INTERNATIONAL FRANCHISE ASSOCIATION

April 19, 2023

Hon. April Tabor
Secretary
Federal Trade Commission
600 Pennsylvania Avenue NW, Suite CC–5610 (Annex C)
Washington, D.C. 20580

Re: Noncompete Clause Rulemaking, Matter No. P201200

Dear Secretary Tabor:

The International Franchise Association (IFA) appreciates this opportunity to submit its views to the Federal Trade Commission in connection with the Commission's January 19, 2023, request, 88 Fed. Reg. 3482 (2023), seeking comments in connection with the Notice of Proposed Rulemaking for the proposed "Noncompete Clause Rule" (proposed 16 C.F.R. Part 910).

INTRODUCTION

Celebrating over 60 years of excellence, education, and advocacy, IFA is the world's oldest and largest organization representing franchising. IFA works through its government relations and public policy, media relations, and educational programs to protect, enhance and promote franchising and the approximately 790,492 franchise establishments that support nearly 8.4 million direct jobs, $825.4 billion of economic output for the U.S. economy, and almost 3 percent of the U.S. Gross Domestic Product (GDP). IFA members include franchise companies in over 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law, technology, and business development.

On January 19, 2023, the Federal Trade Commission ("FTC" or "Commission") published a proposed rule that would ban the use of noncompete clauses in employment contracts and make existing noncompete clauses unenforceable. 88 Fed. Reg. 3482 (Jan. 19, 2023). By its terms, the proposed rule applies only to "workers," which the Commission defined in Section 910.1(f) of the proposed rule as encompassing only the employer-employee relationship. The proposed rule specifically states that it does not apply to the relationship between franchisor and franchisee, 88 Fed. Reg. at 3511, but the FTC requested comments as to whether the proposed rule should be extended to the franchisor-franchisee relationship.

IFA submits this Comment in response to the FTC's solicitation of views about the extension of the proposed rule to the franchisor-franchisee relationship. To our knowledge, there is no empirical evidence that would support extending the proposed noncompete rule to cover the franchisor-franchisee relationship.

We believe that a blanket ban on noncompete clauses in franchise agreements would be extremely damaging to the franchise business model, encourage breaches of contract, and hurt small business owners that depend on the viability of the franchise system to protect their equity in their franchised businesses. For generations, courts have carefully and properly assessed the reasonableness of noncompete clauses in franchise agreements and refused to enforce those that are overbroad or not reasonably related to a legitimate business interest. In making these determinations of reasonableness, courts have identified many legitimate interests of franchisors in having and enforcing noncompete clauses. These interests include protection of the goodwill of the brand and confidential and proprietary information, and in addition to ensuring the continuing viability of the franchise system, which in turn protects franchisees' equity in their businesses. Enforcing reasonably drawn noncompete clauses that relate to these interests promotes competition and is necessary to ensure the survival of the franchise business model. We believe that existing state of law strikes the proper balance and affords adequate and appropriate protections to parties that choose to enter a franchise business relationship.

I. BACKGROUND: THE REGULATION OF THE FRANCHISE BUSINESS MODEL

We believe that the term "franchise" is often conflated with the term chain. Consequently, the term "franchise" is sometimes understood, incorrectly, to refer to any operation of a chain of businesses – and with that, comes a connotation of control by the franchisor that is not generally accurate. That leads to a misinterpretation of how franchised businesses are structured.

A franchise is, in fact, a particular form of business operation that is formed by a detailed contract between a franchisor and a franchisee and is regulated by the FTC's Franchise Rule, 16 C.F.R. Part 436 (the "Franchise Rule"). Franchise agreements typically are long-term arrangements and are entered into by parties only after the franchisor has presented the prospective franchisee with a detailed Franchise Disclosure Document ("FDD"), in a form prescribed by the Franchise Rule and state regulators, and the "waiting period" before the franchisee can lawfully commit to the franchise or pay money has elapsed. The FTC's definition of a "franchise" is found in 16 C.F.R. § 436.1(h):

> (h) Franchise means any continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:
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> (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;
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> (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and

(3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

Franchisees are typically small business owners, although the franchise model has paved the way for many franchisees to become successful multi-unit, multi-brand operators. Franchising offers a gateway to entrepreneurship by providing the opportunity for independent business ownership in an existing brand with an established brand reputation, typically requiring less time, cost and risk than starting an independent business from scratch. Although franchising offers a gateway to entrepreneurship, franchisees are at their core entrepreneurs – business owners that leverage the franchise system as a foundation to build brand recognition in their local markets and equity in their franchised businesses – and are employers that create employee cultures within their business and who become established pillars of their communities. If this proposed noncompete rule were extended to cover the core franchisor-franchisee relationship (along with other regulatory proposals), we fear that the result would be to strip away these entrepreneurs' empowerment and investments, relegating them to become mere employees of their franchisors. As further demonstrated in this Comment, the franchisor-franchisee relationship is markedly distinct from an employer-employee relationship and should not be treated as such.

