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Class Actions Now Flowing From FTC and DOJ's No-Poach Enforcement

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May 04, 2018

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In our article last month, we discussed the Federal Trade Commission (FTC) and the Department of Justice's (DOJ) jointly issued guidance to HR professionals warning that naked employee no-poach agreements could be criminally prosecuted. In early 2018, assistant attorney general for the DOJ's antitrust division Makan Delrahim expressed his "shock" at "how many of these agreements there are." He also divulged that the DOJ would be unveiling criminal indictments over the next couple of months in appropriate no-poach cases.

Following in the wake of the FTC/DOJ guidance and Delrahim's startling announcement, franchises such as Pizza Hut, Jimmy John's and others were hit with class action lawsuits alleging they violated Section 1 of the Sherman Act by imposing employee no-hire agreements on their franchisees. Relying in part on the FTC/DOJ guidance, each of these lawsuits alleged per se violations of the Sherman Antitrust Act, potentially exposing them to treble damages and attorney fees without regard to the potentially procompetitive effects of these arrangements. But will the courts be as eager to analyze these agreements under the per se rule? History suggests the answer is no.

Rule of Reason v. Per Se

While Section 1 of the Sherman Act ostensibly prohibits "every" restraint of trade, the U.S. Supreme Court has read the statute to prohibit only "unreasonable" restraints of trade. Courts assess reasonableness in two ways: the rule of reason and the per se rule. Restraints subject to the rule of reason are balanced to weigh their procompetitive qualities with their anticompetitive consequences. Restraints subject to the per se rule are "necessarily illegal," regardless of their purportedly procompetitive benefits or reasonableness.

Since the Sherman Act was passed in 1890, the per se rule has waxed and waned in favor. Under the prevailing contemporary view, the per se rule is disfavored. According to the U.S. Supreme Court, it is "confined to restraints … that would always or almost always tend to restrict competition and decrease output"—those that are "manifestly anticompetitive" and "lack any redeeming virtue." For example, horizontal agreements (i.e., between competitors) to fix prices, allocate markets, rig bids and engage in group boycotts are considered per se illegal because they deprive the market of independent economic decision-makers and therefore almost always tend to harm competition. By contrast, most vertical agreements (i.e., those between different stages in the supply chain) are analyzed under the rule of reason because there is empirical evidence suggesting they can stimulate competition.

Retreat of the Per Se Rule

In the past, the U.S. Supreme Court was liberal in its application of the per se rule to restraints of trade that appeared sinister on their face. But over time, the court has acknowledged the danger of prematurely labeling restraints per se unlawful, particularly when those agreements do not involve direct competitors. In the process, the court has reexamined and overturned its own prior rulings, concluding that many arbitrarily applied the per se test without evidence of their effect on competition.

In *Leegin Creative Leather Products v. PSKS*, for example, the court in 2007 retreated from century-old case law applying the per se rule to vertical price restraints. There, a leather store sued its supplier for imposing uniform minimum resale price restrictions on its retailers. Noting that "economics literature is replete with procompetitive justifications for a manufacturer's use of resale price maintenance," Justice Anthony Kennedy, writing for the majority, explained that the rule of reason was more appropriate so that courts could assess the specific procompetitive justifications unique to each situation.

Similarly, in *Contintental TV v. Sylvania*, the Supreme Court in 1977 overturned decades-old case law applying the per se rule to vertical nonprice restraints and concluded they too should be assessed under the rule of reason. There, an electronics store sued a TV manufacturer for imposing geographic restrictions on the store's franchise. The agreement required the manufacturer's approval before its TVs could be sold at a new location, and, upon request, the franchisee's application was denied. On appeal to the Supreme Court, Justice Lewis Powell noted the "substantial scholarly and judicial authority supporting nonprice restraints' economic utility." Although in some cases nonprice restraints may prove disproportionately anticompetitive, the court believed the rule of reason better suited to the task or parsing such agreements.

Under its current jurisprudence, the U.S. Supreme Court holds that application of the "per se rule is appropriate only after courts have 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 instance under the rule of reason." Any "departure from the rule-of-reason standard must be based upon demonstrable economic effect," not "formalistic line drawing." Therefore, the court has expressed reluctance to expand the per se rule to new territory "where the economic impact of certain practices if not immediately obvious."

