RAISING THE BAR

IFA LEGAL SYMPOSIUM
MAY 5-7, 2019 | WASHINGTON, DC
In the Limelight: Non-solicitation Clauses and Franchise Agreements

• Richard Duncan, – Faegre Baker Daniels, LLP
• Jan Gilbert, – Gray Plant Mooty, LLP
• Todd Leff, – Hand & Stone Massage and Facial Spa
Agenda

I. No-Poach Agreements: What are They?
II. Antitrust Statutes Implicated by No-Poach Agreements
III. Parsing the Agencies’ and Courts’ Analysis of No-Poach Agreements
IV. Counseling in Various Circumstances
V. Q&A
What Is an Anti-Poaching Agreement?

• In the franchise context, it is an agreement
  1. Between a franchisor and franchisee
  2. That prohibits or restricts
  3. The soliciting, recruiting, and/or hiring of employees from other franchisees or the franchisor.

• It is not a non-compete agreement, since employees are not parties to the agreement.
Booker/Warren Definition

• A “restrictive employment agreement” is an agreement
  – “[B]etween two or more employers, including through a franchise agreement or a contractor-subcontractor agreement” that
  – “[P]robibits or restricts one employer from soliciting or hiring another employer’s employees or former employees.”

• End Employer Collusion Act, S. 2480, 115th Cong. § 2(a)(2); see also H.R. 5632, 115th Cong. § 2(a)(2).
A “No-Poaching Provision” is language in a franchise agreement

- That restricts a franchisee’s ability
- To solicit or hire workers
- From the franchisor or another franchisee in the system
14-State Investigation (Initial) Definition

• ‘No-Poach Provisions’ refers to any and all language
  – Contained within franchise or license agreements or any other documents
  – Which restricts, limits or prevents any system franchisee or franchisor-operated location
  – From hiring, recruiting or soliciting employees of the franchisor or any franchisee for employment.
Between a Franchisor and Franchisee

- Applies to hiring by the franchisee
  - In-term prohibitions apply to current franchisees
  - Post-term prohibitions apply following the termination or expiration of the franchise agreement

- Applies to hiring of employees
  - May apply to recent, as well as current employees
  - May apply to all employees, or restricted to managers, executives, etc.
  - Employees are not parties to the agreement, nor generally aware of it.
Prohibited/Restricted Conduct

- Employment is nearly always addressed by the provision.
  - Many agreements also address:
    - Recruiting
    - Soliciting
    - “Attempting to employ”
Antitrust Statutes Implicated by Non-Solicitation Clauses

• Sherman Act
  – “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.” 15 U.S.C. § 1
  – Only “unreasonable” restraints of trade are prohibited.

• FTC Act
  – “[U]nfair methods of competition in or affecting commerce” are unlawful. 15 U.S.C. § 45(a)(1)
  – An “unfair” method of competition is one that “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.” 15 U.S.C. § 45(n)

• State Law Antitrust Statutes
The Recent Concern Around No-Poach Agreements

- DOJ and FTC civil enforcement during the Obama administration
  - Three DOJ cases against technology companies (2010-2014)
    - Defendants were Adobe, Apple, Google, Intel, Intuit, Pixar, Lucasfilm, and eBay
    - In each case, the companies had agreed not to cold call each other’s employees (a “do not call” list); in two of the cases, they also agreed to certain limits on hiring
    - DOJ settled for consent decrees forbidding the agreements
    - Private lawsuits followed, and the companies paid nearly $1 billion total to settle them
  - FTC action against ski manufacturing companies (2014)
- Oct. 2016: DOJ/FTC release a policy announcing they view “naked” no-poach agreements as per se unlawful and potentially criminal
• No-poach agreements “likely” violate the antitrust laws
• “Going forward, the DOJ intends to proceed criminally against naked wage-fixing or no-poaching agreements”
• What is a “naked” no-poach agreement?
  – According to the Guidance, a no-poach agreement is naked if it is “separate from or not reasonably necessary to a larger legitimate collaboration between the employers”
  – The Guidance gives legitimate joint ventures as an example of a collaboration
  – Filling out what else constitutes a “larger legitimate collaboration” remains a central question about DOJ policy

Available at: https://www.ftc.gov/public-statements/2016/10/antitrust-guidance-human-resource-professionals-department-justice
In the Franchise Context