Franchisees in a franchise system benefit from acquiring the right to operate under a brand, including use of the franchisor's trademark or service mark, access to training in the operation of the business (including the franchisor's business methods and knowhow), and system innovation and upgrades made over the life of the franchisor-franchisee relationship that originate not only from the franchisor, but also from the other franchisees in the franchise system. The ability for franchisees to openly share ideas and innovations for the betterment of the franchise system and to strengthen franchisee equity in their respective businesses without the threat of direct competition from other franchisees is critical to the success of the franchise model, as evidenced by the performance of franchised businesses that consistently outpaces non-franchised businesses.[1]

The presence of noncompete clauses in a franchise agreement is prominently disclosed under the Franchise Rule, specifically in Item 9, which lists the franchisee's principal obligations under the franchise agreement, with cross-references to the corresponding provision of the franchise agreement.[2] Additional disclosure is required in FDD Item 17, again with cross-references to the franchise agreement, which specify

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1 International Franchise Association, 2023 FRANCHISING ECONOMIC OUTLOOK, *available at: https://www.franchise.org/sites/default/files/2023-03/2023-Franchising-Economic-Report.pdf; see also* International Franchise Assoc., 2022 FRANCHISING ECONOMIC OUTLOOK, *available at: https://www.franchise.org/sites/default/files/2022-02/2022%20Franchising%20Economic%20Outlook.pdf*.

2 16 C.F.R. § 436.5(i) (row w).

disclosure of "non-competition covenants during the term of the franchise" and "non-competition covenants after the franchise is terminated or expires."[3] The requirement that disclosure of noncompete clauses in Items 9 and 17 must be in tabular form with cross-references to the franchise agreement highlight specifically to a prospective franchisee the noncompete clauses with which it must comply if it elects to purchase a franchise.[4]

The disclosure requirement is just one of the factors that distinguishes the franchise business model from conventional employment relationships. There is no general regulation of employment relationships that require advance disclosure and a waiting period to permit prospective employees to understand and consider the terms of their employment. Conversely, prospective franchisees are provided disclosures and the opportunity to assess the legal and business implications of the obligations of a franchisee for a required time period before committing to the franchise relationship. Franchisees choose to enter into long-term agreements precisely so that they can gain the benefit of using the franchisor's brand, methodology, and system (including the obligations with which the franchisee must comply); and conversely, franchisors rely on the franchisee's compliance with those obligations in disclosing the franchisor's methodology and system (including its confidential and proprietary information, processes, and trade secrets).

As noted below, franchisors have legitimate commercial justifications to include noncompete clauses in their franchise agreements. Franchisees are aware of these clauses: pursuant to the disclosure standards promulgated by the Federal Trade Commission, prospective franchisees are made fully aware of these and other requirements before they elect to sign a franchise agreement. Furthermore, as we will discuss below, in many cases, franchisees benefit greatly from the protections they receive from noncompete clauses.

II. OVERVIEW OF THE CURRENT STATE OF ENFORCEMENT OF NONCOMPETE CLAUSES IN FRANCHISE AGREEMENTS

Most franchise agreements include a provision under which the franchisee agrees not to operate or have an interest in another business that is the same as or similar to the franchised business. These noncompete clauses typically prohibit competition during the term of the franchise agreement and for a limited period following the expiration or termination of the franchise agreement. They generally prevent the franchisee from competing at or within a specified radius of the franchise location or of other units operating under the franchise system's licensed marks.

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[3] 16 C.F.R. § 436.5(q) (rows q and r).

[4] *Boulanger v. Dunkin' Donuts Inc.,* 442 Mass. 635, 640, 815 N.E.2d 572, 577 (2004) (upholding covenant, Court noted that "the plaintiff entered into his agreement and its attending covenants with his eyes wide open.").

Unlike virtually all other contractual provisions, noncompete clauses historically have been subject to a standard of "reasonableness" when reviewed by courts because of public policy considerations that have evolved in each state. Among other reasons, this review at the state level is because noncompete clauses have the potential to restrain trade and to deprive a person of the ability to earn a living in his or her chosen field. At the same time, courts have long recognized that employers, buyers of businesses, and others in business relationships (including franchises) may have legitimate pro-competitive interests in preventing employees, sellers of businesses, and independent contractors (including franchisees) from engaging in competition that unfairly trades on benefits such as confidential information and goodwill that are shared, developed, or transferred ancillary to those contractual relationships. Whether a noncompete clauses is reasonable depends on factors unique to the relationship to which it is applied (e.g., role and bargaining power of the parties to the contract, the confidential and proprietary information and knowledge received by a party, and the potential adverse effects if that information and knowledge are used to directly compete with the disclosing party). Given the fact-dependent space occupied by noncompete clauses, they can be modified by courts in many states to be consistent with the applicable standard of reasonableness. Judicial scrutiny of noncompete clauses ensures that parties subject to noncompete clauses are protected from overreaching or unreasonable noncompete clauses.

