DANCING IN THE DARK: THE DEPARTMENT OF JUSTICE'S TREATMENT OF NO-POACH AGREEMENTS

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INTRODUCTION

"No-poach" agreements between competing employers, *i.e.*, agreements not to solicit or hire each other's workers, have traditionally escaped extensive antitrust scrutiny. The focus of antitrust law, in the main, has been product and services markets, not labor markets. In recent years, the situation has changed, as enforcement authorities, private attorneys, and scholars have all recognized the potential for anticompetitive harm posed by labor market no-poach agreements.

This paper assesses the Department of Justice's evolving stance on horizontal no-poach agreements and no-poach agreements in the franchise context. Part I provides an introduction and background to the issue. In Part II, I argue that the Department of Justice is justified in treating horizontal restraints in labor markets consistently with their product market counterparts. In Part III, I argue that while the rule of reason approach to (most) franchise no-poach agreements is sensible, the presumption of procompetitive benefits that the Department of Justice and courts appear to assume is unsubstantiated.

BACKGROUND

On October 29, 2019, the House Judiciary Committee convened to hear testimony from government antitrust enforcers and labor economists on the state of competition in labor markets.[1] Democrat David Cicilline of Rhode Island, who chairs the Subcommittee on Antitrust, Commercial, and Administrative Law, decried government inaction in investigating and prosecuting no-poach agreements.[2] Questioning a lawyer from the Department of Justice's Antitrust Division, he remarked, "[f]or those of us who consider these no-poach agreements to be a substantial violation of law but also a very powerful force in keeping workers in place and stagnating their wages, the promise to be rigorous in their enforcement and not in three years have brought a single criminal case, frankly rings hollow."[3] Representative Cicilline also questioned the Department of Justice's decision to evaluate no-poach agreements in the franchise

1. *Antitrust and Economic Opportunity: Competition in Labor Markets: Hearing Before the Subcomm. on Antitrust, Commercial, & Admin. Law of the H. Comm. on the Judiciary*, 116th Cong. (2019).
2. Christopher Cole, *Dems Press DOJ on Feds' Lack of Criminal No-Poach Cases*, LAW360 (Oct. 29, 2019, 7:13 PM), https://www.law360.com/competition/articles/1214111/dems-press-doj-on-feds-lack-of-criminal-no-poach-cases [https://perma.cc/SUB2-UZNV].
3. *Id.*

employment context under the rule of reason[4] rather than treating them as per se illegal; he described the notion that a powerful business could prevent workers from switching locations as "really outrageous."[5]

These hearings, and Representative Cicilline's statements, demonstrated a remarkable turnaround for the level of government interest in no-poach agreements. Historically, neither the government nor academia had considered labor markets to merit as much antitrust attention as product markets, and indeed an imbalance in scrutiny still exists. For example, the 2010 Horizonal Merger Guidelines promulgated by the Department of Justice and Federal Trade Commission do not even list possible adverse labor market effects as a consideration,[6] and Westlaw searches reveal vastly more cases dealing with product markets than with labor markets.[7]

There are many possible explanations for this imbalance. Suresh Naidu, Eric Posner, and Glen Weyl argue that it arose from the consumer welfare standard in antitrust enforcement, which emphasizes competition in product markets since competition affects consumers directly.[8] They also offer as an explanation the post-war economic assumption of competitive labor markets and the erosion of labor and employment law protections.[9] Finally, they note that labor market cases are difficult to

4. *See, e.g.*, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 885–86 (2007) ("'Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.'. . . Appropriate factors to take into account include 'specific information about the relevant business' and 'the restraint's history, nature, and effect.' . . . Whether the businesses involved have market power is a further, significant consideration. . . . In its design and function the rule distinguishes between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest.") (citations omitted).

5. Cole, *supra* note 2. An agreement is "per se" illegal when it "is deemed illegal without any inquiry into its competitive effects." DEP'T OF JUST. ANTITRUST DIV. & FED. TRADE COMM'N, ANTITRUST GUIDANCE FOR HUM. RESOURCE PROF'LS 3 (2016), https://www.justice.gov/atr/file/903511/download [https://perma.cc/FK4N-CW8W].

6. DEP'T OF JUST. & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010), https://www.justice.gov/atr/horizontal-merger-guidelines-08192010 [https://perma.cc/E9FZ-2MEU].

7. As of January 10, 2018, a search within the antitrust cases for "product market" yielded 1736 cases since 2000 while a search for "labor market" yielded just 122. Suresh Naidu, Eric A. Posner & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 HARV. L. REV. 536, 540 n.10 (2018) (quotation marks omitted). And the only major recent merger case to consider labor market effects was *United States v. Anthem, Inc.*, 855 F.3d 345 (D.C. Cir. 2017). Naidu et al., *supra*, at 540 n.10.

8. Naidu et al., *supra* note 7, at 541.

9. *Id.* at 541-43.

litigate.[10] Damages awards, even if trebled, are typically modest, and it is hard to certify a class under Federal Rule 23(b)(3), which requires satisfying commonality and predominance for inherently diverse groups of workers.[11] Product market antitrust litigation, by contrast, may be brought by a single large firm that is harmed by anticompetitive practices; these cases are worth it on their own without aggregation.[12]

Eric Posner has theorized separately that legal barriers such as class certification difficulties, wage data secrecy, and the local nature of labor markets, as opposed to national product markets, create a feedback loop that makes labor market antitrust cases less attractive to plaintiffs' lawyers.[13] In turn, academics may find less demand for research into anticompetitiveness in labor markets than in product markets because there are far fewer labor cases.[14] The end result is a vicious cycle in which fewer cases lead to less empirical investigation, so all parties view anticompetitive behavior in the labor markets as less common than it really is.[15]