Ancillary Restraint Doctrine

As we discussed in last month's article, a body of case law is developing around the idea that the rule of reason, not the per se rule, should apply to no-hire agreements that are ancillary to otherwise procompetitive arrangements. The DOJ has defined ancillary restraints in the labor market as those that are related to and reasonably necessary to a larger legitimate business collaboration between enterprises. In theory, no-hire arrangements ancillary to franchise agreements could arguably fit within this definition.

For example, courts have applied the ancillary restraint doctrine when assessing no-hire arrangements in mergers and acquisitions. In the 2001 case of *Eichorn v. AT&T*, the U.S. Court of Appeals for the Third Circuit approved a 245-day, no-hire arrangement that formed part of an agreement governing the sale of a subsidiary business enterprise. The court concluded that the no-hire clause was "not anticompetitive" because the "primary purpose of the no-hire agreement was to ensure that … the purchaser of the subsidiary could retain the skilled services of the subsidiary's employees." Likewise, in 1980 and 1986, respectively, U.S. District Courts for the Middle District and Eastern District of Tennessee approved indefinite and two-year agreements governing the sale of subsidiary business enterprises. In the first case, *Cesnik v. Chrysler*, the court ruled, "when there is no anti-competitive motive and the anticompetitive effect was incidental, this court will not apply the per se doctrine." In the second, *Coleman v. General Electric*, the court noted that the agreement was "incidental to the effective transition of ownership."

Similarly, courts have applied the rule of reason to no-hire agreements that are ancillary to cooperative ventures between companies who would otherwise compete for the same employees. In *Haines v. Verimed Healthcare Network*, a U.S. District Court for the Eastern District of Missouri applied the ancillary restraints doctrine, in effect if not by name, when it approved a no-hire agreement ancillary to an agreement between an independent contractor and a website operator to draft medical articles for the operator's webpage. The agreement provided: "During the term of this agreement and for one year afterward, neither party shall recruit or solicit for employment any current or former employee or author of the other." Rejecting the argument that the per se rule applied, the court explained that the agreement was "limited in specific ways that narrowly tailor it so as to protect the company's legitimate business interests."

In another case out of the U.S. District Court for the Western District of Pennsylvania, *Molinari v. Consol Energy*, the court declined to apply the *per se* rule to a service agreement between a healthcare provider and its corporate client that provided: "During the initial term and any renewal terms of this contract, and for a period of 18 months after the expiration or earlier termination of this contract, the client covenants and agrees that it will not, directly or indirectly, without the express written consent of the provider (which consent may be withheld in the provider's discretion for any reason), solicit, contract, engage, hire or employ any person who is, or at any time was, an employee of the provider." The court declined to apply the per se rule, relying heavily on the Third Circuit's *Eichorn* case, which applied the ancillary restraint doctrine to the sale of a corporate subsidiary.

No-Hire Franchising Agreements

Against this backdrop, the question remains—how does Section 1 of the Sherman Act apply to no-hire provisions ancillary to franchise agreements? There is surprisingly little authority on this topic. A case out of the District of Nevada called *Williams v. I.B. Fischer Nevada* may be the closest case, although its decidedly cursory analysis provides little guidance. There, a franchisor and a franchisee signed a "no-switching" agreement "not to offer employment to a manager of another store within six months of termination from employment at a previous restaurant without a written waiver from the previous owner." While the court's decision was primarily grounded on the so-called "intracorporate conspiracy doctrine" (that a single enterprise cannot conspire with itself), the judge applied the rule of reason in passing, noting that the agreements did not raise antitrust concerns because the employees were only restricted in their movement to other franchisees.

With a paucity of case law for guidance, what will courts make of no-hire provisions in franchise agreements? Given the U.S. Supreme Court's reluctance to extend the per se rule and the growing popularity of the ancillary restraint doctrine to no-hire agreements, it is likely that courts will use the rule of reason, complete with its balancing factors and complex factual and expert underpinnings that can foster a myriad of defenses. Stay tuned.

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