Although some states have statutes that govern the validity or enforceability of noncompete clauses, the enforceability of noncompete clauses in franchise agreements is usually a matter of state common law. No state, whether by statute or under common law principles, currently bans noncompete clauses in franchise agreements under all circumstances. This makes sense considering the hundreds of industries supported by the franchise model and the myriad of factors that would be at issue if a blanket ban of noncompete clauses were adopted that spanned all such industries. To the contrary, courts have long recognized that although restrictions on trade are generally disfavored, noncompete clauses are enforceable when they are necessary to protect a legitimate interest of the franchisor or the franchise system. Typically, courts assess the reasonableness of noncompete clauses by determining the reasonableness of the length of time, geographic scope, and activity proscribed as they relate to the legitimate interest of the franchise system.[5]

By way of comparison, courts have enforced noncompete clauses in agreements for the sale of a business for literally hundreds of years.[6] In that context, noncompete clauses protect a buyer's investment in the business's goodwill and trade secrets by ensuring that the seller does not use the expertise, confidential information, and goodwill

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5 *See generally* Williston on Contracts § 13:4*; Certified Restoration Dry Cleaning Network, LLC v. Tenke Corp.*, 511 F.3d 535, 546-67 (6th Cir. 2007).

6 *See Mitchel v. Reynolds*, 24 Eng. Rep. (Q.B.), 347 1 P. Wms. 181 (Chancery 1711) (enforcing a restrictive covenant ancillary to the sale of a business).

for which the buyer paid in order to compete with the buyer. And, while we do not offer an opinion as to the FTC's proposed rule as it applies to employment agreements, we observe that courts have also enforced restrictive covenants in employment agreements, although less freely, because they recognize an employer's interest in retaining the customers of its brand and in protecting confidential business information to which employees may have had access during their employment.

Courts have long delineated a distinction between noncompete clauses in employment agreements and noncompete clauses in commercial contracts. Noncompete clauses in employment agreements are subject to stricter scrutiny than that applied to covenants against competition in commercial contracts for the sale of an independent business.[7] A former employee's ability to use information and know-how acquired during employment to compete with a former employer is necessarily dependent on the nature of the job and the nature and quality of the information to which the employee has access. Because there is a strong public interest in promoting employment, courts have tended to analyze whether employee noncompete clauses are reasonably necessary to achieve an employer's legitimate business purpose notwithstanding such public interest.

Conversely, noncompete clauses in franchise agreements are typically enforced to a greater extent than those in employment contracts because the relative interests of franchisors and employers are different. Franchisors normally have significant legitimate business interests in enforcing noncompete clauses, namely protecting the confidential and proprietary information disclosed to franchisees through training, manuals and operational support and the access to innovations shared by other franchisees for the protection of all franchisees' equity in their respective investments, and those considerations are significantly different than the considerations that apply in the employer-employee context, where there is not a similar risk of loss of equity and investment to the remaining employees.[8]

The material difference in the role of noncompete clauses in franchise relationships and employment relationships is the reason underlying courts' application of a "reasonableness" test to evaluate noncompete clauses in franchise relationships. Most judicial decisions analyze noncompete clauses in franchise agreements to determine whether they are reasonable in scope with respect to the territory, time, activities

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7 Restatement (Second) Of Contracts § 188 Comment b (1981) ("courts have generally been more willing to uphold promises to refrain from competition made in connection with sales of good will than those made in connection with contracts of employment.").

8 *See generally Boulanger v. Dunkin' Donuts Inc.*, 442 Mass. 635, 639-40, 815 N.E. 2d 572, 576-77 (Mass. 2004) ("In the context of the sale of a business, courts look "less critically" at covenants not to compete because they do not implicate an individual's right to employment to the same degree as in the employment context.").

restrained, and potential harm to the franchise system, as they relate to the legitimate business interests of the franchisor and franchise system.[9]

III. THE LEGITIMATE INTERESTS THAT MAY SUPPORT ENFORCEMENT OF A REASONABLE NONCOMPETE CLAUSE

Over the years, courts have identified numerous interests of a franchisor which, if present in a particular case, would justify and require enforcement of a noncompete clause in a franchise agreement, including:

- Protection of the integrity of the franchise system and other franchisees' equity in their franchised businesses;
- Protection of confidential information and trade secrets; and
- Protection of the goodwill under the mark owned and licensed by the franchisor.

Courts have analyzed noncompete clauses to determine whether one or more of these or related interests is present in a particular case, and whether the noncompete clause is reasonable in view of these protectable interests.