However, recent events have called into question the premise that labor markets are inherently competitive, and antitrust enforcers have taken a new look at no-poach agreements. In the early 2010s, the Department of Justice Antitrust Division exposed agreements between high tech employers not to solicit each other's expert, specialized employees.[16] In 2016, the Council of Economic Advisers produced a brief about increased consolidation in the domestic economy and low levels of

10. *Id.*
11. *Id.* at 543. *See, e.g.*, Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 359–60 (2011) (reversing class certification in employment discrimination context).
12. Alan B. Krueger & Eric A. Posner, *A Proposal for Protecting Low-Income Workers From Monopsony and Collusion*, THE HAMILTON PROJECT 9-10 (Feb. 2018), https://www.hamiltonproject.org/assets/files/protecting_low_income_workers_from_monopsony_collusion_krueger_posner_pp.pdf [https://perma.cc/XD6X-QNG5].
13. Eric Posner, Remarks at the Competition and Consumer Protection in the 21st Century Panel on Labor Markets and Antitrust Policy, 131–34 (Oct. 16, 2018) (transcript available at Fed. Trade Comm'n website) [hereinafter Eric Posner Remarks].
14. *Id.*
15. *Id.*
16. *See* Complaint at 4–8, United States v. Adobe Sys, Inc., No. 1:10-cv-01629, 2011 U.S. Dist. LEXIS 83756 (D.D.C. 2011) (citing "no cold call agreements" between Adobe, Apple, Google, Intel, Intuit, and Pixar); Complaint at 5–9, United States v. eBay, Inc., 968 F. Supp. 2d 1030 (N.D. Cal. 2012) (No. CV 125869) (featuring communications between then-CEO of eBay Meg Whitman and Intuit Founder and Chairman Scott Cook forming, monitoring, and enforcing an agreement restricting recruiting and hiring between the two firms); *In re* High-Tech Emp. Antitrust Litig., 985 F. Supp. 2d 1167, 1172–73 (N.D. Cal. 2013); *In re* Animation Workers Antitrust Litig., 123 F. Supp. 3d 1175, 1181–84 (N.D. Cal. 2015); Garrison v. Oracle Corp., 159 F. Supp. 3d 1044, 1053–56 (N.D. Cal. 2016).

labor market dynamism, referring in a footnote to Silicon Valley "no-poaching arrangements,"[17] and the White House published a report warning about the increased usage of non-compete agreements.[18] That same year, the Antitrust Division and the Federal Trade Commission issued Antitrust Guidance for Human Resource Professionals.[19] The Guidelines stated succinctly and significantly that, "[n]aked wage-fixing or no-poaching agreements among employers, whether entered into directly or through a third-party intermediary, are per se illegal under the antitrust laws," changing the legal standard from the rule of reason presumption that had governed previously.[20]

The Department of Justice has endeavored to implement the Guidelines through amicus briefs and enforcement actions. In April 2018, it successfully sued two large railway equipment suppliers over agreements not to poach each other's employees, classifying the agreements as per se unlawful restraints of trade in violation of Section 1 of the Sherman Act.[21] As a matter of prosecutorial discretion, DOJ ultimately pursued only civil liability in the settlement, as the defendants terminated the agreements before the issuance of the 2016 Guidelines. However, the enforcement action was the department's first under the new policy.[22]

The Antitrust Division has also filed statements of interest in private lawsuits, elaborating on the Guidelines and outlining the Division's

17. COUNCIL OF ECON. ADVISERS, BENEFITS OF COMPETITION AND INDICATORS OF MKT. POWER, 5 n.8. (2016), https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf.

18. THE WHITE HOUSE, NON-COMPETE AGREEMENTS: ANALYSIS OF THE USAGE, POTENTIAL ISSUES, AND ST. RESPONSES (2016), https://obamawhitehouse.archives.gov/sites/default/files/non-competes_report_final2.pdf.

19. DEP'T OF JUST. ANTITRUST DIV. & FED. TRADE COMM'N, *supra* note 5.

20. *Id.* at 3. Under the rule of reason framework, a plaintiff has the initial burden to show that a challenged restraint has an anticompetitive effect that harms consumers in the relevant market. If the plaintiff meets this burden, the burden shifts to the defendant to provide a procompetitive rationale for the restraint. If the defendant does so, the burden shifts back to the plaintiff to demonstrate that the stated benefit could be achieved reasonably through less anticompetitive means. Per se illegality requires only a showing by the plaintiff that the challenged conduct is of a type that violates the antitrust laws; the defendant may not introduce procompetitive justifications. *See generally* Ohio v. Am. Exp. Co., 138 S. Ct. 2274, 2284 (2018).

21. Complaint at 2, United States v. Knorr-Bremse AG, No. 1:18-cv-00747 (D.D.C. Apr. 3, 2018).

22. *Id.* at 11; *see also* Michael Murray, Deputy Assistant Att'y Gen., Address at Santa Clara University School of Law (Mar. 1, 2019) (transcript available on the Department of Justice website) (explaining that the lawsuit marked the first enforcement action under the 2016 Guidelines).

approach. In a class action challenging a no-poach "guideline" between the medical schools of Duke University and the University of North Carolina, the Division filed a brief rejecting Duke's arguments that the court ought to apply the rule of reason to the employee restraint.[23] Duke argued that courts lack the extensive experience necessary for the per se rule, that the agreement lacked anticompetitive effects, and that the agreement may have had procompetitive effects.[24] The Division disagreed with Duke's assumption that application of the per se rule would create a new per se category, noting that market allocation agreements have always been per se illegal as horizontal market divisions.[25] It stated that "[t]he Supreme Court has made clear that application of the *per se* rule does not depend on the amount of judicial experience with the particular 'industry' at issue, but instead turns on the amount of experience 'with the particular type of restraint challenged.'"[26] Also, the Division rejected Duke's vague claim of procompetitive effects, purportedly the prevention of free riding on investment in medical faculty, as falling short of classification as an ancillary restraint because Duke failed to identify a specific collaboration with UNC to which the no-poach agreement was ancillary, and it did not substantiate why the restraint was reasonably necessary to achieve the benefits of collaboration.[27]

