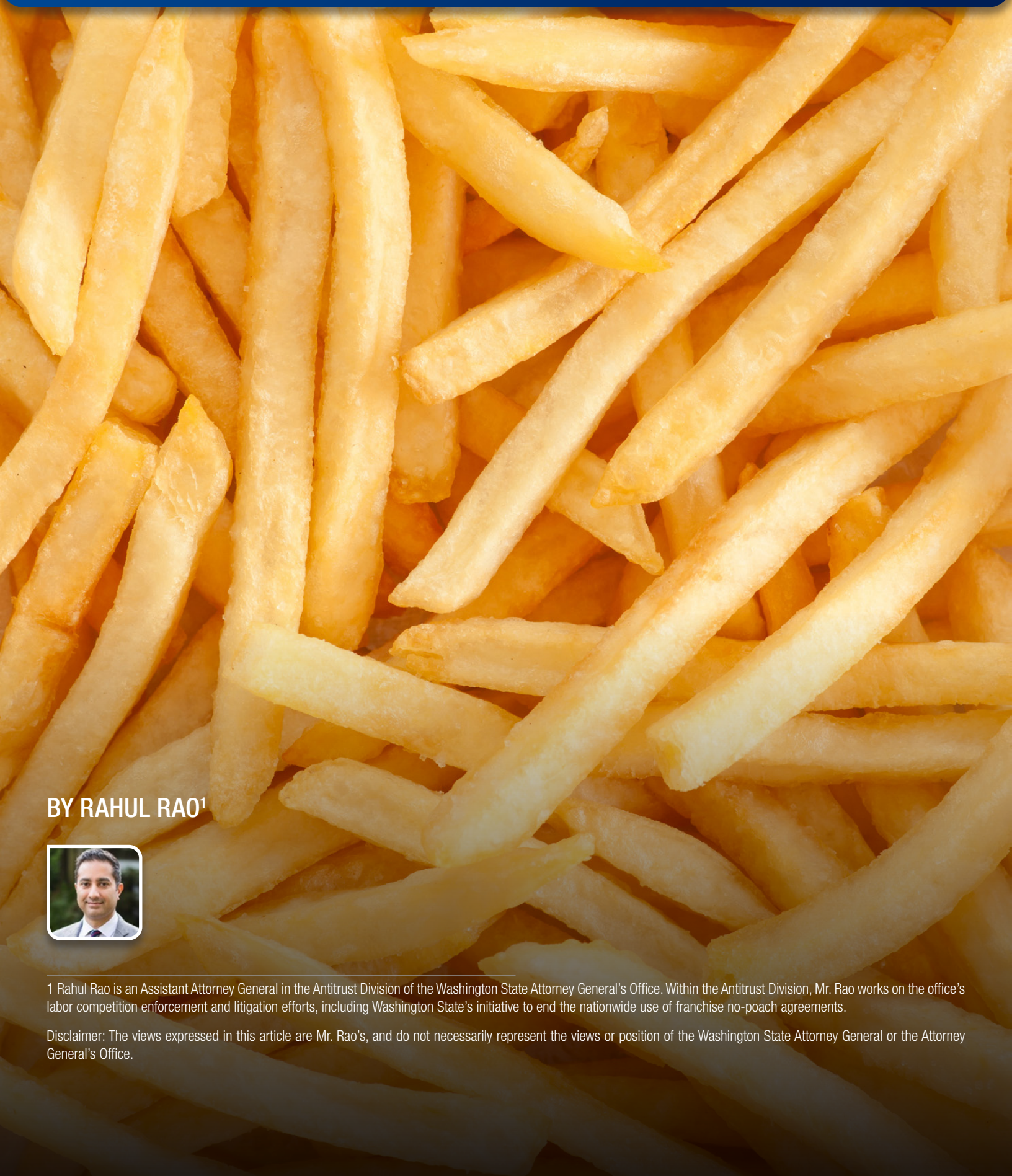
# WHEN COMPETITION MEETS LABOR: THE WASHINGTON ATTORNEY GENERAL'S INITIATIVE TO ELIMINATE FRANCHISE NO-POACHING PROVISIONS



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Disclaimer: The views expressed in this article are Mr. Rao's, and do not necessarily represent the views or position of the Washington State Attorney General or the Attorney General's Office.