The case law identifying these protectable interests illuminates the legitimate bases for the presence and enforceability of reasonable noncompete clauses in franchise agreements.

A. Protection of the Franchise System and Other Franchisees

Noncompete clauses protect the ongoing integrity of a franchise system, including protecting franchisees against competition from existing and former franchisees. Simply put, if a noncompete cannot be enforced, any franchisee or former franchisee can take what it has learned about the business from the franchisor and its fellow franchisees and then directly compete with its own franchise system and fellow franchisees. If any franchisee can do that, all franchisees can do that, and there is nothing left of the franchise system – or for that matter, the franchise business model.

The federal district court in *Economou v. Physician's Weight Loss Centers of America*, 756 F. Supp. 1024, 1032 (N.D. Ohio 1991) explained this phenomenon cogently and graphically. The court stated that the franchisor's important business

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9 *See, e.g. Piercing Pagoda, Inc. v. Hoffner,* 465 Pa. 500, 509, 351 A.2d 207, 211 (1976).

interest in enforcing the noncompete clause was "survival of the business itself."[10] The court quoted the testimony of the franchisor's executive vice president:

> If we don't get a non-compete that we can honor, we don't have a system. If we don't win this case, we don't have a franchise. Because every time something goes wrong, some franchisee is going to say, "screw it." [11]

The court in *Outdoor Lighting Perspectives Franchising, Inc. v. Home Amenities, Inc*., No. 3:11–cv–0567, 2012 WL 137808 (W.D.N.C. Jan. 18, 2012), explained the same concept somewhat differently:

> [The franchisor] also has a legitimate interest in preserving the integrity of its franchise system. If its noncompete provisions are not enforced, the entire …franchise system is placed in jeopardy as franchisees may ignore their agreements and begin operating as a competing business knowing that the noncompete provisions may be disregarded and will [ ] provide no protection to other franchisees.[12]

When every franchisee in a system executes a similar noncompete clause, each of them is protected from other franchisees misappropriating the know-how and goodwill of the franchise system and using it to compete with the franchisee's business. As the court in *Boulanger, supra,* observed, the former franchisee seeking to avoid his noncompete clause had earlier received "protection from competition from former Dunkin' Donuts franchises under the terms of the very covenant not to compete he now challenges."[13]

Other courts have similarly articulated the importance of noncompete clauses in protecting other franchisees. In *Rita's Water Ice Franchise Corp. v. DBI Investment Corp*., No. 96–306, 1996 WL 165518 (E.D. Pa. Apr. 8, 1996), the court enforced a covenant that prohibited the franchisee from operating within a 1.5-mile radius of any shop in the system.[14] The court emphasized the harm to the franchise system as a whole if the covenant were not enforced:

> [T]he franchise agreements at issue are similar to the agreements signed with other franchisees. If [the franchisor] is unable to enforce this restrictive covenant against these defendants, *the values of all its franchises are*

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10 756 F. Supp. at 1032.

11 *Id*.

12 2012 WL 137808, at *3.

13 442 Mass. at 641, 815 N.E. 2d at 578.

14 1996 WL 165518 at *2.

> *lowered*. Other franchisees might violate their franchise agreements in similar ways and use [the franchisor's] good will to establish competing businesses.[15]

In *Casey's General Stores, Inc. v. Campbell Oil Co.*, 441 N.W. 2d 758 (Iowa 1989), the Iowa Supreme Court enforced a covenant that restricted competition within three miles of every existing franchise. The court held:

> Noncompetition agreements between a franchisor and a franchisee are designed not only to protect the interests of the immediate parties *but also to protect other franchisees against competitive activities*. Thus, to the extent that such noncompetition agreements are exacted from all franchisees, *each franchisee* is thereby protected from competition from other franchisees.[16]

In *Baskin-Robbins Inc. v. Golde*, No. 5:99–CV–102–BR(3), 2000 WL 35536665 (E.D.N.C. May 25, 2000), the court observed that a noncompete clause serves a franchisor's legitimate business interests by, among other things, "*protecting the investments made by other . . . franchisees* who have also signed agreements containing covenants not to compete."[17] The *Golde* court quoted the above-quoted language in *Casey's General Stores* and then further noted:

> To the extent that the non-compete covenants included in the franchise agreements extended by [franchisor] *protect the franchisees*, they strengthen the franchise system and serve [franchisor's] legitimate business interests. Failing to enforce the covenants would, accordingly, compromise their legitimate business interests.[18]

Private parties are free to enter into contracts on such terms as they may agree upon, particularly where there is pre-contractual disclosure of those terms. The FTC came to this very conclusion when it issued the Amended Franchise Rule in 2007:

> In our law enforcement experience investigating relationship issues in individual franchise systems, it has been the case that the franchisor actions allegedly causing harm to individual franchisees also frequently generate countervailing benefits to the system as a whole or to consumer welfare overall that may or may not be outweighed by the alleged harm to

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15 *Id.* at *5 (emphasis added).

