SEYFARTH SHAW

Management Alert

Franchise "No-Hire" Agreement Class Actions And The Single Enterprise Defense

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Seyfarth Synopsis: *There are currently pending at least four class actions claiming that provisions contained in franchise agreements prohibiting the hiring of employees of other intrabrand franchisees without the consent of their employer violate the antitrust laws. That being said, in 1993 the Ninth Circuit affirmed summary judgment in favor of a franchisor in a similar "no-hire" case. It reasoned that due to the control the franchisor exercised over its franchisees, the franchisor and its franchisees were incapable of conspiring in violation of Section 1 of the Sherman Act. While the so-called "single enterprise" defense is potentially available, franchisors should be cognizant that in developing that defense, they may create evidence or admissions that would support a subsequent claim that the franchisors are joint employers of their franchisees' employees. In light of the availability of other defenses, franchisor employers should assess whether the joint employer risk is worth accepting in order to pursue the single enterprise defense.*

Introduction

"No-hire" (sometimes referred to as "no-switching") agreements are contracts between or among employers not to hire each other's employees. A "no-poaching" agreement is different but similar. It prevents the solicitation of another employers' employees, but does not prevent their hire, so long as there was no solicitation. The franchise no-hire agreements typically are limited in duration. For example, in pending litigation against Pizza Hut, it is alleged that the challenged agreement only prohibits hiring anyone who was in a managerial position at another Pizza Hut restaurant at any time during the previous six months. *Ion v. Pizza Hut, LLC,* Case No. 4:17-cv-00788, Complaint at ¶ 4, available at https://www.classaction.org/media/ion-v-pizza-hut-llc.pdf (last visited on 4/10/2018).

In 2017, at least three class action cases were brought against separate franchisors alleging that the organizations' "no-hire" agreements suppress wages and violate antitrust laws. And a fourth was filed in January 2018. There may be more to come. In a letter to Attorney General Jeff Sessions dated November 21, 2017, Senators Elizabeth Warren and Cory Booker inquired as to whether DOJ was "currently investigating the use of no-poach agreements in the franchise industry." In that correspondence, Senators Warren and Booker cited to a study by Princeton economists that found that "fully 58% of the 156 largest franchisors operating around 340,000 franchise units used some form of anti-competitive 'no-poach' agreements." *See* https://www.warren.senate.gov./files/documents/2017_11_21_No_Poach.pdf (last visited on 4/10/2018).

To prove a violation of Section 1 of the Sherman Act, the plaintiff must show an agreement between or among two or more persons or entities. *Monsanto Co. v. Spray-Rite Service Corp.,* 465 U.S. 752, 761 (1984). In 1993, a Jack-in-the-Box franchisor successfully defended a challenge to its no-switching agreement on the grounds that the franchisor and its franchisees were a single enterprise and incapable of conspiring in violation of Section 1. *Williams v. I.B. Fischer Nevada,* 999 F.2d 445, 447-48 (9th Cir. 1993) *(per curiam).*

That defense is premised upon the control that a franchisor has over the operations of its franchisees. And the question then is whether developing that defense creates an unacceptable risk of creating evidence or admissions supporting joint employer status.

The Single Enterprise Defense

In the franchise no-hire context, usually there is little dispute that an agreement exists. It is typically contained in the franchise agreements between the franchisor and each of its franchisees. But the parties to the alleged unlawful agreement must also be legally capable of conspiring. In *Copperweld Corp. v. Independence Tube Corp.,* 467 U.S. 752, 771 (1984), the U.S. Supreme Court held that a parent and its wholly owned subsidiary were incapable of conspiring in violation of Section 1 because their conduct must be viewed as that of a single enterprise. The Supreme Court reasoned that "[a] parent and its wholly owned subsidiary have a complete unity of interest. The objectives are common, not disparate; the general corporate actions are guided or determined not by two separate corporate consciousnesses, but one." *Id.* It therefore reversed the decision of the Seventh Circuit which had affirmed a jury verdict in favor of the plaintiff.

