

No-Poaching and Non-Compete Provisions: Long-Time Practices Go Under the Microscope

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For the last several years, the attention of franchise lawyers has been focused on the subject of joint employer liability. This topic has been dragged through the courts as though it were a ping-pong ball, with courts and administrative officials pronouncing one rule, and then pronouncing another. This has made it difficult for franchise lawyers to advise clients on this subject. Most recently, the courts/administrators have stated that joint liability issues would be decided by an examination of numerous factors, with no lawyer knowing exactly how to advise clients as to the weight of importance that would be given to any of these factors. With the switch to the Trump Administration in 2017, it looked almost certain that the test for joint employer liability would return to old principles—that is, the courts would examine the controls placed on a franchisee by the franchisor, and if the controls crossed an imaginary line, there was too much control. A franchisor would then have joint liability for the franchisee's sins in several areas, mostly relating to labor and employment issues. Meanwhile, courts have continued to struggle with non-competes, rendering a plethora of decisions each year on this issue, again making it difficult for lawyers to properly counsel clients.

In the meantime, a new employment issue is taking center stage—the subject of employee “poaching” in the franchising context. Non-competes and “no-poaching” of another franchisee's employees are provisions that have been found in franchise agreements for decades. There is no need at this point to provide an example of a non-compete. However, many of us have never focused on the significance of a no-poaching provision. Typically, a no-poaching provision might read as follows:

Interference With Employment Relations of Others. During the term of this Franchise Agreement, Franchisee shall not employ or seek to employ any person who is at the time employed by Franchisor, any of its subsidiaries, or by any person who is at the time operating a XXX franchise to leave such employment. This paragraph shall not be violated if such person has left the employ of any of the foregoing parties for a period in excess of six (6) months. It is surprising that it has taken so many years for no-poaching provisions to come to the surface. From the franchisor's perspective, before two years ago, it had been assumed that no-poaching provisions were valid.

Although not necessarily treated this way by the courts, a no-poaching provision resembles a traditional non-compete. Non-competes are generally enforceable if they are limited in scope, territory and time. But although the laws of the states of the United States may generally be the same throughout the country, they are typically interpreted or applied in different ways, even by courts within the same state. A franchisor might choose the law of state X to control an agreement, but a court in state Y might not honor the agreement between the parties.

No-poaching provisions are intriguing because they limit a franchisee's ability to switch from Franchisee A to Franchisee B, who are both in the same franchise system. In that respect, they are narrower than non-competes, which focus more upon the type of activities rather than on an internal issue such as who may work for whom. If a franchisor has invested heavily in its labor

force, the franchisor takes the chance that an employee might switch employment from A to B, where B is the poacher. The result is that B's new employee might receive more money or better benefits. The same result may occur in a non-compete situation. However, an employee moving from one system to another will be less valuable to the competitor because the training the employee had received from A will not be as useful to a franchisee in another system. It is likely that a greater degree of training, and hence expense, will be necessary where the employee is not as familiar with the aspects of being part of another system. On the other hand, if an employee has been trained in the ways of a particular franchise system, it will be easier and less costly to the franchisor for the employee to continue working within the same system. Hence the employee will be more valuable to another franchisee in the same system. Therefore, there will be preference to poach another franchisee's employees from the same system.

A no-poaching provision might cause serious concerns from an antitrust perspective. In this situation, an agreement between two franchisees is a horizontal arrangement to restrain trade; it is an agreement among competitors to restrict competition. Horizontal restrictions have historically been looked at suspiciously by both the courts and state and federal antitrust officials, because it adversely affects the market for employees, and can lead to stagnating wage increases as well as less mobility for employees. Horizontal arrangements like this are generally judged under a per se rule, which means that it is not necessary for the plaintiff-employee to prove the restriction will be harmful to the marketplace. That is, history has taught us that these horizontal restrictions almost always lead to less competitive results. Horizontal restraints include price control, wage control, and market and customer allocations, among other things. In the employment market, these horizontal restrictions may mean employers will feel less pressure to raise wages because there will be fewer employers competing for employees.

This can be contrasted with a vertical arrangement, where history has shown that there is more likely to be a possibility of a positive effect on competition. Thus, courts have developed a "rule of reason" test under which the party imposing a vertical restriction will be allowed to demonstrate the pro-competitive benefits to a court, as opposed to a horizontal arrangement where the adversely affected party will not have to prove that there are economic justifications to the arrangement. The employee only has to show that a horizontal arrangement existed, and is spared, in large measure, the need to show the negative effect of the restriction on the marketplace, in this case, the marketplace for employees. Thus, in the no-poaching situation, the cost for the employee to prove his case is much less. Many plaintiff claims are probably not prosecuted because they are expensive and complicated if the rule of reason will be used to judge the validity of the restriction.

So what is likely to occur with respect to no-poaching provisions? It is likely that their presence in franchise agreements will diminish because the probability of success in litigation by the franchisee seems to be increasing, and this may be one situation where a franchisor decides that any success in battle is not worth the cost. This trend can already be seen in the judicial context as well as in the legislative setting. In one recent decision, the court found a no-poaching provision may be invalid, and thus, the court refused to dismiss the claim at an early stage of the proceeding. *Deslandes v. McDonald's USA*, 2018 WL 3105955 (N. D. Ill, 2018). The case is presently on appeal. Many legal experts believe that it is unlikely that the court's ruling would be reversed at this point.

There has also been legislative and administrative pressure applied to the franchisor community to force franchisors to abandon enforcement of no-poaching provisions permitted under their franchise agreements. At the federal level, Senators Elizabeth Warren and Cory Booker have

introduced federal legislation that would prohibit no-poaching agreements. The Justice Department's Antitrust Department has instigated investigations against several large franchisors, which has added more pressure to franchisors to agree not to enforce these provisions. The Justice Department has increased the pressure on franchisors even further by suggesting it might bring *criminal* charges against franchisors who try to enforce them. And, given the situation, there are numerous franchisors who have voluntarily and pre-emptively agreed not to enforce such a provision. Although *Deslandes* involved a no-poaching provision, approximately two years ago, McDonald's began eliminating them from new franchise agreements, and indicated that it would not enforce such a provision which would be present in its older agreements.

There is also a movement at the state level to prohibit them as well, following the Illinois statute which essentially bans no-poaching provisions. Several states are considering enactment of a no-poach statute, and approximately a dozen state attorneys general have indicated they plan to investigate their effect on commerce.

But, if states continue their attempts to outlaw no-poaching provisions, we may find ourselves in the raucous situation where there is no national consistency in the laws among state jurisdictions. This is the situation with respect to non-competes, where crossing state lines may change a valid non-compete into one that is not valid. It is highly doubtful that pre-emption will ever occur in the area of non-competes. However, in the areas of franchise sales, disclosure, termination and non-renewal, it becomes evident how complex any area of regulation can become absent takeover, through pre-emption, by the federal government. The same thing may occur with respect to no-poaching laws absent federal pre-emption. Franchising is, on the whole, an interstate phenomenon and the law should be crafted to address this potential problem.

Thus, it is appropriate to ask: Should Congress pre-empt all state legislation on no-poaching? This would head off the coming herd of state statutes and provide a universal result that would be applicable throughout the United States.

And, it might demonstrate that now may be the time to consider federal pre-emption with respect to franchise sales, disclosure, termination and non-renewal law. With such a change, the regulatory environment for franchising would be considerably improved, and would become more efficient, less expensive and more friendly for the franchise community.

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