16 *Id.* at 761 (emphasis added).

17 2000 WL 35536665 at *5 (emphasis added).

18 *Id*. at *5 n.4 (emphasis added).

> franchisees. Commenters advocating that the Rule include unfairness remedies have asserted injury, but have failed to bring forth evidence that such injury outweighs potential countervailing benefits that arise from the alleged acts or practices. Therefore, the Commission declines to impose industry-wide provisions mandating substantive terms of private franchise contracts that would impact on the entire franchise industry, not just those franchise systems that are the subject of commenters' complaints.[19]

There is no evidence that suggests it is now proper to deviate from the Commission's enunciated position. Indeed, to conclude otherwise would be to significantly impinge upon parties' freedom to contract, for which a substantial rulemaking record would be required to justify such an action. As noted in this comment, we believe there is no empirical evidence to support any extension of the proposed noncompete rule to cover the franchisor-franchisee relationship.

B. Protection of Confidential Information.

Courts have held that a franchisee's possession of confidential information, including business methods of the franchisor, was a protectable interest that justified enforcement of a noncompete clause.

In *Boulanger, supra,* the Supreme Judicial Court of Massachusetts considered noncompete clauses in a case of first impression in Massachusetts. The Court recognized the importance of protecting franchise systems from competition by its own franchisees. There, the Court found that protection of the confidential information and the goodwill connected with the trademarks constituted legitimate business interests. In that case, the plaintiff, a former Dunkin' Donuts franchisee sought to become a franchisee of a competing donut shop system. The competing system, on learning of the existence and continuing applicability of the plaintiff's noncompete clause, refused to continue discussions with him, and the plaintiff sued his former franchisor. The court held that the covenant was reasonable and should be enforced. The court focused on the franchisor's protectable interest in its confidential information. The court reasoned:

> Here, [franchisor] had an interest in protecting confidential information. … [Franchisor's] confidential information included operating manuals and similar information contained in videotapes, CD–ROMs, and websites; recipes for coffee and baked goods; financial information and data; marketing and promotion strategy; new product development; and the location of sites for new stores and building plans…. [D]istrict meetings were held several times a year, often involving the dissemination of confidential information such as financial data and profitability of particular

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[19] Statement of Basis and Purpose for the Amended Franchise Rule, 72 Fed. Reg. 15443, 15447-15448 (Mar. 30, 2007).

> stores, new product development, and marketing and promotion strategies.…[19]

The court concluded that the noncompete clause was justified by the franchisor's interest in protecting its confidential business information, protecting its system, and protecting its franchisees from competition with a party that had been privy to the methods and techniques that are integral to their operations. The Massachusetts Supreme Judicial Court, similar to the courts referenced in the cases above, reviewed the circumstances and facts of the noncompete clause and concluded that in the franchisor-franchisee relationship, enforcement of noncompete clauses was fair, reasonable, and necessary to protect the confidential and proprietary information of the franchise system.

Similarly, in *Economou v. Physician's Weight Loss Centers of America*, 756 F. Supp. 1024, 1032 (N.D. Ohio 1991), the court enforced the noncompete clause, finding that "the franchisee has gained knowledge and experience from the franchisor, and to allow the franchisee to use this knowledge and experience to serve former or potential customers of the franchisor would work a hardship and prejudice to the latter."[20]

C. Protection of goodwill under a licensed mark.

In evaluating and then enforcing the noncompete clause in an H&R Block franchise agreement, the Indiana Court of Appeals held:

> Block has a valuable property right in its service mark. The value is reflected by customers' name recognition and resultant use of the service offered under the Block name. [Franchisee] was willing to pay for that customer affiliation as would a buyer of a business. In return, Block gave [Franchisee] the right to use that service mark and benefit from the customers it drew as long as the contract terms were met. By including the

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19 442 Mass. at 642, 815 N.E. at 578.

20 *See also Service Master Residential/Commerce Servs., L.P. v. Westchester Cleaning Serv., Inc*., No. 01-CV-2229, 2001 WL 396520 at *4 (S.D.N.Y. Apr. 19, 2001) ("When a terminated franchisee continues to operate a competing business, the 'potential harm arises from Defendant's ability to trade on the knowledge and customer relations gained as a… franchisee'"); *In re KBAR, Inc.*, 96 B.R. 158, 160 (C.D. Ill. Bankr. 1988) (enforcement of noncompete clause was justified by former franchisee's "access to [franchisor's] uniform system, know-how, and technical assistance, including confidential marketing and operational information."); *Discount Muffler Shops, Inc. v. Seely,* No. L-83-048, 1983 WL 6849 at *2 (Ohio Ct. App. July 1, 1983) (franchisee's knowledge of the franchisor's method of operations, even if not trade secrets, was a sufficient justification to enforce the covenant.)

