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# Challenges to Non-Solicitations and Non-Competes

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# No-Poach Provision

- “During the term of this Franchise Agreement, Franchisee shall not solicit, offer to hire, or hire the employee(s) of any other [Brand] franchisee.”

# No-Poach Provision

## **Purposes:**

- Encourages franchisee investment in training
- Protects stability of franchisee staff
- Supports brand quality system-wide

# FTC/DOJ Antitrust HR Guidance

- “Naked 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.”
- FTC/DOJ Antitrust Guidance for Human Resource Professionals, October 2016

# DOJ Turns Its Attention to Labor Restrictions

- No-hire/no-poach agreements
- Wage limitations
- Benefit constraints
- Recruiting limitations

# Sherman Act Section 1

- Condemns “contracts, combinations or conspiracies” that unreasonably restrain trade
  - Anticompetitive agreements among competitors (horizontal agreements) in restraint of trade are *per se* or automatically illegal
  - The legality of agreements between competitors at different market levels, or agreements that are not clearly anti-competitive is assessed under a Rule of Reason analysis

# Sherman Act Sec. 1

## Elements:

- Agreement between more than one actor that unreasonably and adversely affects competition in a relevant market causing the plaintiff antitrust injury



# DOJ Actions

- **Genesis:**
  - *U.S. v. Adobe Systems, Inc.*, D.D.C. 2011
  
- **Resurgence:**
  - *U.S. v. Knorr-Bremse AG*, D.C. Cir. 2018 (civil)
  - *U.S. v. Surgical Affiliates*, N.D. Ill. 2021 (criminal)

# Washington State Joins The Chorus

- 2018: Washington AG challenges no-poach clauses in franchise agreements
- One lawsuit filed in 2018 against *Jersey Mike's*, resulting in fine and agreement not to enforce provision
- AG negotiates non-enforcement of clauses *nationwide* with 237 franchisors

# DOJ/FTC Clarifies Franchise Analysis

## **No-poach provision in Franchise Agreement may be subject to Rule of Reason analysis\***

- Usually not *per se* illegal
- Washington AG announces success and ends its challenges to no-poach clauses in Fall, 2019

\*DOJ Division Update, Spring 2019

# But The Die Is Cast

- Private antitrust claims based on no-poach/no-hire provisions blossom, featuring:
  - Claims on behalf of a putative class
  - Allegations of *per se* Sherman Act violations
- Jurisprudence is in its infancy

# Per Se, ROR, or Quick Look?

## The competitive impact analysis

- ***Per se* (the plaintiffs' dream)**
  - Rare application
  - Horizontal agreements among competitors
  - Unreasonably anticompetitive impact overwhelmingly obvious – restraints always or almost always restrict competition and decrease output

# Competitive Impact Analysis

- **Rule of Reason**
  - Usual means of analysis, particularly with vertical restraints
  - Anticompetitive impact assessed in light of impact of practice in the relevant market (labor market)
  - Pro-competitive benefits may outweigh anticompetitive impacts

# Competitive Impact Analysis

- **Quick Look**
  - A variant of the ROR analysis
  - Proof of market power truncated
  - But plaintiff must demonstrate that the anticompetitive impact is obvious *and* that the conduct lacks any procompetitive purpose

# Any Emerging Analytical Trend?

- **Some courts reject *per se* analysis, but defer decision on ROR or quick look**
  - *Ogden v. Little Caesar's Ents.*, 393 F.Supp.3<sup>rd</sup> 622 (E.D. Mich. 2019)
  - *Deslandes v. McDonald's USA, LLC*, 2018 WL 3105955 (N.D. Ill. 6/25/2018)
  - *Yi v. SK Bakeries, LLC*, 2018 WL 8918587 (W.D. Wash. 11/13/2018)



# Any Emergency Analytical Trend?

- **But many courts have deferred the analytical decision at Motion to Dismiss stage**
  - *Butler v. Jimmy John's Franchise*, 331 F.Supp.3d 786 (S.D.Ill 2018)
  - *Blanton v. Domino's Pizza Franchising*, 2019 WL 2247731 (E.D. Mich. 5/24/2019)
  - *In re Papa John's Employee*, 2019 WL 5386484 (W.D.Ky 10/21/2019)
  - *Conrad v. Jimmy John's Franchise*, 2019 WL 4596762 (S.D. Ill. 8/6/2019)