The Division has also waded into the debate around no-poach clauses in franchise agreements, explaining why these agreements are not naked horizontal restraints and thus deserve rule of reason treatment. In a group of class actions brought by fast food workers, the Division first articulated its view on the threshold question of whether franchisees are separate entities capable of concerted action.[28] The Division explained that "a court should evaluate how the alleged business relationship operates in practice

23. Statement of Interest of the United States of America at 25, Seaman v. Duke Univ., No. 1:15-cv-462 (M.D.N.C. 2019).
24. *Id.* at 25-29.
25. *Id.* at 26. "Horizontal" agreements are those between competitors, whereas "vertical" agreements are those between parties at different stages of production, i.e. manufacturers and distributors. *See, e.g.*, Thomas Leary, A Structured Outline for the Analysis of Horizontal Agreements (Apr. 3, 2003) (unpublished paper) (on file with the Federal Trade Commission), https://www.ftc.gov/public-statements/2003/04/structured-outline-analysis-horizontal-agreements [https://perma.cc.FJC9-R8F5].
26. *Id.* (citing Arizona v. Maricopa Cty. Med. Soc'y, 457 U.S. 332, 349 n.19 (1982)) (referring to numerous examples of market allocation cases cited on previous pages, including the Silicon Valley no-poach cases).
27. *Id.* at 29.
28. Section 1 of the Sherman Act reaches concerted activity, such as unreasonable restraints of trade between separate entities; a threshold question, then, is whether entities should be viewed separately. *See, e.g.*, Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 767 (1984).

with respect to the entities' economic interests."[29] The Division argued that franchisor-franchisee restraints are generally subject to the rule of reason because the relationship between the two entities is vertical for purposes of this analysis.[30] And, although franchise agreements restrain intrabrand competition, the Division pointed out that they enable more vigorous interbrand competition, which the Supreme Court has labeled "the primary concern of antitrust law," so they may be approved under the rule of reason.[31] However, the Division did note that if a franchisor and franchisee operate in the same geographic market, they may directly compete within a single labor market, and in such a case a no-poach agreement between them would be horizontal (and thus per se unlawful if not ancillary to a legitimate, procompetitive joint venture).[32]

I. HORIZONTAL NO-POACH AGREEMENTS

The decision to treat naked no-poach agreements between employers as per se illegal under the antitrust laws, announced in the federal government's aforementioned Guidance for Human Resource Professionals, is an entirely sensible one. First, the anticompetitive harm that these agreements generate in labor markets is analogous to the impact of horizontal market divisions in product markets, which are per se illegal. Second, competition in labor markets is especially vulnerable to horizontal restraints.

The effects of market power in product markets mirror the effects in labor markets. In anticompetitive product markets, firms can earn greater profits at consumers' expense by redistributing surplus to themselves; consumers willing to pay the marginal-cost price that the firm would have charged in a competitive market may be unwilling to pay the higher prices that firms in anticompetitive markets are able to charge.[33] This effect creates an inefficiency that reduces consumer welfare.

Similarly, in labor markets, employer market power redistributes surplus from employees to employers in the form of lower wages, resulting in deadweight loss because workers willing to work for a wage reflective of the marginal revenue their work adds to a firm may not work if they are

29. Statement of Interest of the United States of America at 7, Stigar v. Dough Dough, Inc., No. 2:18-cv-00246 (E.D. Wash. 2019).
30. *Id.* at 11 ("The franchise relationship is in many respects a vertical one because the franchisor and the franchisee normally conduct business at different levels of the market structure.").
31. *Id.* at 12 (citing Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 54 (1977); Ohio v. Am. Express Co., 138 S. Ct. 2274, 2290 (2018)).
32. *Id.* at 13
33. Naidu et al., *supra* note 7, at 558.

offered marked-down wages.[34] Employers can obtain market power either "by restricting competition for labor or by colluding with other employers to suppress pay or benefits below the competitive level."[35] The Antitrust Division treats market allocation agreements in input markets identically to those in output markets, so it is logical for horizontal no-poach agreements between firms competing in labor markets to be deemed per se illegal.[36]

Economist Robert Topel, testifying before the House Judiciary Committee, proposed a potential qualification of the harm that no-poach agreements cause.[37] He pointed out that no-poach agreements may not cause widespread harm if they are targeted to focus on specific positions, rather than all employees in general, and also that they may generate benefits for employees who fall under their scope. Using the no-poach agreement between Apple and Pixar as an example, Topel explained:

> It follows that an Apple employee who did not receive a superior cold-call-generated offer from Pixar as a result of such an agreement was clearly harmed by some amount. But given that Pixar had an open position it wished to fill, that position would be filled by either promoting an existing Pixar employee or by hiring from some other firm that was outside of the agreement. Those employees *benefitted* from the no-poach agreement.[38]

In a product market analogue to this situation, Company A and Company B agree not to sell to some of each other's customers. There could be a third party, Company C, that benefits in a similar way that Pixar's employees in the previous example benefited from being insulated by Pixar's inability to cold-call their counterparts at Apple: "[i]f the agreement caused A to sell more to C, then C likely benefitted."[39] The fact that horizontal agreements dividing product markets among competitors are held per se illegal notwithstanding the possible benefits to Company C suggests that Topel's speculation about the potential beneficial effects of horizontal no-poach agreements is on weak ground.