> covenant not to compete in the agreement, Block preserved the value of that property right to itself alone after the termination of the agreement.[21]

Many courts, in assessing the enforceability of noncompete clauses in franchise agreements, have focused on the damage to the goodwill associated with the franchisor's mark if a franchisee were permitted to continue operating at the same location under a different mark. One example was *Jiffy Lube Int'l, Inc. v. Weiss Brothers, Inc*., 834 F. Supp. 683, 691-92 (D.N.J. 1993), in which the court observed:

> [T]he primary characteristic of a franchise is the license given to the franchisee to trade upon and exploit the franchisor's good will...
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> One can view a franchise agreement, in part, as a conveyance of the franchisor's good will to the franchisee for the length of the franchise. When the franchise terminates, the good will is, metaphysically, reconveyed to the franchisor. A [noncompete clause], reasonably crafted, is necessary to protect the good will after that reconveyance; ...
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> Were we not to grant a preliminary injunction, the good will of the franchisor would be harmed by the existence of a competing service center at the very site of the former Jiffy Lube center. Since customers are likely to patronize businesses close to home or work, the operation of a second service center, even without the Jiffy Lube logo, would greatly impair plaintiff's ability to establish another franchise in the area.[22]

Courts have recognized that the franchisor's goodwill extends to the franchise itself, not just the underlying goods and services. Therefore, the franchisor has a legitimate interest in protecting the goodwill from unfair competition from its present and former franchisees. In *Tantopia Franchising Co., LLC v. West Coast Tans of PA, LLC*, 918 F.Supp.2d 407 (E.D. Pa. 2013), the court held:

> [I]n a franchise, the goodwill inherent in the name and mark attaches to the entire business of the franchisee, not just to the goods themselves…. The Supreme Court of Pennsylvania also held that restrictive covenants in

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21 *McCart v. H&R Block, Inc.,* 470 N.E.2d 756, 763-64 (Ind. Ct. App. 1984).

22 *See also* ServiceMaster Residential/Commercial Serv., L.P. v. Westchester Cleaning Serv., Inc., 01–CV–2229, 2001 WL 396520, at *3 (S.D.N.Y. Apr. 19, 2001) ("continued operation under a different name may confuse customers and thereby damage the good will of the franchisor.").

franchise agreements are enforceable to protect "the basic product which the franchisor has to sell, namely the franchise itself, ..."[23]

IV. THERE IS NO EVIDENCE OR OTHER BASIS FOR MAKING NONCOMPETE CLAUSES IN FRANCHISE AGREEMENTS PER SE UNLAWFUL

The foregoing overview of the law of the enforcement of noncompete clauses in franchise agreements demonstrates the legitimate interests that are served by enforcement of reasonable covenants in franchise agreements in many circumstances. The American Bar Association recently published the Fourth Edition of its monograph on "Covenants Against Competition in Franchise Agreements," a state-by-state analysis of the topic that consumes over 600 pages.[24] Although that book is not intended to be comprehensive, that overview shows that noncompete clauses are not (and should not be) *per se* enforceable; they are not, and numerous cases are reported showing where noncompete clauses were found unenforceable[25] (typically because in the particular case

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23 *Id*. at 418, *quoting Piercing Pagoda, Inc., supra,* 464 Pa. at 509, 351 A.2d at 211. *See also Servpro Indus, Inc. v. Pizzillo,* No. M2000-00832, 2001 WL 120731 at *7 (Tenn. Ct. App. Feb. 14, 2001) (in analyzing enforceability of noncompete clause, "we must consider [franchisor's] interest in protecting the value of the basic product it has to sell: its franchises"); *Armstrong v. Taco Time Int'l, Inc.*, 30 Wash. App. 538, 547, 635 P.2d 1114, 1119 (1981) (franchisor has "a legitimate interest in protecting the basic product it sells—its franchise").

24 https://www.americanbar.org/products/inv/book/427078334/.

