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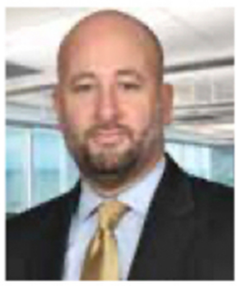
Franchisors Beware: The Death of No-Poach Agreements . . . Are Non-Competes Next?



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Oft-used no-poach provisions in franchise agreements, in which franchisees agree not to recruit each other's employees, have gained considerable attention from the Department of Justice (DOJ), the Federal Trade Commission (FTC), U.S. Senators, and state attorneys general. A recent study by Princeton economists report that 58% of major franchises use no-poach agreements. Even though no-poach agreements cultivate harmony within a franchise system, which in turn gives such franchise system a competitive edge over others, no-poach agreements may also restrict worker mobility and cause wage stagnation.

The enforceability of no-poach provisions depends on a complex anti-trust analysis. In short, "vertical" no-poach provisions, which prohibit workers from leaving one franchise store for another within the same chain (i.e., an intra-brand restriction or e.g., Wendy's to Wendy's), are more likely to be enforced than a "horizontal" no-poach agreement which prohibit workers from leaving one franchise for another in the same industry (i.e., an inter-brand restriction or e.g., Wendy's to Arby's).

While a franchisee's breach of a no-poach provision may give the franchisor the right to terminate the franchisee, the focus has been on their impact on employees. In late 2016, the DOJ and FTC issued their Antitrust Guidance for Human Resource Professionals to make clear that "naked" no-poach agreements among competing employers – i.e., one unrelated or unnecessary to a larger legitimate collaboration between employers – are per se illegal under federal antitrust laws and warned that criminal penalties may be imposed against employers who participate in such agreements. The DOJ has taken the position that "[r]obbing employees of labor market competition deprives them of job opportunities, information, and the ability to use competing offers to negotiate better terms of employment."

On July 13, 2018, U.S. Senators Elizabeth Warren (D-Mass) and Cory Booker (D-N.J.) sent a letter to about 100 large franchise CEOs urging them to abandon no-poach agreements for the same reasons stated by the DOJ.

Employee litigation concerning the enforcement of no-poach agreements has escalated, and the outcomes vary. In Deslandes v. McDonald's USA, LLC, 2018 WL 3105955 (N.D. Ill. June 25, 2018), a McDonald's franchisee prohibited a lower level employee from leaving to take a better paying position at a corporate owned McDonald's. The employee alleged that a no-poach agreement, which prohibited the hiring of current employees of other McDonald's or anyone who had worked for a McDonald's in the last six months, was an illegal restraint of trade.

The court denied McDonald's motion to dismiss, holding that the no-poach provision was a "horizontal" restraint even though it only prohibited intra-brand competition. The court relied on the distinguishing fact that McDonald's franchisees are not given exclusive territories and, thus, compete directly with corporate owned McDonald's.

In March 2019, after attorneys general from New York and thirteen other states joined forces in an investigation to expel no-poach agreements, Arby's, Dunkin', Five Guys, and Little Caesars agreed to ditch their no-poach practices. New York Attorney General Letitia James stated, "My office will continue to work with other state attorneys general to ensure the workers at other national chains are not unnecessarily barred from opportunities for career and financial growth."

Following the DOJ, FTC, and state attorneys general, the court in Blanton v. Domino's Pizza Franchising LLC, 2019 WL 2247731 (E.D. Mich. May 24, 2019) denied Domino's motion to dismiss, ruling that the plaintiff sufficiently pled a horizontal restraint despite the no-poach provision's application to only intra-brand franchisees. The court focused "on whether the allegations are sufficient to demonstrate that Defendants entered into agreements with franchisees that resulted in less mobility and lower wages for employees."

By stark contrast, another judge in the same court granted Little Caesar's motion to dismiss in Christopher Ogden v. Little Caesar Enterprises, Inc. et al., 2019 WL 3425266 (E.D. Mich. July 29, 2019). The plaintiff, a general manager, brought an action against Little Caesar's alleging that its no-poach agreement was horizontal and, thus, violated antitrust laws. Little Caesar, similar to Domino's, prohibited its franchisees in exclusive territories from hiring an employee in a managerial position at another Little Caesar's. The court found that Little Caesar's no-poach provision was neither per se "horizontal" nor close to it because Little Caesar's no-poach provision had some "vertical" component (i.e., intra-brand restriction), and the plaintiff failed to allege that Little Caesar's restriction on intra-brand competition was not negated by the pro-competitive effects the no-poach provision had on inter-brand competition.

Recently, on October 7, 2019, Washington State Attorney General Bob Ferguson announced that his initiative to end the use of no-poach clauses nationwide has reached 100 corporate chains. "We won't stop until every corporate franchise with a significant presence in Washington eliminates these clauses nationwide," said Ferguson.

With this scrutiny, franchisors should ensure that their no-poach provisions only restrict management level employees from switching employment between their own franchisees who have exclusive territories for a reasonable period of time. Franchisors should also consider whether the DOJ, FTC, or states attorneys general will next turn their attention to more traditional non-compete agreements.