## I. INTRODUCTION

Starting in January 2018 and continuing for a little over two years, Washington State championed an initiative to permanently end the nationwide use of franchise no-poach clauses. This initiative was a success. And through its efforts, Washington eliminated no-poach clauses from about 235 corporate chains, representing nearly 200,000 locations across the country. Eliminating these clauses expanded competition for *millions* of workers' labor throughout the United States.

## II. FRANCHISE NO-POACH PROVISIONS DEFINED

To start, a no-poach provision is an agreement — either by itself or as part a broader contract — between two employers, where one or both agree not to hire, solicit, or recruit the other's employees. For franchise systems, the no-poach agreement appears as a single provision within a franchise agreement — a lengthy contract between a franchisor and the independently owned and operated franchisee — that restricts employee mobility within that system.

Franchise no-poach provisions may take different forms. For example, some prohibit hiring another location's employees, while others prohibit recruiting. Some no-poach provisions may prevent poaching only the franchisor's employees. Others protect only company-owned locations. While some only restrict poaching between franchisees. And finally, some no-poach provisions include all the above restrictions.

Despite their variations, all franchise no-poach provisions share a single, unifying quality: restricting franchise entities' ability to hire or recruit new employees. Thus, all no-poach provisions, in some way, inhibit the competition for franchise workers' labor. The consequences for this reduction in competition include diminished opportunities, stagnated wages, and non-competitive benefits and working conditions.

## III. WASHINGTON'S INITIATIVE

In September 2017, the New York Times published the article: "Why Aren't Paychecks Growing? A Burger Joint Clause Offers a Clue."[2] That article explores why wages were stagnating across the country, specifically looking at low-wage employees in fast food and quick serve restaurants. Underlying the New York Times's reporting was research by leading labor economists — Alan Krueger & Orley Ashenfelter, both of Princeton University — suggesting that downward pressure from no-poach agreements may be partly responsible for wage stagnation.[3]

2 Rachel Abrams, *Why Aren't Paychecks Growing? A Burger Joint Clause Offers a Clue*, New York Times, September 27, 2017, https://www.nytimes.com/2017/09/27/business/pay-growth-fast-food-hiring.html.

3 See Alan B. Krueger & Orley Ashenfelter, *Theory and Evidence on Employer Collusion*

That article — and Professors Krueger & Ashenfelter's research — caught the attention of the Washington Attorney General's Office. Finding the presented issue compelling and concerning, the Washington Attorney General's Office, in January 2018, began to investigate franchise systems' use of no-poach provisions.

Within seven months, Washington secured legally binding agreements, through an Assurance of Discontinuance ("AOD"), from seven fast food franchisors to immediately stop enforcing and eliminate no-poach clauses from their franchise agreements nationwide.[4] The AOD also required the franchisor to give nationwide notice of the agreement to its system. While Washington's initiative to end franchise no-poach provisions began with fast food chains — where most workers tend to make minimum wage and are especially vulnerable to wage suppression — the state enforcer believes that all franchise no-poach provisions are *per se* violations of Washington's antitrust laws, as well as its federal analogues.

For that reason, Washington sought to investigate nearly every franchise system with a significant presence in the state. This number is in the many hundreds. As the investigation revealed, most franchise systems had no-poach provisions either at the time of the investigation or recently before then. For the few franchisors that never used a no-poach, Washington took no enforcement action. But for those systems who were using or recently used a no-poach provision — about 235 corporate chains — the Washington Attorney General's Office secured their binding commitments to eliminate these clauses nationwide. In total, these settlements impact nearly 200,000 locations nationwide, and frees competition for the labor of millions of workers.