25 *See, e.g., Novus Franchising, Inc. v. Dawson,* 725 F.3d 885 (8th Cir. 2013) (affirming denial of injunction enforcing noncompete clause where showing of harm to franchise system was too speculative); *Liautaud v. Liautaud,* 221 F.3d 981 (7th Cir. 2000) (refusing to enforce noncompete clause that contained no time limitation even though franchisor had an interest in protecting the confidentiality of its trade secrets*); Breadeaux's Pisa, LLC v. Beckman Bros. Ltd.,* 599 F.Supp.3d 826 (W.D. Mo. 2022) (franchisor's showing that in the absence of enforcement of noncompete clause, other franchisees would follow suit insufficient to warrant enforcement of clause by preliminary injunction); *Rohm and Haas Electronic Materials, LLC v. Electronic Circuit Supplies, Inc*., 759 F. Supp. 2d 110 (D. Mass. 2010) (court declined to enforce a noncompete clause because the plaintiff failed to show that the information in the defendant's possession constituted protected trade secret or confidential trade information)*; Anytime Fitness, Inc. v. Family Fitness of Royal, LLC,* No. 09–3503, 2010 WL 145259 (D. Minn. Jan. 8, 2010) (harm to franchisor's goodwill and franchise system were insufficient to support injunction enforcing noncompete clause)*; Jiffy Lube International, Inc. v. Weiss Brothers, Inc.,* 834 F. Supp. 683, 692 (D.N.J. 1993) (three year post-term noncompete clause reduced to 10 months because three years was excessive when measured against the franchisor's protectable interests); *Winston Franchise Corp. v. Williams*, No. 91 Civ. 796, 1992 WL 7843 (S.D.N.Y. Jan. 10, 1992) (noncompete clause not enforced when franchisor did not show that the franchisee possessed any technical know-how and did not intend to establish another franchise in the market); *American Nursing Care of Toledo, Inc. v. Leisure,* 609 F. Supp. 419 (N.D. Ohio 1984) (noncompete clause restricting the business of providing temporary nursing

the franchisor's legitimate interest was not present or proven, or where the covenant was overbroad in view of the franchisor's legitimate interest and state laws did not permit reformation or "blue penciling").

Rather, the legion of cases referencing the legitimate interests of franchisors in the enforcement of noncompete clauses shows that there is no basis on which to render such clauses *per se* unenforceable. The concept of *per se* unlawfulness is one that derives from the federal antitrust laws and is reserved only for activities that cannot be justified under any circumstances. As the U.S. Supreme Court held in *Leegin Creative Leather Prods., Inc. v. PSKS, Inc*., 551 U.S. 877 (2007):

> The *per se* rule, treating categories of restraints as necessarily illegal, eliminates the need to study the reasonableness of an individual restraint in light of the real market forces at work, and, it must be acknowledged, the *per se* rule can give clear guidance for certain conduct. Restraints that are *per se* unlawful include horizontal agreements among competitors to fix prices, or to divide markets. ...
>
> To justify a *per se* prohibition a restraint must have "manifestly anticompetitive" effects and "lack . . . any redeeming virtue."
>
> As a consequence, the *per se* rule is appropriate only after courts have had considerable experience with the type of restraint at issue, and only if courts can predict with confidence that it would be invalidated in all or almost all instances under the rule of reason. It should come as no surprise, then, that "we have expressed reluctance to adopt *per se* rules with regard to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious."[26]

Imposition of a rule rendering all noncompete clauses in all franchise agreements *per se* unenforceable should be considered—and rejected—under the same standard.

Parties to business agreements are typically free to make contracts and do business under such terms as they see fit. Noncompete clauses have been included in business contracts literally for centuries, and in franchise agreements since the inception of the franchise business model. They have at all times been scrutinized by courts in a

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services was unreasonable in light of the undue hardship imposed on the franchisees and undue interference with the franchisees' right to make a living, and the franchisor had not established a protectable interest in its business format); *South Bend Consumers Club, Inc. v. United Consumers Club, Inc.,* 572 F. Supp. 209, 214 (N.D. Ind. 1983) (refusing to enforce noncompete clause that prohibited franchisee from operating a competing business within 25 miles of any other unit in the system).

[26] 551 U.S. 877, 886–87 (internal citations omitted).

way that other contract provisions are not, precisely because they are restraints of trade. But, notwithstanding such restraint of trade, courts have frequently upheld and enforced noncompete clauses in franchise agreements because there are legitimate reasons to do so, in furtherance of the promotion of the franchise system and brand and protection of all franchisees' equity in the businesses they built—or, in other words, to promote the ability of the franchisor and all of its franchisees to compete with other brands. Noncompete clauses cannot then be said to fall within the category of restraints that are "manifestly anticompetitive" or that "lack…any redeeming virtue."

Moreover, as noted above in this Comment, the existence of noncompete clauses is clearly, explicitly, and prominently disclosed to a prospective franchisee before a franchise agreement is signed as part of Items 7 and 19 of a franchisor's FDD, pursuant to the FTC Franchise Rule.[27]

The State of California was famously and historically hostile to the enforcement of noncompete clauses, but its Supreme Court recently rejected the application of a *per se* rule barring the enforcement of noncompete clauses in a business context under any circumstances. In *Ixchel Pharma, LLC v. Biogen, Inc*., 9 Cal. 5th 1130, 470 P.3d 571, 266 Cal. Rptr. 665 (2020), the California Supreme Court unanimously rejected an invitation to hold noncompete clauses *per se* unlawful under Cal. Bus. & Prof. Code §16600.[28] The Court analogized the analysis under that statute to California's antitrust statute, the Cartwright Act, and observed that despite the absolute terms of the statutory restrictions, not every agreement that restrains trade in some fashion can be void, but every agreement concerning trade restrains it in some fashion. But, as is the case under the federal antitrust laws, the California Supreme Court found that some contractual restraints can promote competition.[29] And, while the case before it did not specifically involve a noncompete clause in the context of a franchise agreement, the Court cited restrictions in franchise agreements, such as exclusive dealing provisions, as examples of contract provisions that restrain trade <u>but that can also promote competition</u>.[30] The case before

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27 As to the benefit of disclosure, we note the famous passage written by Louis Brandeis, that "[s]unlight is said to be the best of disinfectants …." L. Brandeis, Other People's Money and How the Bankers Use It 62 (1914).