# Antitrust Injury

- **Plaintiff must demonstrate *antitrust* injury**
  - An injury caused by the anticompetitive impact of the challenged practice on the plaintiff
    - E.g., loss of job offer, inability to assume new position
  - A standing issue in no-poach cases

# Antitrust Injury

- **Generalized potential injury should not suffice**
  - *Ogden v. Little Caesar's Ents.*, 393 F.Supp.3d 622 (E.D. Mich. 2019)
  - *Fuentes v. Royal Dutch Shell*, 2019 WL 7584654 (E.D. Pa. 11/26/2019)

# Risks & Opportunities

- Parameters of no-poach antitrust claims are not clear
- Proof of market power (the ability to control prices or output) will be difficult
- Antitrust injury requirement may discourage class actions (although not as yet)
- Pro-competitive goals of restraints in franchising are demonstrable

# It's Not Just Antitrust

- State common law claims may torpedo no-poach agreements
- E.g., *Pittsburgh Logistics Systems v. Beemac Trucking*, 2021 WL 1676399 (PA 4/29/2021) (Non-compete analysis results in nixing of no-poach agreement)

# Non-Compete Issues

- Reasonableness
- What Needs to be Protected
- State Law differences
- Drafting Alternatives
- Litigation Strategies

# Reasonableness for Enforceable Covenants

- Covenants reasonably balance the interests of protecting the brand and existing franchisees against competition by other existing franchisees and by former franchisees

# Reasonableness (cont.)

- Enforcement of covenants is governed by state law
- Most states have case law guidance on reasonableness, and some states have statutes
- In-term covenants are more liberally enforced than post-term



# Reasonableness (cont.)

## **Most states will protect franchisor's business interests if the covenant has:**

- Sufficient consideration
- Reasonable geographic scope
- Reasonable limit in time restrictions

# Legitimate Business Interests

- As a partial restraint of trade, a court will scrutinize why the covenant is needed
- The legitimate business interests of the franchisor can be expressed or implied, but needs to be clear on enforcement

# Legitimate Business Interests

- **To prevent unauthorized exploitation of good will**
  - Includes the name, mark, product, recipes, and any unique way of doing business, which may be expressed in training and operation manuals

# Legitimate Business Issues

- **Protection of confidential information and trade secrets, such as:**
  - Training and operations instruction,
  - Know-how, negative know how (what not to do),
  - Market and demographic studies, expansion issues, real estate selection,
  - Social media optimization, existing and potential customers, sources of product and equipment

# Legitimate Business Interests

- Protecting the basic product sold by franchisors - a new franchise
- Protecting existing franchisees against cannibalization by rogue former franchisees

# Legitimate Business Interests

- Protection against franchisees breaking away from the franchise system
- Preventing unfair competition through tortious interference or unfair advertising
- Preventing copyright infringement using sales materials or instruction unique to the franchise system

# Legitimate Business Interests

- **Narrow scope of restriction defined narrowly:**
  - Competitive business - just ok
  - Restaurant - better
  - Italian restaurant with more than 10% pizza
  - Sales - best

# Reasonable Geographic Restrictions

- Generally does not apply to in-term covenants, as franchisor has an expectation that franchisee during the term will not compete elsewhere



# Reasonable Geographic Restrictions

- For post-term, case law and statutes provide guidance, but the enforceability really is decided on the facts
- Why should a franchisor be exempt from competition by the former franchisee in a certain geography?

# Reasonable Geographic Restrictions

- **One size does not fit all**
- Pennsylvania case law generally supports a 1-10 mile radius for retail
- Geographic restrictions in an urban setting may be very different than rural setting
- The internet may make local businesses international

# Reasonable Geographic Restrictions

- **Options to define geographic scope:**
  - “Within a two mile radius of your location”
  - “Within your protected territory”
  - “Within two miles of your location and any then operating branded unit of the franchisor”

# Reasonable Time Limitations

- Case law and statutes provide some guidance as to time restrictions found as reasonable
- Ultimately, the decision is based on the facts of the case

# Reasonable Time Limitation (cont.)

- Pennsylvania case law generally considers two year restrictions reasonable
- Several federal cases ask how long it will take to rebrand the area given real estate, hiring, and opening challenges
- Courts will support a time restriction estimated to rebrand the market and prevent a competitive advantage to the former franchisee