While most chains accepted Washington's offer to resolve the investigation without suit, one franchisor refused. Washington sued that franchisor — Jersey Mike's Franchise System — and its Washington franchisees in state court in Seattle.[5] This was the first lawsuit brought by a state attorney general against a company over no-poach clauses. Washington's complaint asserted a *per se* theory of liability and alleged a quick-look analysis in the alternative. Rejecting Jersey Mike's motion to dismiss, the Court left intact both *per se* and quick-look arguments. The parties eventually settled — two months before trial — on terms substantively identical to all other AODs, plus $150,000. Every other franchise system cooperated with the State's investigation.[6]

Growing beyond fast food, Washington's initiative expanded across several industries, including: automotive services, child care, commercial cleaning, convenience stores, custom window treatment, electronic repair, home healthcare, home repair, hotels, insurance adjustors, parcel services, residential housekeeping, tax preparation, and travel agencies.

In June 2020, the Washington Attorney General's Office announced the successful end of the no-poach initiative — eliminating no-poach practices nationally for every franchise system with a significant presence in Washington.[7]

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*in the Franchise Sector* (September 28, 2017), Working Paper #614, Princeton University Industrial Relations Section, https://dataspace.princeton.edu/jspui/handle/88435/dsp014f16c547g.

4 See Press Release, Washington State Office of the Attorney General, AG Ferguson Announces Fast-Food Chains Will End Restrictions on Low-Wage Workers Nationwide (July 12, 2018), https://www.atg.wa.gov/news/news-releases/ag-ferguson-announces-fast-food-chains-will-end-restrictions-low-wage-workers.

See also RCW 19.86.100 ("In the enforcement of [Washington's Consumer Protection Act (CPA)], the attorney general may accept an assurance of discontinuance of any act or practice deemed in violation of [the CPA], from any person engaging in, or who has engaged in, such act or practice. Any such assurance shall be in writing and be filed with and subject to the approval of [a Washington State Superior Court]. Such assurance of discontinuance shall not be considered an admission of a violation for any purpose; however, proof of failure to comply with the assurance of discontinuance shall be prima facie evidence of a violation of [the CPA].")

5 Complaint, *Washington v. Jersey Mike's Franchise Sys., Inc., et al.*, No. 18-2-25822-7 SEA (King City Sup. Ct. Oct. 15, 2018).

6 See Press Release, Washington State Office of the Attorney General, *Jersey Mike's Will Pay $150k To Resolve AG Ferguson's First No-Poach Lawsuit* (Aug. 23, 2019), https://www.atg.wa.gov/news/news-releases/jersey-mike-s-will-pay-150k-resolve-ag-ferguson-s-first-no-poach-lawsuit.

7 See Press Release, Washington State Office of the Attorney General, *AG Report: Ferguson's Initiative Ends No-Poach Practices Nationally at 237 Corporate Franchise Chains* (June 16, 2020) (full report linked in press release), https://www.atg.wa.gov/news/news-releases/ag-report-ferguson-s-initiative-ends-no-poach-practices-nationally-237-corporate.

## IV. FRANCHISE NO-POACH PROVISIONS ARE MARKET ALLOCATION AND PRICE FIXING AGREEMENTS — AND THEY ARE *PER SE* UNLAWFUL

Both Section 1 of the Sherman Act and Washington's Consumer Protection Act prohibit "[e]very contract, combination . . . or conspiracy" in restraint of interstate trade or commerce.[8] Naked restraints of trade among horizontal competitors — such as those competing for employees in a labor market — are *per se* unlawful.[9]

Most common in the category of *per se* violations are agreements among horizontal competitors to fix prices or divide markets.[10] It does not matter if a specific price was actually "fixed," rather than simply suppressed.[11] Market allocation among competitors — by customers or geography — is also *per se* unlawful. Under *per se* analysis, once the plaintiff shows that certain agreements exist, courts automatically find the agreement is unreasonable.[12]