In 1993, without mentioning *Copperweld*, the Ninth Circuit extended this single enterprise concept to the franchise environment in a no-hire case. *Williams,* 999 F.2d at 447-48. Other courts have also found that franchisors were incapable of conspiring with their franchisees within the meaning of the Sherman Act. *See Danforth & Associates, Inc., v. Coldwell Banker Real Estate, LLC,* Case No. C10-1621, 2011 U.S. Dist. LEXIS 10882, *6-7 (W.D. Wash. Feb. 2, 2011) (franchisor and franchisee cannot conspire within the meaning of the Sherman Act); *Search International, Inc. v. Snelling and Snelling, Inc.,* 168 F. Supp. 2d 621, 626-27 (N.D. Tex. 2001) (unity of interest between franchisor and its franchisees made them incapable of conspiring in violation of the Sherman Act); *Hall v. Burger King Corporation,* 912 F. Supp. 1509, 1548 (S.D. Fla. 1995) (franchisor and franchisee were incapable of conspiring under the Sherman Act).

But the authorities cited above do not stand for the broad proposition that franchisors, in general, cannot unlawfully conspire with their franchisees. The district court in *Williams* itself acknowledged that the issue required an examination of the particular facts. *Williams v. I.B. Fischer Nevada,* 794 F. Supp. 1026, 1030 (D. Nev. 1992). Likewise, some have opined that the Supreme Court's subsequent decision in *American Needle v. National Football League,* 560 U.S. 183 (2010), makes it more difficult for franchisors to argue that the franchise system is a single economic enterprise. *See* B. Block & M. Ridings, *Antitrust Conspiracies in Franchise Systems After American Needle*, Franchise L.J., Vol. 30, No. 4 (Spring 2011). In *American Needle*, the Supreme Court held that the National Football League was not a single enterprise for antitrust purposes regarding certain licensing activities. *Id.* at 186.

Thus, while certainly authority exists to support the argument that franchisors cannot conspire with their franchisees in violation of Section 1, the defense may not be successful in every case. And as noted, developing that defense may create evidence or admissions that could be used to support a joint employer argument that could create legal risks for franchisors in other contexts.

Potential Joint Employer Liability

There are numerous laws that recognize that an employee can be simultaneously employed by more than one employer. This is referred to as joint or co-employment. If a franchisor is found to be the joint employer of the employees of its franchisee, it could be exposed to liability for, among other things: benefits under the franchisor's benefit plans; Occupational Safety and Health Act ("OSHA") violations; violations of the National Labor Relations Act ("NLRA"); violations of the Fair Labor Standards Act ("FLSA"); violations of state and federal employment practices statutes; and violations of numerous state laws, depending upon the state.

Franchisors have had notable success in defeating claims that they are a joint employer of their franchisees' employees. For example, in *Pope v. Espeseth, Inc.,* 228 F. Supp. 3d 884, 889-91 (W.D. Wis. 2017), the court held that the franchisor was not a joint employer of the franchisees' employees under the FLSA. The court found, among other things, that the franchisor did not exercise control over the franchisees' employees' working conditions. *See also Ochoa v. McDonald's Corp.,* 133 F. Supp.

3d 1228, 1235-38 (N.D. Cal. 2015) (franchisor was not joint employer of franchisees' employees because, among other things, it did not exercise requisite control of their wages, hours or working conditions).

But it is difficult to predict whether a joint employer relationship exists. First, the tests vary depending upon the law or statute at issue. *Compare Hy-Brand Industrial Contractors, Ltd.,* 365 NLRB No. 156, slip op. at 6 (Dec. 14, 2017), *vacated on other grounds by Hy-Brand Industrial Contractors, Ltd.,* 366 NLRB No. 26 (Feb. 26, 2018) (applying common law agency principles) with *Barfield v. New York City Health and Hospitals,* 537 F.3d 132, 141-43 (2d Cir. 2008) (applying an economic realities test under the FLSA). And even under the same law, the courts sometimes apply different tests depending upon the jurisdiction. *See Hall v. DirecTV, LLC,* 846 F.3d 757, 766 (4th Cir. 2017) (noting that "courts in various jurisdictions within this Circuit and throughout the country [apply] numerous, distinct, multifactor joint employment tests" under the FLSA). Likewise, even under the NLRA, the law has fluctuated between a direct and indirect control test. *See Hy-Brand Industrial Contractors,* Ltd., 365 NLRB No. 156, slip op. at 1-8 (Feb. 26, 2018).