Despite his qualification, Topel ultimately agreed that per se treatment is proper for horizontal no-poach agreements because, on an overall cost-benefit basis, "it is unlikely that any benefits derived from

34. *Id.*
35. Krueger & Posner, *supra* note 12, at 6.
36. *See, e.g.*, Competitive Impact Statement at 9, United States v. Knorr-Bremse AG, 2018 U.S. Dist. LEXIS 142125 (D.D.C. July 11, 2018) (No. 1:18-cv-00747) (footnote omitted).
37. *Antitrust and Economic Opportunity: Competition in Labor Markets: Hearing Before the H. Comm. on the Judiciary*, 116th Cong. (2019) (statement of Robert Topel, Professor, Univ. of Chi.) [hereinafter Topel Statement].
38. *Id.* (emphasis in original).
39. *Id.*

applying a 'Rule of Reason' analysis to every no-poach agreement that might be challenged would offset the costs of such case-by-case evaluation."[40] Instead, Topel favored clear, broad "carve-outs for joint ventures and related business models."[41] Discussion of this issue follows in Part III.

The second reason favoring the Department of Justice's decision to treat naked horizontal no-poach agreements as per se illegal is that labor markets are especially vulnerable to the anticompetitive harm that the agreements may create. Eric Posner, speaking at a Federal Trade Commission hearing on "Competition and Consumer Protection in the 21st Century," explained that hiring decisions require both employers and employees to incur costs from searching for jobs and so the matching costs involved can be more significant than transaction costs in product markets.[42] The result of this need for mutuality (in the sense that both employer and employee must locate each other and agree to an employment relationship) is that labor markets are inherently difficult to transact in, or "thin."[43] Given this thinness, enforcement agencies ought to concern themselves with concentration in labor markets at least as much as they do in product markets. A small increase in labor market concentration, meaning that employers have fewer competitors seeking to attract the same employees, may produce anticompetitive effects that are outsized relative to those in product markets because of the unique difficulties in transacting in labor markets.[44]

An understanding of matching effects is key to Posner's argument about the inherent susceptibility of labor markets to monopsony power. The basic concept is that "in labor markets, unlike in product markets, the preference of *both* sides of the market affect whether a transaction is desirable . . . In employment, the employer cares about the identity and characteristics of the employee *and* the employee cares about the identity and characteristics of the employer."[45] In product markets, by contrast, a manufacturer selling a good cares little, if at all, about the characteristics and identity of a buyer in making a decision about whether or not to sell; the transaction is less personal than employer-employee transactions.

Importantly, it is not merely the fact that labor markets involve separate decision-makers that makes them vulnerable to monopsony. The decision-making process also contains frictions that reduce employees'

40. *Id.*
41. *Id.*
42. Eric Posner Remarks, *supra* note 13, at 130-31.
43. *Id.*
44. *Id.*
45. Naidu et al., *supra* note 7, at 554–55.

ability to substitute options or even know of substitutes in the first place. Frictions can result from quotidian issues like access to transportation, housing, childcare, and job information (which may come through informal, localized networks, shrinking a worker's range of options), and these frictions become even more complex in the case of dual-earner families; switching jobs can be disruptive.[46]

Many economists believe that increased monopsony power has diminished the dynamism of the labor market in the United States. In 2016, the Council of Economic Advisers released a report citing evidence that as firm concentration has increased in recent years, firm entry has decreased, rates of job changes have decreased, and licensing requirements and other restrictions on workers' ability to move have increased.[47]

Economist Alan B. Krueger, testifying at a Federal Trade Commission hearing, offered further evidence pointing to labor market monopsony. He noted that 25 percent of the United States workforce was unionized in 1980 but just 10.7 percent was in 2017, and the real value of the minimum wage was down 20 percent in 2018 compared with 1979.[48] Krueger described a proliferation of practices enhancing monopsony power and weakening worker bargaining power: increased reliance on temporary staffing agencies, increased use of noncompete agreements, increased occupational licensing requirements which have the effect of decreasing labor mobility, and increased inclusion of no-poaching clauses in franchise contracts.[49]

In summary, horizontal no-poach agreements produce the same harm as product market analogues that are given per se treatment; workers' ability to bargain for competitive wages may be inherently imperiled because sticking points make job switching impracticable. Data suggest that labor markets are currently concentrated and that employers exploit this imbalance by paying low wages. Given this context, Robert Topel's statement—that even if horizontal no-poach agreements might create some benefits for workers, the benefits from assessing each under the rule of reason do not outweigh the costs of case-by-case adjudication—makes

46. *Id.* at 555-56.

47. COUNCIL OF ECON. ADVISERS, *supra* note 17, at 5 (footnote omitted); *See also* Krueger & Posner, *supra* note 12, at 6–7 (citing the 2016 CEA Report). *But see* Carl Shapiro, *Antitrust in a Time of Populism*, 61 INT'L J. OF INDUS. ORG. 714, 722–23 (2018) (disputing the accuracy of these statistics because of unrealistic market definition).

48. Alan Krueger, Competition and Consumer Protection in the 21st Century, 12-13 (Oct. 16, 2018) (transcript available at Federal Trade Commission website), https://www.ftc.gov/system/files/documents/public_events/1413712/ftc_hearings_session_3_transcript_day_2_10-16-18_1.pdf [hereinafter Alan Krueger Address].

49. *Id.* at 14–16.

sense.[50] The Department of Justice's decision to adopt a per se rule in this context is sound.