While the most common horizontal conspiracies involve an agreement among sellers to raise *prices*, antitrust laws equally apply to horizontal conspiracies among *buyers* to stifle competition.[13] Buyers markets include labor markets, where employers compete to *purchase* labor from workers who *sell* it.[14] No-poach agreements among competing employers are "a type of customer allocation scheme which courts have often condemned in the past as a *per se*" violation of antitrust laws. And thus, it is *per se* unlawful for competing employers/buyers to agree with each other not to compete for workers/sellers.[15]

In the franchise context, franchisees, among themselves and with the franchisor, are direct competitors for labor. As separately owned and operated entities with discretion to make independent hiring and employment decisions — such as whom to hire and how much to pay — these clauses are agreements among employers not to compete for workers. And because franchise agreements are uniform within a system, each franchisee knows that other franchise units are subject to the same no-poach restriction.[16] Thus, agreements among employers not to compete for workers — even if done through an intermediary — are both horizontal labor market allocations and price fixing conspiracies, and are *per se* unlawful.[17]

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8 See, e.g. *supra* note 4. See also 15 U.S.C. § 1; RCW 19.68.030 (Washington's Consumer Protection Act). See also, e.g. *Bhan v. NME Hospitals, Inc.*, 929 F.2d 1404, 1410 (9th Cir. 1991) (listing elements of a Section 1 claim).

9 *White Motor Co. v. United States*, 372 U.S. 253, 263, 83 S. Ct. 696, 9 L. Ed. 2d 738 (1963).

10 *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007); see *United States v. Socony-Vacuum Oil*, 310 U.S. 150, 218 (1940) ("[T]his Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful *per se*."); *Knevelbaard Dairies v. Kraft Foods, Inc.*, 232 F.3d 979, 986 (9th Cir. 2000).

11 *Socony-Vacuum Oil*, 310 U.S. at 222; see *Fed. Trade Comm'n v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 422 (1990) (constricting supply is "the essence of 'price-fixing'").

12 *Maricopa Cty. Med. Soc'y*, 457 U.S. at 343–44 (1982); see also *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) (stating that because these agreements "have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit, [ ] they are deemed unlawful *per se*.").

13 *Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235 (1948) (finding antitrust liability "even though the price-fixing was by purchasers, and the persons specially injured . . . are sellers, not customers or consumers.") (footnotes omitted); see also *Knevelbaard Dairies*, 232 F.3d at 988–89 ("[A] buying cartel's low buying prices are illegal and bring antitrust injury.").

14 *United States v. Brown*, 936 F.2d 1042, 1045 (9th Cir. 1991) (agreements among competitors limiting upstream inputs—such as labor—can be *per se* unlawful).

15 *In re High-Tech Emp. Antitrust Litig.*, 856 F. Supp. 2d 1103 (N.D. Cal. 2012) (plaintiffs "successfully pled a *per se* [antitrust claim] for purposes of surviving a 12(b)(6) motion" in alleged conspiracy among defendants to fix and suppress employee compensation and to restrict employee mobility through "Do Not Cold Call" agreements).

16 In its complaint against Jersey Mike's, Washington argued that the franchise agreements document "a 'hub and spoke' contract, combination, and/or conspiracy to restrain trade and commerce in which all Defendant Franchisees agreed with the Franchisor not to solicit or hire other Franchisees' workers. Because the agreement is standard and because the terms of the franchise agreement are made public, Franchisees know the basic contents of each other's agreements." See *supra* note 4.

17 *United States v. eBay, Inc.*, 968 F. Supp. 2d 1030, 1039 (N.D. Cal. 213) ("The court thus finds that the United States' allegations concerning agreement between eBay and Intuit [not to hire each other's employees] suffice to state a horizontal market allocation agreement" that is *per se* unlawful); *Fleischman v. Albany Med. Ctr.*, 728 F. Supp. 2d 130, 157–58 (N.D.N.Y. 2010) (holding that information exchange between defendants to fix nurse wages was illegal *per se* and tantamount to a conspiracy to fix prices); see *Brown*, 936 F.2d at 1045 (holding that agreements among competitors limiting upstream inputs can be *per se* unlawful).

