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Evolving No-Poach Landscape Requires A Vigilant Eye

By **Bob Buchanan and Stefano Sharma** (September 11, 2019, 2:25 PM EDT)

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No-poach agreements have been in the news nearly every week this summer. Multiple class actions are currently pending against franchise organizations, with the applicable standard for analyzing no-poach provisions hanging in the balance.[1]

State attorneys general offices have been vigorously attacking such provisions, reaching dozens of settlements with nationwide impact,[2] and creating a possible tension between state and federal law.[3] No-poach provisions have even made their way to the national election stage, as presidential hopefuls Sen. Elizabeth Warren, D-Mass., and Sen. Cory Booker, D-N.J., recently reintroduced legislation to eradicate the restrictive agreements.[4]

While often these agreements have no competitive justification, in certain situations they can be a legitimate component of a bona fide collaboration. This is a good time to review the current landscape and to state practical takeaways.

DOJ Enforcement Surged in 2010

US v. Adobe Condemned Naked No-Poach Agreements

While the Sherman Act has always applied to competition for employees, federal enforcement surged in 2010, when the U.S. Department of Justice filed United States v. Adobe Systems Inc.,[5] alleging that Adobe, Apple Inc., Google Inc., Intel Corp., Intuit Inc. and Pixar Inc. violated Section 1. According to the DOJ's complaint, these tech giants entered into naked no-poach agreements promising they would not cold call each other's employees. The DOJ alleged that these agreements "were not ancillary to any legitimate collaboration between Defendants."

The companies entered a consent decree the same day the suit was filed. The final judgment encapsulates the DOJ's stance on no-poach provisions and is a useful starting point for the framework to analyze such provisions.

DOJ's Resolution Permitted Ancillary Restraints

Even in Adobe, which resolved allegations of a naked violation, the DOJ expressly permitted the parties

to use no-poach agreements where they are reasonably ancillary to a bona fide collaboration. Antitrust law treats naked and ancillary agreements differently.

In a naked horizontal agreement, competitors merely agree to fix prices or divide markets, with no broader collaboration. Such agreements are per se illegal, and do not require inquiry into their market effects, because they suppress competition with little or no possibility of a pro-competitive benefit. But not all horizontal restraints are per se illegal, of course.[6]

When restraints are ancillary to a legitimate business collaboration, the rule of reason should be applied to determine whether they are pro-competitive. Often this requires taking into account the totality of the circumstances, since there may be both pro-competitive and anti-competitive effects in the relevant market or markets.[7]

Sometimes, a class action plaintiff will allege only a violation of the per se rule or, in the alternative, of the quick look variant on the rule of reason. This means that even at the motion to dismiss stage the claim may rise or fall on the determination of the applicable standard.[8]

The 2010 final judgment[9] in Adobe, recognizes several examples of a bona fide collaboration. As it sets out, the six tech companies were not prohibited from entering into or enforcing "a no direct solicitation provision" that is reasonably necessary for:

- "[Mergers] or acquisitions, consummated or unconsummated, investments, or divestitures, including due diligence related thereto";
- "[Contracts] with consultants or recipients of consulting services, auditors, outsourcing vendors, recruiting agencies or providers of temporary employees or contract workers";
- "[The] settlement or compromise of legal disputes"; or
- "[Contracts] with resellers or OEMs; contracts with certain providers or recipients of services; or the function of a legitimate collaboration agreement, such as joint development, technology integration, joint ventures, joint projects (including teaming agreements), and the shared use of facilities."

Each of these contexts can have a legitimate role for a no-poach clause. In a merger, for example, the buyer wants to know it can retain the employees; and in a consulting arrangement, the consulting firm wants to know that the customer will not steal its employees when they go on site. Businesses that are engaged in one of these collaborations (or something similar) can consider using a no-poach provision.

Even where there is a reasonable context for the provision, however, the business must carefully consider whether the provision is reasonably tailored to serve a pro-competitive purpose. The final judgment set forth additional requirements which are useful in guiding this analysis:

- For written contracts, the final judgment requires that the defendants: "(1) identify, with specificity, the agreement to which the no direct solicitation provision is ancillary; (2) narrowly tailor the no direct solicitation provision to affect only employees who are anticipated to be directly involved in the arrangement; (3) identify with reasonable specificity the employees who are subject to the no direct solicitation provision; (4) include a specific termination date or event; and (5) sign the agreement, including any modifications to the agreement."

- For unwritten contracts, defendants must maintain documents sufficient to show: "(1) the specific agreement to which the no direct solicitation provision is ancillary; (2) the employees, identified with reasonable specificity, who are subject to the no direct solicitation provision; and (3) the provision's specific termination date or event."