II. NO-POACH AGREEMENTS IN THE FRANCHISE CONTEXT

The franchise context is different from the familiar horizontal situation involving similarly situated competitors. In the circumstances of a franchise relationship, there is a vertical relationship between the franchisor and its franchisees. A "no-poach" agreement imposed by a franchisor on its franchisees, a promise that they will not solicit or hire each other's workers, presents different questions. Indeed, a threshold question for considering antitrust problems in the franchise context is whether franchisors and their franchisees are even capable of conspiring to violate the antitrust laws. The Supreme Court has explained that the inquiry into whether concerted action exists is "different from and antecedent to the question whether it unreasonably restrains trade."[51] Whether franchisors and franchisees are capable of concerted action depends on whether an agreement between them "deprives the marketplace of independent centers of decision making" and requires "a functional consideration of how the parties involved in the alleged anticompetitive conduct actually operate."[52] The Antitrust Division has advised that franchisees should not be presumed to be subsumed within a single corporate entity; instead, their status should be determined based on how the franchisee-franchisor business relationship functions in fact.[53]

Courts have found that franchisees and franchisors are capable of concerted action because franchisees retain significant amounts of independence to manage their own operations, particularly in the area of employment.[54] In a putative class action against McDonald's that has served as precedent for other franchise no-poach cases, one district court remarked "[a]lthough franchisees make most of their employment decisions independently, their hiring decisions are restricted in one respect by the standard franchise agreement."[55]

50. *See* Topel Statement, *supra* note 37.
51. Am. Needle, Inc. v. Nat'l Football League, 560 U.S. 183, 186 (2010).
52. *Id.* at 190–91 (quoting Copperweld Corp. v. Indep. Tube Corp., 467 U.S. 752, 769 (1984)).
53. Statement of Interest of the United States of America at 7, Stigar v. Dough Dough, Inc., No. 2:18-cv-00246 (E.D. Wash. 2019).
54. *See, e.g.*, Butler v. Jimmy John's Franchise, LLC, 331 F. Supp. 3d 786, 789-90 (S.D. Ill. 2008); Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2018 WL 3105955, at *2 (N.D. Ill. June 25, 2018).
55. *See Deslandes*, 2018 WL 3105955, at *2.

Once a plaintiff has cleared the "single entity doctrine" hurdle, per se illegality does not automatically apply to "no-poach" agreements imposed by a franchisor on its franchisees; because these agreements are vertical, or "imposed by agreement between firms at different levels of distribution,"[56] they are assessed under the rule of reason.[57] Under the rule of reason framework, a plaintiff has the initial burden to show that a challenged restraint (here, a no-poach agreement) has an anticompetitive effect that harms consumers in the relevant market.[58] If the plaintiff meets this requirement, the burden shifts to the defendant to provide a procompetitive rationale for the restraint; if a satisfactory rationale is given, the burden shifts back to the plaintiff to demonstrate that the stated benefit could be achieved reasonably through less anticompetitive means.[59]

An agreement's horizontal or vertical orientation is not the sole factor that determines whether a per se or rule of reason standard of analysis applies. Its substantive terms may also be relevant. If a restraint is ancillary, or "reasonably necessary to a separate, legitimate business transaction or collaboration between the companies," or if the entities party to the challenged agreement do not compete with each other, the rule of reason applies too.[60]

In March 2019, the Department of Justice weighed in on no-poach litigation concerning employees at Auntie Anne's, Arby's, and Carl's Jr.[61] In a statement of interest, the Antitrust Division opined that because the franchisor-franchisee relationship is vertical, no-poach clauses in franchise agreements are generally subject to the rule of reason.[62] Franchisors and franchisees conduct business at different levels of the market structure unless they are in the same geographic market and compete directly to fill similar jobs within the same pool of labor (for example, if a franchise's restaurant location and corporate office competed for janitorial staff).[63] The Antitrust Division stated further that no-poach agreements within franchises may produce significant procompetitive benefits that may make them reasonable. Classifying competition within a

56. Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 730 (1988).
57. Ohio v. Am. Express Co., 138 S. Ct. 2274, 2284 (2018).
58. *Id.*
59. *Id.*
60. Statement of Interest of the United States of America at 8, Stigar v. Dough Dough, Inc., No. 2:18-cv-00246 (E.D. Wash. 2019); *see also* Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 224 (D.C. Cir. 1986).
61. Statement of Interest of the United States of America at 3, Stigar v. Dough Dough, Inc., No. 2:18-cv-00246 (E.D. Wash. 2019).
62. *Id.* at 11.
63. *Id.* at 12–13.

franchise as "intrabrand" and competition between franchises of different banners as "interbrand," the Division claimed that an intrabrand restraint allows "the manufacturer to achieve certain efficiencies in the distribution of his products," which benefits interbrand competition, "the primary concern of antitrust law."[64]

However, the Washington State Office of the Attorney General has argued that the Antitrust Division's presumption of procompetitive benefit is unsubstantiated. The Attorney General of Washington has maintained that a prohibition on switching between franchise locations "stagnates wages."[65] In January 2018, the Attorney General of Washington launched an investigation that, as of December 5, 2018, had secured legally binding "Assurance of Discontinuance" agreements with thirty-nine chains, representing 95,000 locations nationwide, to remove no-poach agreements.[66]

Washington's investigation was inspired by research by Alan B. Krueger and Orley Ashenfelter that discussed the potential harm to workers that no-poach clauses can cause.[67] Krueger and Ashenfelter used the largest database of franchise disclosure documents in the world to examine the franchise agreements used by 156 of the largest United States franchise chains in 2016. They found that 58 percent of these agreements included "noncompetitive clauses" that "restrict the recruitment and hiring of workers currently employed (and in some cases extending for a period after employment) by other units affiliated with the franchisor."[68] The authors also found that these clauses have become more common over time, with the share of franchisors with a no-poach provision rising from

64. *Id.* at 12 (citing Cont'l. T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 54, 51 n.19 (1977) (internal quotes omitted).