• In Sept. 2017, two Princeton economists published a paper about no-poach terms in franchise contracts
  – They found that 58% of major franchisors’ contracts include no poach terms, including McDonald’s, Burger King, Jiffy Lube, and H&R Block
  – They also suggested that no-poach terms suppress wage competition
• It got traction – the New York Times wrote an article, and Senators Warren and Booker cited the paper in their letter to AG Sessions
• A wave of state AG investigations and class action cases followed
DOJ Enforcement Continues

- In November 2017, Senators Warren and Booker sent a letter to then-AG Sessions asking if DOJ intended to enforce its no-poach policy.
- In January 2018, AAG for Antitrust Delrahim reaffirmed that DOJ is following the 2016 Guidance and views naked no-poach agreements as per se unlawful.
- So far, the DOJ has only brought civil actions:
  - DOJ has said it “will pursue no-poach agreements terminated before October 2016 through civil actions” (Delrahim Testimony to Senate Subcommittee, Oct. 2018).
  - In April 2018, DOJ brought and settled a civil case for a no-poach agreement in the rail industry that had already ended before October 2016.
  - But, DOJ occasionally says that it has ongoing criminal investigations.
Meanwhile, in the Franchise Context

• In June 2017, a class action antitrust suit was filed against McDonald’s based on the no-poach terms in its franchise agreement:
  – *Interference With Employment Relations of Others*. During the term of this Franchise, Franchisee shall not employ or seek to employ any person who is at the time employed by McDonald’s, any of its subsidiaries, or by any person who is at the time operating a McDonald’s restaurant or otherwise induce, directly or indirectly, such person to leave such employment. This paragraph [] shall not be violated if such person has left the employ of any of the foregoing parties for a period in excess of six (6) months.

• The antitrust claim survived a motion to dismiss
  – A “naked horizontal no-hire agreement would be a *per se* violation of the antitrust laws.” Slip op. at 12. But the McDonald’s term isn’t naked – it is “ancillary to an agreement with a procompetitive effect,” e.g., the franchise agreements. *Id.* at 13-14
  – The court held that the no-poach term could still be unlawful under a “quick look.” “Even a person with a rudimentary understanding of economics would understand that if competitors agree not to hire each other’s employees, wages for employees will stagnate.” *Id.* at 14

• A California state law case was also brought against Carl’s Jr. and later settled
State AG Investigations of Franchisors/Franchisees

• In January 2018, the Washington AG opened an investigation into no-poach terms in fast food franchise agreements, which later expanded to include other industries.

• In July 2018, AGs from 10 other states and D.C., led by Massachusetts, announced a joint investigation into no-poach agreements at fast food franchises.

• Since then, in exchange for an Assurance of Discontinuance from the Washington AG, over 50 franchisors have agreed (on a nationwide basis):
  – Not to include no-poach language in their future franchise contracts, and
  – Not to enforce the no-poach provisions in their existing franchise contracts.

• Washington AG: “My goal is straightforward – eliminate [no-poach clauses] nationwide.”
  – Washington also brought the first state AG action, against Jersey Mike’s, which survived dismissal.
Legislative Developments

• In March 2018, Senators Booker and Warren introduced the “End Employer Collusion Act” (S. 2480)
  – The Act would prohibit no-poach agreements
  – It specifically includes those that are made through franchise agreements

• A companion bill was introduced in the House in April 2018 (H.R. 5632)

• No action has been taken on either bill
Class Actions

• Private class actions have been filed against a wide range of franchisors
  – They typically allege that the agreements are unlawful per se or alternatively under the “quick look” test
• Two cases have survived a motion to dismiss and continue under a “quick look” standard
  – Deslandes v. McDonald’s (N.D. Ill.) (Order on MTD in June 2018)
  – Yi v. SK Bakeries LLC (E.D. Wash.) (Cinnabon) (Order on MTD in Nov. 2018)
• One case survived a motion to dismiss, but the court declined to decide which standard would apply
  – Butler v. Jimmy John’s (S.D. Ill.) (Order on MTD in July 2018)
  – A new motion to dismiss is pending, arguing DOJ statement requires rule of reason treatment
DOJ Weighs In