## V. EVEN IF NOT *PER SE* UNLAWFUL, ONE NEED ONLY TAKE A "QUICK LOOK" AT THE RESTRAINTS TO SEE ANTI-COMPETITIVE EFFECTS

In the spectrum of antitrust analyses — with *per se* occupying one end and full rule of reason on the other — "[a]n abbreviated or 'quick-look' analysis is appropriate when an observer with even a rudimentary understanding of economics could conclude that the arrangements in question have an anticompetitive effect on customers and markets."[18]

Among other situations, courts do a "quick look" when a restraint would normally be illegal *per se*, but "a certain degree of cooperation is necessary if the [product at issue] is to be preserved."[19] In other words, quick look review "is usually best reserved for circumstances where the restraint is sufficiently threatening to place it presumptively in the *per se* class, but lack of judicial experience requires at least some consideration of proffered defenses or justifications."[20]

Here, one with even a rudimentary understanding of economics could conclude that a worker trained in a franchise's unique operations would be valuable to another franchise unit. Indeed, logic itself might dictate that no-poach agreements only make sense if there is a risk that a worker might switch employers for better pay, benefits, or working conditions.

That same observer would also see that a no-poach agreement limits workers' bargaining power with their current employer, eliminates the threat of moving to a competing employer, and limits workers' ability to go to a competing employer for better money or working conditions. One need no more than lay observation to see that no-poach provisions eliminate a market that would otherwise allow qualified, trained workers to capitalize on their value.

## VI. ARGUMENTS FOR A FULL RULE OF REASON ANALYSIS MISUNDERSTAND THE FRANCHISOR-FRANCHISEE RELATIONSHIP IN THE RELEVANT MARKET

As interest in franchise no-poach provisions ballooned, franchisors and others[21] sought to shield no-poach provisions from *per se* treatment. Specifically, the U.S. Department of Justice ("DOJ") inserted itself into three no-poach class actions in the Eastern District of Washington to file statements of interest.[22] In response to its statements of interest, Washington filed amicus briefs with the district court setting forth its position on the class plaintiffs' claims that the franchise no-poach provisions violated Washington's Consumer Protection Act.[23]

In its statements of interest, DOJ articulated certain fundamentals of antitrust analysis of franchise no-poach provisions consistent with Washington's view. First, both enforcers agree that a franchisor and franchisee can be separate entities able to conspire under Section 1. And second, both agree that naked, horizontal no-poach agreements between rival employers within a franchise system are subject to the *per se* rule.

Washington, however, disagreed with DOJ's assertion that a no-poach clause contained within a franchise agreement, is, absent some other agreement between the franchisees, subject to the rule of reason because it is — in DOJ's view — a vertical restraint. The two enforcers also disagree on DOJ's position that even if there were some alleged agreement among franchisees, the no-poach provision would still fall under the full rule of reason because it is ancillary to the broader franchise agreement. Washington believes both arguments are incorrect.

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18 *Cal. Dental Ass'n v. Federal Trade Commission*, 526 U.S. 756, 770 (1999).

19 *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 117 (1984).

20 Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law: An Analysis of Antitrust Principles and Their Application ¶ 1911. (3d. and 4th Editions, 2019 Cum. Supp. 2010–2018).

21 "Others" includes the United States Department of Justice, who, in March 2019, filed statements of interest in the District Court for the Eastern District of Washington in support of franchisor-defendants in three no-poach class actions. See *Harris v. CJ Star, LLC*, 2:18-cv-00247 (E.D. Wash. Mar. 11, 2019), *Richmond v. Bergey Pullman Inc.*, 2:18-cv-00246 (E.D. Wash. Mar. 11, 2019), and *Stigar v. Dough Dough, Inc.*, 2:18-cv-00244 (E.D. Wash. Mar. 11, 2019).