28 That statute provides, in its entirely, "[e]xcept as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is that extend void."

29 *Ixchel*, 9 Cal. 5th at 1160-61, 470 P.3d at 589, 266 Cal. Rptr. at 687.

30 "Many forms of exclusive dealing restrain parties from "engaging in a lawful ... business." Franchise agreements often prohibit the franchisee from selling a third party's products; requirements and output contracts restrain buyers and sellers respectively from doing business with third parties." <u>*Ixchel*</u>, 9 Cal. 5th 1130 at 1161, 470 P.3d 571 at 589, 266 Cal. Rptr. at 687.

the Court did restrain a party to a commercial contract from doing business with a competitor; however, the Court declined to find that provision *per se* unlawful. In *Ixchel,* the California Supreme Court concluded "[w]e also hold that a ***rule of reason*** applies to determine the validity of a contractual provision by which a business is restrained from engaging in a lawful trade or business with another business."[31]

Indeed, there is no factual underpinning for barring all noncompete clauses in franchise agreements under all circumstances. To the contrary, the breadth of industries supported by the franchise model and the myriad of varied noncompete clauses relevant to specific industries renders a complete bar on noncomplete clauses counterproductive to the notion of trying to protect franchisees' interests.

We have conducted research and found no legitimate empirical data to suggest that the enforcement of reasonable noncompete clauses causes competitive harm in any market or in any way suppresses competition or the freedom to engage in legitimate business activities.

Consistent with the U.S. Supreme Court's long-standing approach to the application of *per se* rules, banning a particular contract provision under any and all circumstances would be justified only after a record of evidence is developed that provides unambiguous proof to support the conclusion that such a clause is inherently anti-competitive or unjust, and without any redeeming value.

Even if there may be anecdotal evidence in some cases that applying noncompete clauses benefitted or caused harm to specific ***competitors***, we have seen no empirical data to demonstrate that noncompete clauses harm ***competition***;[32] in fact, we believe that the opposite is true.

CONCLUSION

Noncompete clauses serve an important and legitimate function for businesses, including franchising. They serve to protect the equity of franchisees in the businesses that they have established, the confidential and proprietary information of franchisors, and the goodwill, knowhow, and integrity of franchise systems, and in ensuring such protections, they promote competition. There is neither a factual nor a legal basis that would support voiding all noncompete clauses under all franchise agreements across hundreds of industries under all circumstances.

Because noncompete clauses may restrain trade, they are subjected to judicial scrutiny under state law. Courts applying state law engage in rigorous analyses of the totality of the circumstances to determine whether a noncompete clause is reasonable

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31 9 Cal. 5th at 1162, 470 P.3d at 590, 266 Cal. Rptr. at 687 (emphasis applied).

32 *See also* the Commission's comment on this point in the 2007 Statement of Basis and Purpose, referenced at the text accompanying note 19, *supra*.

under the facts presented. Courts have broad power in this context to do justice, and we are aware of no suggestion that courts are not properly or adequately fulfilling that function.

Furthermore, to the extent that a franchisee may feel aggrieved by the enforcement of a noncompete clause because of its inability to take the knowhow it acquired from a franchisor and compete with the franchisor's other franchisees, we note that:

1. As many courts, including notably the Supreme Judicial Court of Massachusetts, have observed, a former franchisee seeking to avoid the noncompete clause has necessarily obtained the benefit of the protection afforded by that clause during the course of its franchise;

2. Courts are exceedingly cautious before adopting *per se* rules, as shown by the U.S. Supreme Court in *Leegin* and the California Supreme Court in *Ixchel*; and

3. The regulation of franchising by the FTC and many states ensures that before entering into their franchise agreements, prospective franchisees are informed of the existence of the noncompete clause, had the opportunity to consult with counsel, had the ability to weigh the benefits of the franchise against the perceived restraint of the noncompete clause, and are in a position to make an informed decision about whether to execute the franchise agreement containing the noncompete clause.

In sum, we see no basis upon which the FTC can or should override or preempt the very well-developed body of state law that has arisen over decades with respect to the enforceability of noncompete clauses in franchise agreements.

Thank you for the opportunity to submit our views, and for considering our perspective.

Respectfully submitted,

International Franchise Association

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