These stated requirements can be useful in anticipating how no-poach agreements will be viewed in various contexts.

Employers Were Warned of Criminal Enforcement in 2016

No-poach agreements took a giant step into the spotlight in 2016, when the DOJ and the Federal Trade Commission jointly issued the "Antitrust Guidance for Human Resources Professionals." The federal agencies put employers on notice: Naked no-poach agreements are per se illegal and criminal sanctions may be enforced against companies engaging in such agreements. ("Going forward, the DOJ intends to proceed criminally against naked wage-fixing or no-poaching agreements.") Most employers likely had not realized they could face potential jail time for engaging in this practice.

The 2016 guidance suggested, however, that ancillary agreements would be subject to the more lenient rule of reason. ("Legitimate joint ventures ... are not considered per se illegal under the antitrust laws.") A look at relevant case law, coupled with the final judgment in Adobe, confirms that a narrowly tailored no-poach provision, which furthers the specific goals of procompetitive collaboration, should not be condemned as per se unlawful.

Framework for Analysis

The final judgment in Adobe, and courts in cases considering the issue, has laid out the following analytical framework: A no-poach provision will likely be considered under the rule of reason if it is (1) ancillary to a legitimate business transaction or collaboration; (2) narrowly tailored to affect only employees who are anticipated to be directly involved in the transaction or collaboration; (3) reasonably specific in identifying the affected employees and the nature of the restraints; and (4) limited in geography and duration.

As the DOJ recently reiterated[10] ancillary agreements "must be subordinate and collateral to a separate, legitimate transaction," and "serve to make the main transaction more effective in accomplishing its purpose."

Two Examples in the Case Law

Two results in the case law — one in which a no-poach provision was found to be subject to the rule of reason and one in which per se claims were allowed to proceed — illustrate the difference between reasonable and presumptively unreasonable ancillary restraints.

First, Eichorn v. AT&T Corp., decided by the U.S. Court of Appeals for the Third Circuit in 2001, remains the most authoritative case applying the ancillary restraints doctrine to no-poach agreements. A company was being sold. The buyer wanted to keep the benefit of the company's skilled workers. Consistent with customary practice, the seller agreed not to hire them away after the closing.

Plaintiffs — former employees of the acquired company — argued that the agreement to restrict hiring was per se illegal. The Third Circuit ruled that the no-poach agreements were ancillary restraints,

properly reviewed under the rule of reason.

The court found that the restrictions were narrowly tailored and served a legitimate purpose, because the successful sale of the company required workforce continuity. The no-poach agreement was limited to eight months. And it only limited employees from working at two companies in the context of a market that included "a vast number of jobs" across the United States.

The Third Circuit concluded that "any restraint on plaintiffs' ability to seek employment ... was incidental to the effective sale [of the company]."

Second, a contrasting example is found in Aya Healthcare Services Inc. v. AMN Healthcare Inc.[11] where the U.S. District Court for the Southern District of California denied a motion to dismiss last year. The court recounted the allegations in Aya Healthcare Services., as follows.

> The plaintiffs and defendants both staffed traveling nurses in hospitals around the United States. The defendants operated the largest provider network in the country and also employed other providers (e.g., plaintiffs) as subcontractors. The defendants required each subcontractor to promise that it would not poach any of defendants' employees. These restraints lasted in perpetuity and applied to all of defendants' traveling nurses "no matter how or where employed, and even when not currently on assignment [for defendant]."

According to the court, the plaintiffs plausibly alleged that the agreements were not ancillary to the subcontractor agreements — because the restraints lasted beyond the termination of the joint venture and reached beyond its geographic scope, the defendants were not subject to the same restrictions and the restrictions applied to all of the defendants' employees, not just those who came in contact with the plaintiff.

Given this overreaching, the court was "unable to determine with certainty whether the restraints [were] ancillary to procompetitive business purposes, or so broad that part of the restraint suppresses competition without creating efficiency."[12] The plaintiffs, therefore, adequately pled the existence of restraints that are subject to per se treatment.

The case presents an example of an ancillary agreement on the borderline of per se and the rule of reason, where the agreement likely would have been found presumptively reasonable had the drafters made it narrowly tailored.

Class Action Plaintiffs and State AG Enforcement

Even where a no-poach agreement is narrowly tailored to serve a legitimate purpose, business attorneys must still watch out for hostile treatment under special state laws — and for potential liability to state attorneys general and class action plaintiffs.