65. Press Release, Wash. State Office of the Att'y Gen. at 1, AG Ferguson's Initiative to End No-Poach Clauses Nationwide Continues with Five Additional Chains (Dec. 5, 2019), https://www.atg.wa.gov/news/news-releases/ag-ferguson-s-initiative-end-no-poach-clauses-nationwide-continues-five [https://perma.cc/A2HY-AY6Y].

66. *Id. See also* Statement of Interest of the United States of America at 8, Stigar v. Dough Dough, Inc., No. 2:18-cv-00246 (E.D. Wash. 2019).

67. Alan B. Krueger & Orley Ashenfelter, *Theory and Evidence on Employer Collusion in the Franchise Sector* (IZA Inst. of Labor Econ., Discussion Paper No. 11672). Washington Solicitor General Noah Purcell originally referred the subject of franchise no-poach agreements to Attorney General Robert Ferguson after reading a 2017 New York Times article about the ubiquity of such agreements. AG Ferguson's Initiative to End No-Poach Clauses Nationwide Continues with Five Additional Chains, *supra* note 65. The New York Times article cites Krueger and Ashenfelter. Rachel Abrams, *Why Aren't Paychecks Growing? A Burger-Joint Clause Offers a Clue*, N.Y. TIMES (Sept. 27, 2017), https://www.nytimes.com/2017/09/27/business/pay-growth-fast-food-hiring.html [https://perma.cc/Y2AF-FUWN].

68. Krueger & Ashenfelter, *supra* note 67, at 3–4 (internal quotes omitted).

35.6 percent in 1996 to 53.3 percent in 2016.[69] In searching for correlates of no-poach agreements, *i.e.*, sets of firm and industry characteristics that could predict their utilization, Krueger and Ashenfelter found that the most robust predictor for whether a franchise might adopt a no-poach agreement was the hiring rate within its industry; no-poach agreements are more likely in industries with high employee turnover.[70] The authors added that the "agreements are comparatively less frequent in industries with higher average wages and education levels, contrary to models that view no-poach agreements as a mechanism to encourage training investment or to protect intellectual property."[71] Krueger and Ashenfelter posited that franchises with undesirably high employee turnover could insert no-poach clauses into contracts, rather than just paying employees wages that encouraged them to stay, facilitating what they termed a "low-wage strategy."[72]

Krueger and Ashenfelter studied the quick service restaurant (QSR) industry in Rhode Island, analyzing the market's concentration because of no-poach agreements.[73] They counted 261 quick service restaurants belonging to 18 major chains.[74] Counted individually, the 261 restaurants would produce a Hirschman-Herfindahl Index (HHI) of 38.3, suggesting a highly competitive market, but if the restaurants within each chain refrained from hiring each other's workers, the HHI would rise to 1,678.0, which the Department of Justice would consider moderately concentrated.[75]

Concentration not only reduces competition among franchises of the same franchisor but also enables collusion across different franchisees of different chains. When a market is more concentrated, fewer parties need to come together and agree to collude, and any agreement reached can be monitored more easily, increasing collusion's profitability.[76] These vertical no-poach agreements could reduce obstacles that otherwise could make orchestrating and maintaining horizontal agreements impractical and unwieldy.

Not only do no-poach agreements risk pernicious effects, but the Washington State Attorney General's Office takes the view that they are

69. *Id.* at 7.
70. *Id.* at 19.
71. *Id.* at 4.
72. *Id.* at 16 (quotation marks omitted).
73. *Id.* at 12–13.
74. Krueger & Ashenfelter, *supra* note 67, at 12.
75. *Id.* at 12–13. *See also Herfindahl-Hirschman Index*, DEPT. OF JUST., https://www.justice.gov/atr/herfindahl-hirschman-index [https://perma.cc/W4B7-UTDP] (last visited Jan. 21, 2021).
76. *Id.* at 13.

not even necessary in the first place to promote competition. Drawing on its "unique perspective on the use and purported justification of these no-poach provisions" from its investigation, the Office filed an amicus brief responding to the Department of Justice's Statement of interest in the case concerning Auntie Anne's, Arby's, and Carl's Jr.[77] The Office agreed with the Department of Justice's decision to analyze no-poach agreements under a rule of reason analysis when they existed vertically and to reserve per se illegality for horizontal agreements, stating that "to the extent a franchise agreement restricts solicitation and hiring among franchisees and a corporate-owned store—which is indisputably a horizontal competitor of a franchisee for labor—the agreement must properly be analyzed as a *per se* restraint."[78]

The two antitrust enforcers disagreed, however, in their views about what the competitive balance may look like under the rule of reason. While the Department of Justice stated (without support) that intrabrand restraints benefit interbrand competition,[79] the Washington Attorney General's Office argued that "franchisors should have a heavy burden to show that a no-poach provision in a franchise agreement can be justified as a restraint that is 'reasonably necessary' to a separate, legitimate business transaction or collaboration."[80] The Office referred to its enforcement experience to explain its skepticism of the Department of Justice's view that these provisions play an important role in promoting interbrand competition: nearly one third of the more than 150 franchisors to whom the Office issued process did not and had never included any form of a no-poach provision in their agreements.[81] Among the franchisors that did have agreements, there was little evidence that they had ever enforced them.[82] And, as a result of the Office's investigation, nearly all franchisors with no-poach agreements agreed, without litigating, to remove them from future contracts.[83]

These observations call into question the utility or importance of no-poach agreements – whether they can truly be considered reasonably necessary to effectuate a business transaction. One commonly-cited justification, to which Krueger and Ashenfelter referred, is that the reduction in labor mobility brought about by no-poach agreements