# State Statutes Governing Covenants

## California Business and Professional Code Sec. 16600

- With limited exception, voids all post-term covenants on public policy grounds
- Trade secret exception: will enforce contractual provisions intended as trade secret protections. See *Bambu Franchising, LLC v. Nguyen*, 2021 WL 1839664 (N.D. Cal. May 7, 2021)
- Narrow restraint exception: will enforce very narrow restraints where the failure to do so would be akin to unjust enrichment
- Will enforce in-term covenant in limited geographic area

# State Statutes (cont.)

- **Colorado Rev. Stat. Sec. 8-2-113**
- Covenants unenforceable except for:
  - Contracts for sale of business
  - Contracts for protection of trade secrets
  - Contracts for executive and management personnel

# State Statutes – Colorado (cont.)

- Purchase of franchise is similar to sale of business and covenant enforceable
- Trade secrets contained in Operations Manual also held to support enforcement of covenant



# State Statutes - Florida-Fla. Stat. Ann. Section 542.335

## **An exception to the Florida Antitrust Act:**

- Covenants not prohibited if “reasonable in time, area and line of business”
- Presumed reasonable against franchisor up to one year
- Presumed unreasonable if over three years

# State Statutes - Georgia, O.C.G.A Sec. 13-8-50 et. seq.

## **Presumptions of reasonableness:**

- Time - 3 years franchisee/distributor
- Geographic - areas where franchisor does business during the franchise term
- Prohibited activity - determined by business of franchisor
- Blue pencil authorized - court may modify an overbroad covenant

# State by State Comparison - Reference

- Michael R. Gray, Natalma M. McKnew,  
Covenants Against Competition in Franchise  
Agreements (3<sup>rd</sup> ed. 2012)

# Examples of Useful Clauses

- **Non-Solicitation**
  - “Franchisee and its principals agree that for 1.5 years after termination, they shall not, directly or indirectly, solicit, contact, or attempt to solicit or contact, through social media or otherwise, any of Franchisee’s former customers for the purpose of offering goods or services similar to those offered by the Franchisor.”

# Examples of Useful Clauses (cont.)

- **Non-Disclosure:**
  - Franchisee and its principals agree they will not directly or indirectly, disclose, divulge, publish or share with others, any Confidential Information or Trade Secrets, except as required to operate the franchised business on a need to know basis. This non-disclosure obligation shall survive termination or expiration of this agreement until such information no longer constitutes Confidential Information or a Trade Secret.

# Useful Clauses - Confidential Information

- **Confidential Information:**
  - Data or information related to the franchised business which is marked “Confidential,” and is disclosed to the Franchisee to enable performance of this franchise agreement and is generally not known to the public. For example, the Operations and Training Manuals are Confidential Information. Confidential Information under this agreement includes Trade Secrets as determined under applicable law.

# Useful Clauses-In-Term Non-compete

- During the term and any renewal, neither the Franchisee nor its principals shall directly or indirectly, engage in or offer services to, whether as an investor, lender, officer, director, owner or consultant, to a Competitive Business anywhere in the world. A Competitive Business is defined as a \_\_\_\_\_.

# Useful Clauses-Post-Term Non-compete

- For two (2) years after expiration or termination of this agreement, neither Franchisee nor its principals may, directly, or indirectly, own, engage in or render services to, whether as an investor, consultant, officer, director, representative or agent, any Competitive Business within 5 miles of Franchisee's Protected Area, or within 5 miles of any branded outlet of the Franchisor. This restriction shall not apply to ownership of 5% or less of any publicly listed company
- Franchisee may arbitrate before the American Arbitration Association prior to breach of this provision, the reasonableness of the time and geographic limitations and such decision by the AAA shall be binding upon the parties, otherwise, this provision shall be presumed reasonable
- The parties agree that this provision may be modified by the court to be enforceable only to the extent reasonable based on competitive circumstances. Franchisor retains the right to unilaterally reduce the scope of this restriction without waiver or impairment of the restrictions as so modified



# Bankruptcy Issues

- **Stay Relief** - *In re Stephen L. Mainous and Raenne E. Mainois*, 610 B.R. 916 (2019) (granted)
- **Dischargeability** - Older cases probably implicitly overruled by *Mission Products v. Tempnology, LLC*, 139 S. Ct. 1652 (2019) (supporting state law contract analysis)
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# Black-Belt Training