A consolidated case against franchisors Carl's Jr. Restaurants LLC, Auntie Anne's Inc. and Arby's Restaurant Group Inc. highlighted a potential dichotomy between federal and state enforcement, with the DOJ and Washington's Attorney General Bob Ferguson stating opposite views. The cases involved vertical no-poach agreements among franchisors and franchisees.

Consider the small-business person who is deciding whether to buy a franchise. This prospective franchisee might like to know whether he/she will need to invest in training employees, and whether a

competing franchise owner will hire them away. Suppose the franchisor requires all of the franchisees to promise that they will not poach from one another. Should this provision be considered per se illegal?

The DOJ argued that if the restraint is vertical in nature, then it should be judged under the rule of reason as an ancillary restraint. The attorney general of Washington contended that the agreements should be condemned as per se illegal, arguing that to the extent federal antitrust law supported applying the rule of reason to franchise no-poach agreements, courts should diverge from it in their interpretation of state law.

The Washington state attorney general's office recently announced five franchisor settlements whereby the franchisors have agreed to eliminate their use of no-poach clauses and refrain from enforcing or renewing existing no-poach clauses. The five chains, Jersey Mike's Subs, Aaron's Inc., H&R Block Inc., Mio Sushi and United Parcel Service Inc. must all make these changes nationwide. The five companies join 62 other corporations that have signed similar agreements with the Washington state attorney general's office to date.

Plaintiffs class action lawyers have also jumped aboard, bringing multiple recent suits against franchise chains such as Domino's Pizza Inc., Jimmy John's Franchise LLC, Cinnabon Inc. and McDonald's Corp.[13] These suits allege that no-poach agreements have suppressed market competition for workers between franchisees, in violation of the Sherman Act and state antitrust laws.[14]

Special No-Poach Laws and Applicable Industry Rules

Finally, when a business is considering a no-poach agreement in a particular situation, the business will need to watch out for special state laws and industry regulations. Maine recently took the battle against no-poach agreements one step further by passing An Act To Promote Keeping Workers in Maine. The act, set to take effect on Sept. 18, prohibits employers from entering into any no-poach agreements regardless of ancillary business purpose.[15]

Special rules apply in particular industries, as well. As lawyers are well aware, post-employment noncompetition agreements that restrict an attorney's ability to practice law are prohibited under ABA Model Rule of Professional Conduct 5.6. Nearly every state has adopted an identical or substantially similar version of Rule 5.6. Special regulations apply to doctors and dentists in many states as well.

Conclusion — Practical Framework

Naked no-poach agreements are per se illegal and can potentially result in jail time. By contrast, no-poach agreements can be one of the tools used to help make sure a legitimate transaction or collaboration (e.g., a merger, a joint venture or the settlement of a lawsuit) achieves its purpose. In those situations, the no-poach clause should be (1) ancillary, (2) narrowly tailored, (3) specific, and (4) limited in geography and duration.

Currently this is an area that requires an extra-vigilant eye toward the evolving legal landscape. With the presidential campaigns getting started, we should expect to see more of these politically relevant cases, but it may be a while before the appellate courts reaffirm the governing principles.

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[1] https://www.law360.com/competition/articles/1188660

[2] https://www.law360.com/articles/1192394

[3] https://www.law360.com/articles/1138170

[4] https://www.congress.gov/bill/116th-congress/senate-bill/2215/text

[5] (D.D.C. Sept. 24, 2010) https://www.justice.gov/atr/case/us-v-adobe-systems-inc-et-al

[6] United States v. Knorr-Bremse AG and Westinghouse Air Brake Technologies Corporation, Case No. 1:18-cv-00747-ckk.

[7] Deslandes v. McDonald's USA, LLC et al., Case No. 1:17-cv-04857.

[8] Ogden v. Little Caesar Enterprises Inc. et al., Case No. 2:18-cv-12792.

[9] https://www.justice.gov/atr/case-document/file/483426/download

[10] In re Railway Industry Employee No-Poach Antitrust Litigation, Case No. 2:18-mc-00798.

[11] S.D. Cal. June 19, 2018.

[12] Internal quotation marks omitted.

[13] Blanton v. Domino's Pizza Franchising LLC et al., Case No.2:18-cv-13207; Butler v. Jimmy John's Franchise LLC et al., Case No. 3:18-cv-00133; Yi v. SK Bakeries LLC et al., Case No.3:18-cv-05627; Deslandes v. McDonald's USA LLC et al., Case No.1:17-cv-04857.

[14] See Law360's recently published Where Franchise No-poach Agreements Stand Today for a detailed summary of these cases https://www.law360.com/competition/articles/1188660

[15] https://www.natlawreview.com/article/new-maine-law-bans-no-poach-agreements-and-dramatically-limits-noncompetes