors). These types of vertical restraints are almost always analyzed under the rule of reason because they likely have both anticompetitive and procompetitive effects.

The DOJ went on to explain that even where a franchisor operates its own stores in competition with its franchisees—meaning that any restraint on competition in a labor market would be horizontal—a no-poach provision would likely need to be reviewed under the rule of reason because it would be ancillary to a separate, legitimate business transaction—the franchise agreement itself. In other words, it is in the franchisor’s independent economic interest to have a franchise agreement that gives new franchisees confidence that if they invest in the business and training of new employees, there will not be new nearby franchisees of the same brand that will steal those employees. From the franchisee’s perspective, it is in its economic interest to choose a franchisor that gives the franchisee the greatest likelihood of success, which might include protecting the franchisee’s investment in personnel. The DOJ cautioned that this analysis would be different if the franchisees agreed among themselves either to honor the franchise agreement or to convince the franchisor to implement the policy.

## The Practical Effect

In October 2016, the [DOJ and FTC issued guidance](#) that suggested that no-poach deals would be treated as per se illegal under federal law. This created a number of questions about how universally the DOJ would apply its analysis. With this brief, the DOJ put a finer point on how it views no-poach agreements by arguing that the 2016 guidance was limited to horizontal competition, not vertical agreements that are ancillary to a broader business relationship.

While the parties to the suits in which the DOJ filed its brief have now settled, the DOJ's brief comes as a welcome clarification to its previous guidance, which had spurred wide-ranging investigations into activity that largely affected intrabrand competition that is typically not the principal aim of antitrust regulation. The brief will no doubt be used in many similar class actions and could spark dismissals or additional settlements. Moreover, if district courts begin to adopt the DOJ's thinking, plaintiffs will have to meet the higher rule of reason standard to maintain their suits against defendant franchisors and franchisees. Such cases are harder to win for plaintiffs and take more time, energy and resources; as a result, a few district court victories on the rule of reason could help stem the recent tide of these types of no-poach cases.

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