77. Amicus Curiae Brief by the Attorney General of Washington, Stigar v. Dough Dough, Inc., No. 2:18-cv-00244 (E.D. Wash. Mar. 11, 2019).
78. *Id.* at 6–7.
79. *See supra* text accompanying note 31.
80. Amicus Curiae Brief by the Attorney General of Washington, Stigar v. Dough Dough, Inc., No. 2:18-CV-00244, 9 (E.D. Wash. 2019).
81. *Id.*
82. *Id.*
83. *Id.*

incentivizes employers to invest in training their employees, which enhances productivity. As discussed, Krueger and Ashenfelter did not find that the existence of no-poach agreements actually correlated with higher training levels.[84] And, in another paper, Krueger and Eric Posner made the point that even if no-poach agreements *do* lead to more training, franchises' preserved return on training, and thus their incentive to provide more of it, cannot be viewed as "reasonably necessary" to effectuate business transactions.[85] This is because "there is even less economic justification for a no-poaching agreement among franchisees in the same chain than among other unrelated employers."[86] The investment in training that a franchisee fails to recoup when an employee departs for another franchise location within the same chain after receiving it is not lost in the same way that it would be in an agreement between two unrelated employers because the parent franchise still recoups the benefit overall. It is not hard to imagine ways in which the parties could compensate each other for this redistribution of risk (franchisees could pay lower licensing fees, for example). In addition to Krueger and Ashenfelter's empirical findings, there is also little theoretical basis to believe that franchise no-poach agreements are especially likely to stimulate employee training and improve productivity. There is less harm from failing to recoup investment in training among locations within a single chain than there is in the open market, and yet horizontal competitors in the open market are not allowed to enter into no-poach agreements simply to preserve incentives to train. In fact, such an agreement would be characterized as per se illegal, so competitors sued for making such an agreement would not even be allowed to offer this procompetitive benefit as evidence for the agreement's reasonableness.

Courts that have adjudicated franchise employee no-poach litigation have rejected the incentive-to-train argument as a procompetitive rationale. In *Deslandes v. McDonald's USA, LLC*, the plaintiff successfully alleged that a McDonald's franchisor and franchisee were in direct competition for the same employees, making their no-poach agreement horizontal.[87] The Northern District of Illinois opined that "every employer fears losing the employees it has trained. That fear does not, however, justify, say, law firms agreeing not to hire each other's associates. Employers have plenty of other means to encourage their employees to stay without resorting to unlawful market division."[88]

84. *See supra* text accompanying note 71.
85. Krueger & Posner, *supra* note 12, at 13.
86. *Id.*
87. *Deslandes*, 2018 WL 3105955, at *1.
88. *Id.* at *8.

The *Deslandes* case did not go to trial, but in the same pretrial decision, the court decided that despite the horizontal nature of the no-poach agreement, the rule of reason framework applied. It found the no-poach agreement to be "ancillary to an agreement with a procompetitive effect," since McDonald's "increased output of burgers and fries" with each franchise agreement signed.[89] Despite this supposed connection between the employee no-poach agreement and the expansion of the company's business, however, the court later explicitly discounted the ancillary nature of the challenged provision:

> That is not to say that the provision itself was output enhancing. The very fact that McDonald's has managed to continue signing franchise agreements even after it stopped including the provision in 2017 suggests that the no-hire provision was not necessary to encourage franchisees to sign.[90]

Given the Northern District's determination that the agreement was not "output enhancing," its conclusion that the agreement was "ancillary to an agreement with a procompetitive effect" is hard to understand.[91] The Northern District of Illinois, like the Department of Justice in its statement of interest in the case concerning the Auntie Anne's, Arby's, and Carl's Jr. franchises,[92] seemed to put a thumb on the scale for defendants by presuming that mysterious, unexplained procompetitive benefits result from no-poach agreements.

Also notable about *Deslandes* was that the plaintiff pursued her claims through an abbreviated rule of reason analysis, termed "quick-look," which may apply when "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets."[93] The court explained that "[u]nder quick-look analysis, if the defendant lacks legitimate justifications for facially anticompetitive behavior then the court 'condemns the practice without ado' without resort to analysis of market power."[94] Even though "quick-look" analysis requires plaintiffs to show that cases are exceedingly simple, the decision to proceed this way was likely a tactical decision by the plaintiff to increase the size of the potential class of plaintiffs and thus make bringing the case economically feasible. Normally, considerations of market power would force litigants to define a relevant antitrust market and, given that

89. *Id.* at *7.
90. *Id.* at *7.
91. *Id.*
92. *See supra* discussion notes 61-64.
93. Cal. Dental Ass'n v. FTC, 526 U.S. 756, 770 (1999).
94. *Deslandes*, 2018 WL 3105955 at *5.

labor markets are constrained by the distances that workers are able to commute, the relevant antitrust markets in these cases are likely to be small. Avoiding market definition thus enabled the plaintiff in this case to litigate on behalf of a larger class (by representing workers beyond commuting distance to her franchise location, too).

Other plaintiffs have followed this approach. In *Yi v. SK Bakeries, Inc.*,[95] which concerned a vertical restraint, the Western of District of Washington accepted the plaintiff's quick-look claim against Cinnabon for its no-poach agreement.[96] But the court, like the Northern District of Illinois, rejected the plaintiff's claim that the franchise no-poach agreement was per se illegal, also resorting to a mechanical recitation of the ancillary restraints doctrine. The court reasoned that "[w]hen a defendant advances plausible arguments that a practice enhances overall efficiency and makes markets more competitive," as defendants do here, "per se treatment is inappropriate, and the rule of reason applies."[97]

The court's argument is curious because an examination of Cinnabon's motion to dismiss reveals nothing resembling a "plausible argument" that the no-poach agreement enhanced overall efficiency. Cinnabon stated that vertical agreements are analyzed under the rule of reason and not the per se rule because they "may have procompetitive justifications that benefit consumers" and that they "can stimulate interbrand competition" in general.[98] It also made a defensive argument that the plaintiff could not prove that the no-poach agreement caused lower wages, explaining that wages are the result of numerous and complex economic forces and phenomena affecting the relevant geographic and labor markets.[99]