• The DOJ filed a statement of interest in three no-poach class action cases in the Eastern District of Washington (Carl’s Jr, Auntie Anne’s, Arby’s), arguing that:
  – A franchise no-poach agreement that prohibits franchisees from hiring other franchisees’ employees should be assessed under the rule of reason. (Pgs. 17, 21)
  – But an agreement that prohibits the franchisee and franchisor from hiring each other’s employees could be unlawful per se, if they actually compete for employees – and if the no-poach agreement is not reasonably ancillary to the franchise agreement. (Pgs. 17-18)

• The Washington AG also filed a statement, arguing that under Washington state law, franchise no-poach agreements can be per se unlawful, depending on the facts

• All three cases settled before the motions could be argued and decided

• Defendants in other class actions have begun using the DOJ’s statement of interest
Counseling Franchisors and Franchisees

• Franchise Agreement
  – Two Provisions Implicated in Franchise Agreement
  – General Operations Manual Compliance Provision
  – Specific - Deleted in 2018
    • Section 7.3 – During the term of this Agreement, neither Franchisee . . nor any executive, manager . . . shall:
      – (c) Solicit or otherwise attempt to induce or influence any employee or other business associate of Franchisor or any other HAND AND STONE franchise to breach his, her or its employment or business agreement with, Franchisor or any other HAND AND STONE franchise.
• Replaced No Solicitation Operations Policy
• Hiring of Current Employees
  – You will work hard to develop a great team at your Hand and Stone Massage and Facial Spa. In order to develop that team you are going to expend time, money and training of your new employees. It is important for our system and your Spa that you have assurance other Hand and Stone Spas will not unduly benefit from your investment. Therefore, if you hire a current employee of another Hand and Stone Massage and Facial Spa you will be required to reimburse the other spa the sum of $500.00 in order to offset the cost of recruiting and training a replacement employee. This sum may be deducted from gift card or inter Spa reimbursement by the Franchisor and paid to the other Spa.
  – In the event that an employee has been terminated from another Hand and Stone Spa or Hand and Stone Franchise Corp. or has quit their employment after providing the proper notice you may hire such employee without any charge.
Other Areas of Concern

- Sharing of Compensation Information in System
- Setting Compensation Parameters in POS System
- Requiring Employee Non-Compete or Non-Solicitation Provisions in Franchise Agreements
Permissible Provisions

• Non-Compete Agreements
  – Accomplishes Similar Result – May Not Work for Another Franchisee or Another Competitor
  – Typically Must be Limited in Scope and Time – Not legal in all states
  – Between Employer and Employee – Not Between Two Employers
  – “While we are concerned with the overuse of non-compete agreements, the bill we introduced earlier this year prohibits no-poaching clauses and does not address non-compete agreements. A non-compete is typically an agreement between employer and and an employee, while no poaching clauses are between two or more employers and exist unbeknownst to the employee, even though they directly affect his or her job prospects.” Sens. Booker and Warren, Franchising World, Jan. 2019
Non-Solicitation and Confidentiality Agreement

- Accomplishes Some of the Tangential Objectives
- Can’t Solicit former Customers or Current Employees
- Preserves Use of Confidential Information
- Much More Likely to Pass Review
- Directly Between Employer and Employee
- Should Limit to Managers and Be Reasonable in Scope
Ancillary Restraints Doctrine

- Those that are Part of a Larger Endeavor
  - Judged under Rule of Reason
- Agreements with Consultants, Auditors, Vendors
- Incorporated Into a Legal Settlement – Separation Agreements
- Joint Recruiting Programs
  - A way to promote intrabrand competition for employees would be an advertising campaign extolling the virtues of working for McDonald’s. That is not what defendants are alleged to have done here. . . . In the employment market, the various McDonald’s stores are competing brands. Deslandes v. McDonald’s USA LLC
Joint Recruiting Site
Merger Activity

• Agreement Not to Poach Key Employees after a Sale
  – *Eichorn v. AT&T Corp.*, 248 F.3d 131 (3d Cir. 2001)
  – Would Not violate antitrust laws under Rule of Reason
  – Any restraint is incidental to ensuring a successful sale and continuity of the business

• Agreement Not to Solicit Employees During Due Diligence
  – Ancillary to exchange of Confidential Information
  – Evaluated under Rule of Reason
QUESTIONS?