22 See Corrected Statement of Interest of the United States, filed in *Harris v. CJ Star, LLC*, 2:18-cv-00247 (E.D. Wash. Mar. 8, 2019), *Richmond v. Bergey Pullman Inc.*, 2:18-cv-00246 (E.D. Wash. Mar. 8, 2019), and *Stigar v. Dough Dough, Inc.*, 2:18-cv-00244 (E.D. Wash. Mar. 8, 2019).

23 See Amicus Curiae Brief by the Attorney General of Washington, filed in *Harris v. CJ Star, LLC*, 2:18-cv-00247 (E.D. Wash. Mar. 11, 2019), *Richmond v. Bergey Pullman Inc.*, 2:18-cv-00246 (E.D. Wash. Mar. 11, 2019), and *Stigar v. Dough Dough, Inc.*, 2:18-cv-00244 (E.D. Wash. Mar. 11, 2019).

First, as to the contention that no-poach provisions are vertical, DOJ qualifies this position by noting that certain agreements may be horizontal if they restrain competition between the franchisor and franchisee.[24] This exception to DOJ's argument includes no-poach provisions that restrict a franchisee from poaching an employee of a company-owned store or poaching from the franchisor itself. The only circumstance falling within DOJ's verticality argument is where the no-poach provision restricts only franchisees from poaching each other's employees. Yet even in that single no-poach variation, the franchise agreement's uniformity — that they are all identical, and thus all parties know and intend to be bound by the same restrictions — presents enough circumstances to plead a hub-and-spoke conspiracy, with the franchisor as hub.

More, in an open letter to DOJ's Antitrust Division, the American Antitrust Institute ("AAI") questioned many of DOJ's arguments.[25] As to the argument that a vertical relationship demands a rule of reason analysis, AAI noted that the orientation of the restraint, by itself, does not determine the mode of analysis. Rather, what is critical is the economic *effect*, not formalistic line drawing.[26] Thus, even if parties operate at different levels of distribution, agreeing to a restraint that has a horizontal, anticompetitive effect, would be subject to the *per se* rule. For franchise no-poach clauses, the restraint only impairs horizontally positioned parties who would otherwise compete in labor markets. It thus deserves *per se* treatment.

DOJ's second argument — that even if the restraint is horizontal, the no-poach provisions are ancillary restraints — is also incorrect. Under the ancillary-restraints doctrine, a traditionally *per se* restraint escapes *per se* liability if, among other things, it is reasonably necessary to complete the main transaction.[27] Both Washington and AAI agree that the facts and results of Washington's initiative undercut any argument that these clauses are *necessary* to the franchise agreement. That 100 percent of relevant franchise systems in Washington State — about 235 chains — immediately eliminated their no-poach provisions with no subsequent harm to the franchise systems, shows that the restraints were never necessary. Without showing necessity, one never triggers the ancillary-restraints doctrine, and the restraints remain *per se* unlawful.

The actions in which DOJ and Washington filed competing briefs settled before any argument or decision on the merits.

## VII. CONCLUSION

It is uncontroversial to state that antitrust law is not limited to sellers; that it applies equally to buyers. It is similarly without dispute that employers who hire workers are buyers of labor. In a labor market, firms that compete to hire or retain employees are direct, horizontal competitors for those workers. This horizontal, competitive relationship in a *labor* market exists without regard to the parties' relationship in *any other* market.

And while the complex — and sometimes confounding — business structures of franchise systems understandably create some analytical confusion because of the necessary coordination of outputs, when evaluating the entities' labor-inputs, the franchise units are independent centers of employment decision-making who compete with each other for workers. At their core, franchise no-poach provisions seek to eliminate that competition much like any other market allocation or price fixing agreement. This is conduct that has always been, and will always be, *per se* unlawful.

24 See *supra* note 22 at 12-13.

25 See American Antitrust Institute Letter to AAG Delrahim and DAAG Murray (May 2, 2019), https://www.antitrustinstitute.org/wp-content/uploads/2019/05/AAI-No-Poach-Letter-w-Abstract.pdf.

26 *Id.* at 6. (citing *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 887 (2007)).

27 See, e.g. *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 224 (D.C. Cir. 1986).

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