But these arguments do not identify a procompetitive benefit achieved by Cinnabon's no-poach clause in its franchise agreement. Much like the Department of Justice in its statement of interest in the case concerning Auntie Anne's, Arby's, and Carl's Jr., Cinnabon seemed to lack a justification for its claim that the no-poach agreement was procompetitive. Without this justification, the Western District of Washington could not properly have upheld Cinnabon's no-poach agreement as "reasonably necessary to a separate, legitimate business

95. Yi v. SK Bakeries, LLC, No. 18-5627RJB, 2018 U.S. Dist. LEXIS 220966 (W.D. Wash. Nov. 13, 2018).
96. *Id.* at 9.
97. *Id.* at 13.
98. Defendant Cinnabon Franchisor SPV LLC's Motion to Dismiss Pursuant to Rule 12(b)(6) at 13, Yi v. SK Bakeries, LLC, No. 18-5627 RJB, 2018 WL 8918587 (W.D. Wash. 2018) (No. 3:18-cv-05627-RJB) (quoting *In re* Musical Instruments & Equip. Antitrust Litigation, 798 F.3d 1186, 1192 (9th Cir. 2015)) [hereinafter Motion to Dismiss].
99. *Id.*

transaction or collaboration between the companies," a characterization which supports a rule of reason approach.[100] The court misguidedly reduced the inquiry into whether a no-poach agreement is ancillary to a legitimate business transaction into a meaningless acceptance of vague statements referring to unidentified procompetitive benefits. If courts treat the inquiry this way, the Department of Justice's decision to condemn naked no-poach agreements between competitors as per se illegal, thus bringing antitrust law in labor markets in line with that in product markets, will be nullified in many cases.

CONCLUSION

Antitrust law in the area of horizontal no-poach agreements has come to a comfortable rest on a per se rule, but the law with respect to franchise no-poach agreements is perched on a precipice. The willingness of the Department of Justice and some federal courts to assume the procompetitiveness of restraints that do not seem to promote or ensure any specific benefits is unfounded. Unwarranted assumption of procompetitive benefits does not matter in a case in which the court has labeled the restraint at issue per se illegal because the court will have no opportunity to consider the benefits. However, a court's attitude towards these restraints may influence whether it reaches the per se rule in the first place. The unexplained willingness to view a no-poach agreement as ancillary to a legitimate business transaction in the *Cinnabon* case is instructive.[101] And, in a fully litigated rule of reason case, in which a court would weigh anticompetitive and procompetitive effects, this groundless presumption of pro-competitiveness would stack the odds unduly against a plaintiff.

The effects of this unsubstantiated presumption of procompetitive benefits on litigation are clear, but the effects on competition are less so because the anticompetitive harms that franchise no-poach agreements actually cause may be more theoretical than factual. Krueger and Ashenfelter, on whose research the Washington State Attorney General's investigation relies, admit as much themselves. Krueger and Ashenfelter remark in their conclusion that "systematic evidence on the impact of no-poaching agreements on workers' pay and within-franchise job mobility is unavailable. A first order question for future research is to document whether within-franchise job-to-job transitions are lower for franchise chains that have no-poaching agreements compared with those that do not

100. Statement of Interest of the United States of America at 8-9, Stigar v. Dough Dough, Inc., No. 2:18-cv-00246 (E.D. Wash. 2019); *see also* Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 224 (D.C. Cir. 1986) (citing ancillary restraints doctrine).
101. *See supra* discussion notes 98–99.

contain such agreements."[102] In other words, we do not know whether these agreements have any real-world impact.

One can speculate that no-poach agreements could have significant impacts that are difficult to measure. For example, employees might err on the side of caution when deciding whether to switch between locations to avoid incurring the potential cost of defending a lawsuit, and prospective employers might avoid hiring employees subject to non-poach agreements in order to avoid potential litigation (if they know of the no-poach clause's existence). Or, if employees complain about their jobs and threaten to quit, an employer could respond by pointing out that their contracts contain no-poach provisions, foreclosing their ability to work for other franchisees and thereby closing off potentially important avenues for alternative employment.

Rahul Rao, a lawyer with the Washington State Office of the Attorney General working on the Office's investigation, aptly described the nebulous effect of franchise no-poach agreements in a testimony before the House Judiciary Subcommittee on October 29, 2019. Noting that many firms had voluntarily removed no-poach clauses from their franchise contracts in response to the Office's investigation, he compared these agreements to the human appendix: "You don't know what it is, you don't know what it does, and you're happy to get rid of it when it causes a problem."[103] As it stands, franchises' economic viability does not seem to rest on these worker mobility restraints. And as time passes and more franchises remove them in response to scrutiny, this observation may become more obvious.

The question of whether the removal of these clauses is a solution in search of a problem remains. We do not currently know when or in what manner franchisees even rely on these contractual provisions. But if plaintiffs' lawyers see value in bringing cases, and courts allow no-poach cases to move past the motion-to-dismiss stage, perhaps the litigation-research feedback loop that Eric Posner described[104] will begin to work in favor of, rather than against, these cases, enabling labor economists to tackle empirical questions about the use and effect on no-poach restrictions that currently are stuck in the theoretical realm.

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102. Krueger & Ashenfelter, *supra* note 67, at 20.

103. Christopher Cole, *Dems Press DOJ on Feds' Lack of Criminal No-Poach Cases*, LAW360 (Dec. 19, 2019), https://www.law360.com/competition/articles/1214111/dems-press-doj-on-feds-lack-of-criminal-no-poach-cases [https://perma.cc/KVA9-FU6W] (internal quotes omitted).

104. *See supra* discussion surrounding notes 13 and 42.