## Practical Guidance

# The Unpredictable Future

- No-poach/no-hire *and* Non-competes may be doomed or sharply curtailed by state or federal statutes
  - E.g., Workforce Mobility Act (federal)
  - End Employer Collusion Act (NY)

# No-Poach/No-Hire Avoid or Minimize the Risk

- **Do you as franchisor really need the no-poach provision?**
- **Do you really need it at *all* staff levels?**
  - Management or highly specialized positions versus minimum wage workers?
- **Do you operate units (theoretically competing with your franchisees)?**
  - Increases risk that restraint will be deemed horizontal subject to *per se* analysis

# Avoid or Minimize risk

- **Will a non-compete or non-disclosure suffice?**
- **What about any of the following?**
  - Payment from poaching franchisee to prior employing franchisee
  - An extended notice period prior to departure, during which time compensation continues but employee does not work
  - Forfeiture of benefits or payments by employee on changing employment

# Non-Competes Enforcement Issues and Strategy

- **Litigation Issues and Strategy**
- **Bankruptcy Issues**

# Litigation Issues

- **Early case assessment:**
  - Cease and desist letter?
  - Temporary restraining order?
  - Expedited Discovery?
  - Preliminary Injunction?

# Litigation Issues - Early Case Assessment

- How bad is the conduct/any bad facts?
- How much harm will you suffer?
- Is it irreparable? Will damages suffice?
- Who wears the white hat?



# Litigation Issues - Cease and Desist

- Essential if a litigation surprise is not advantageous - shows reasonableness and willingness to resolve without litigation
- Should not use if there is a race to the courthouse to select an advantageous forum

# Litigation Issues - Choice of Forum and Law

- All Franchise Agreements should have a forum selection clause and a choice of law favorable to the franchisor
- Should contain a waiver of personal jurisdiction and venue

# Litigation Issues - State or Federal Court

- State court typically is less formal, more interested in protecting local business, and can have some parochial views
- Emergency relief is easier in state court
- Weigh this against federal remedies for some of the claims, such as the Lanham Act for trademarks, Defend Trade Secrets Act and Computer Fraud and Abuse Act

# Litigation Issues - Temporary Restraining Order

- **A temporary injunction can be obtained *ex parte*, but usually requires notice, and:**
  - High likelihood of success on the merits
  - Immediate and irreparable harm to movant if injunction not granted
  - Harm greater if injunction is not granted to movant than if granted to the respondent
  - Granting an injunction is in the public interest

# Litigation Issues -Temporary Injunction/Temporary Restraining Order

- Almost always requires a bond - even if your franchise agreement waives the bond requirement (which it should)
- Great tactical benefit to claimant - but difficult to obtain absent clear facts and law

# Litigation Issues - Expedited Discovery

- After filing suit, a court on motion may allow expedited discovery and can accelerate an answer to pleadings
- Expedited discovery can ferret out the necessary facts to support continuation of a temporary injunction or prepare for a preliminary injunction
- Expedited discovery may be limited to the essential fact finding for injunction issues so it may duplicate time and cost for full discovery
- Presentation of the case and defense is enhanced with discovery

# Litigation Issues - Preliminary Injunction

- **To obtain a Preliminary Injunction the party must establish:**
  - likely to succeed on the merits
  - likely to suffer irreparable harm in the absence of preliminary relief
  - balance of the equities tip in favor of claimant
  - an injunction is in the public interest

# Litigation Issues - Preliminary Injunction (cont.)

- **Not a trial on the merits, but results in being dispositive of the case because:**
  - The judge evaluates the case
  - The outcome will dictate the parties relative positions going forward and is a good predictor of the ultimate outcome



# Litigation Issues - Preliminary Injunction (cont.)

- You only have one opportunity to make a first impression - a loss can be devastating
- How compelling is your irreparable harm and how strong are the merits?
- Is the system really at risk?

# Litigation Issues - Preliminary Injunction (cont.)

- If you delay in seeking preliminary relief, then the immediacy of the irreparable harm is lost and a permanent injunction may never be granted
- On the other hand, seeking a damage claim only may have the desired effect of curtailing the wrongful activity

# Litigation Issues - Preliminary Injunction (cont.)

- Injunctions bind not only the parties, but can be broadened to enjoin those acting in concert, agents and representatives, as well as other non-signatories or parties

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