The joint employer tests are also ambiguous. Most of the tests require consideration of multiple factors, no one of which is controlling, and require the decision-maker to consider the "totality of circumstances." *See, e.g., Barfield,* 537 F.3d at 141-42 (noting that the FLSA multifactor test considers the totality of the circumstances). The courts recognize that this is an inherently ambiguous test that at times leads to arbitrary results. *See Salinas v. Commercial Interiors, Inc.*, 848 F.3d at 137 ("[L]ike other open-ended balancing tests," this universe of nebulous factors test has "yield[ed] unpredictable and at times arbitrary results") (internal citations and quotations omitted).

But in all of these multifactor tests, one of the factors considered is whether the potential joint employer has the right to, or exercises, "control." *See, e.g., Hy-Brand Industrial Contractors, Ltd.,* 365 NLRB 156, slip op. at 35 ("requires proof that the alleged joint-employer entities have actually *exercised* joint control over essential employment terms") (emphasis in original); *Zheng v Liberty Apparel Co.,* 355 F.3d 61, 72 (2d Cir. 2003) (listing factors to consider to ascertain whether alleged joint employer has "functional control over workers" for purposes of the FLSA).

Certainly, the case can be made that the control necessary to establish the single enterprise defense is not the type of control necessary to support a joint employer finding. For example, a parent-subsidiary relationship is sufficient to establish the single enterprise defense, *see, e.g., Copperweld, 467 U.S.* at 777, but insufficient to show a joint employer relationship, *see Anwar v. Dow Chemical Co.,* 876 F.3d 841, 852-53 (6th Cir. 2017) (parent company not joint employer of subsidiary's employees). To establish the single enterprise defense in the franchise context, the franchisor will have to show that it has substantial control over the franchisees' operations. For example, in *Williams*, the court found that the franchisor exercised "almost complete control" over all decisions affecting the operation of the restaurants. 794 F. Supp. at 1032. Whether a franchisor can make a similar showing without creating evidence of joint employment is not risk free.

Other Defenses To The Antitrust No-Hire Claims May Be Strong

Normally, an agreement will violate Section 1 of the Sherman Act only if it has an unreasonably adverse effect on competition. The so-called "rule of reason" standard requires courts, in most cases, to analyze the effect of the agreement on competition in a relevant market and determine whether its anticompetitive effects outweigh its procompetitive benefits in that market. *See generally Atlantic Richfield Co. v. U.S.A. Petroleum Co.,* 495 U.S. 328, 342 (1990). Judicial experience with certain types of agreements, however, has demonstrated that such agreements are so plainly or manifestly anticompetitive that no elaborate study is necessary. Such agreements are conclusively presumed to be unreasonable and are deemed unlawful per se. *See, e.g., Business Electronics Corp. v. Sharp Electronics, Corp.,* 485 U.S. 717, 723-24 (1988).

Rule Of Reason Analysis Should Apply

The rule of reason should apply in determining the antitrust legality of no-hire agreements in the franchise setting. First, the restraint is not naked but rather ancillary to the franchise agreement. In *Williams*, the agreement's purpose was to prevent raiding after time and expense had been invested in training. 794 F. Supp. at 1092. Ancillary restraints are judged under the rule of reason. *See generally Eichorn v. AT&T Corp.*, 248 F.3d 131, 142-46 (3d Cir. 2001) (ancillary agreements are judged

under the rule of reason).

Second, since the agreements are limited to a single brand, they should be viewed as an intrabrand restraint imposed vertically by the franchisor to encourage training by franchisees to assist in competing against other franchise brands. Interbrand, as opposed to intrabrand, competition is "the primary concern of antitrust law." *Continental T.V. v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.19 (1977). And nonprice vertical restraints that impose limitations on intrabrand competition are normally judged under the rule of reason. *See generally* ABA Section of Antitrust Law, Antitrust Law Developments, 152-57 (8th ed. 2017) ("Developments"); *see also Bogan v. Hodgkins,* 166 F.3d 509, 515 (2d Cir. 1999) (refusing to apply *per se* rule to antitrust challenge to no-switching agreement).

