States Look for New Angle to Fight No-Poach Agreements

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Attorneys general in ten states and the District of Columbia have recently launched an investigation into the employment practices of eight fast-food franchises. The group sent a joint letter to the companies requesting information on the companies' use of restrictive covenants including "'employee non-competition,' 'no solicitation,' 'no poach,' 'no hire,' or 'no switching' agreements (collectively referred to as 'No Poach Agreements')."

In October 2016, the White House issued a Call to Action to have these issues addressed. Last week's investigation announcement is just the latest effort in a series of actions at the state level to provide increased scrutiny towards restrictive covenants. It also consistent with previous enforcement efforts by attorneys general limiting the enforcement of restrictive covenants against low wage workers.

The "no-poach" agreements utilized by these companies may be of particular concern. These agreements typically involve two employers agreeing not hire each other's employees. In the franchise context, such a clause is often contained in the franchise agreement between the franchisee and the franchisor. The franchisee agrees not to hire employees (typically management) from other locations in that franchise.

Employers like to use no-poach agreements because they help retain talent and protect investments that employers make in personnel. For instance, employers invest time and resources into training to ensure that employees have the requisite skills to successfully deliver products or services to consumers. As the joint letter illustrates, however, opponents actually believe that no-poach agreements are harmful to the economy because they limit potential job opportunities and the earning potential of low-wage workers.

Employers should also be mindful of the federal antitrust concerns created by no-poach agreements; specifically, the Sherman Act prohibits entities from entering into agreements that unreasonably restrain trade. The U.S Department of Justice (USDOJ) has taken the position that "naked" no-poaching agreements (i.e. agreements separate from, or not reasonably necessary to, a larger legitimate collaboration or agreement between employers) are unlawful. These agreements are unlawful whether entered into directly or through a third-party intermediary. Indeed, the agreements can give rise to criminal liability, and have been a recent area of emphasis by the USDOJ. It has already brought enforcement actions against several large U.S. companies and has a number of ongoing investigations.

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No-poach agreements may be permissible if ancillary to a joint venture, business collaboration, or settlement of litigation. To withstand scrutiny as part of a larger transaction, the restriction must be reasonably necessary for the underlying transaction and narrowly tailored both in scope and duration. When assessing these agreements, the USDOJ has historically applied the "rule of reason," which is a balancing test that weighs the anti-competitive effects against the pro-competitive benefits.

With the recent rise in interest and increasing scrutiny of restrictive covenants, and in particular no-poach agreements, you need to be mindful of the types of provisions you are including in your agreements. Your agreements should be narrowly tailored to protect your legitimate business interests. No-poach agreements should be limited in scope and duration, and if no-hire provisions are included, they should be limited to upper-level management. State-level scrutiny from legislators and attorneys general is not going away and likely to only increase.