Individual Franchisors Do Not Have the Power To Suppress Wages In The Market For Restaurant Manager Jobs

Under the rule of reason, courts usually require "proof of a defendant's market power as a prerequisite for a plaintiff seeking to satisfy its burden of proving likely anticompetitive effect." Developments at 71. Market power is defined as the ability to raise prices above those that would be charged in a competitive market. *Id.* at 70-71. In the wage suppression context, that translates into the capability of a defendant to lower wages below those that would be paid in a competitive market. Courts rarely find that market power exists if a defendant's market share is under 30 percent. *Id.* at 71.

To prove that a defendant has market power, the plaintiff must normally establish a relevant market, both in terms of the product involved and the geographic scope. The product market must include all products that are reasonably interchangeable. *See generally id.* at 583-88. Significantly, "relevant markets generally cannot be limited to a single manufacturer's products." *Id.* at 591. In the franchise no-hire cases, that means that the product market must include jobs provided by all employers who offer positions that are reasonable substitutes for one another.

The plaintiffs in the pending franchise no-hire cases claim that specialized training renders jobs at other franchises unreasonable substitutes. *E.g., Ion v. Pizza Hut, LLC,* Case No. 4:17-cv-00788, Complaint at ¶¶ 80-81, available at https://www.classaction.org/media/ion-v-pizza-hut-llc.pdf (last visited on 4/10/2018). Thus, the plaintiffs are necessarily contending that the relevant product market is limited only to jobs at the defendant franchisor's franchisees. But to accept this argument the court would have to adopt the disfavored single brand market, and plaintiffs have failed to prevail on similar arguments in at least three other no-hire cases. *See Eichorn*, 248 F.3d at 148 (rejecting argument that relevant market was limited to jobs at AT&T and its affiliates); *Bogan*, 166 F.3d at 516 (affirming summary judgment in a no-switching agreement case because plaintiffs were unable to show that the "specialized training and expertise" was sufficient to create an antitrust submarket consisting of agent positions provided by a single insurance company); *In re: Compensation of Managerial & Technical Employees Antitrust Litigation* ("*CMT*"), No. 02-CV-2924 (GEB), 2008 U.S. Dist. LEXIS 63633 at *29-31 (D.N.J. Aug. 20, 2008) (granting summary judgment to defendants because plaintiffs had not shown that the relevant market was limited to jobs in the oil and petrochemical industry).

It is also highly unlikely that a plaintiff can show that any single franchisor possesses market power (*i.e.*, the ability to suppress wages) in the market for supervisor jobs, or even for manager or supervisor positions limited to such establishments. Certainly, no franchisor possesses 30 percent or more of either of those markets.

Plaintiffs may try to avoid this outcome by arguing that they can demonstrate actual anticompetitive effects resulting from the no-hire agreements with direct evidence, making a showing of market power unnecessary. *See generally* Developments at 68-70 (noting that some cases have acknowledged that proof of actual competitive harm can obviate the need to show market power even when restraints are not naked restrictions on price or output). But such a showing is difficult to make and has been rejected in at least one wage suppression case involving the exchange of wage information because the plaintiffs were unable to show that the relevant market was limited to jobs in the oil and petrochemical industry. *See CMT,* 2008 U.S. Dist. LEXIS 63633 at *23-26; *see also* Developments at 68-70 ("attempts to prove substantial, actual anticompetitive effects have often been unsuccessful," citing cases).

For these reasons, franchisors have very strong arguments that no-hire agreements limited to their own franchisees that are limited in duration and designed to create incentives for franchisees to provide training do not violate the antitrust laws. Thus, franchisor defendants in these cases should carefully consider whether it is necessary to pursue the single enterprise defense

and risk creating evidence that could support a joint employer argument in other contexts.

Conclusion

While each case will turn on its own facts, franchisors may have strong defenses available to them to resist antitrust challenges to their no-hire agreements. One of those defenses is the single enterprise defense, but pursuing that defense may create evidence that could be used against the franchisor in a subsequent joint employer claim. And, it is difficult to predict the potential adverse effects of creating that evidence given the current ambiguity and evolving nature of the joint employer doctrine. Thus, before raising the single enterprise defense, franchisors should carefully analyze the strength of that and other available defenses to the no-hire claim and weigh that against the risk of a joint employer claim.

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