No-Hire Clauses—Ancillary Restraints for Protection of Brand Goodwill

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No-hire clauses in franchise agreements, often referred to as no-poaching clauses, are the subject of class actions directed against a number of franchise systems, from McDonald's, to Papa John's Pizza, to Jiffy Lube. Long in common use within the franchise industry, no-hire clauses prohibit a franchisee from soliciting or hiring employees (a) of another franchisee or (b) from a restaurant or store operated by the franchisor. Plaintiffs, who are current or former franchisee employees, claim in a series of recent lawsuits that enforcement of the clauses violates Section 1 of the Sherman Act. This article shows that the clauses, while incrementally limiting employee mobility, serve significant procompetitive purposes and that courts have been unwarrantedly indulgent in denying motions to dismiss. As restraints ancillary to business format franchise agreements, no-hire clauses prevent franchisee free riding and are reasonably necessary for achievement of the objectives of the franchise agreement, including protection of brand goodwill for the collective benefit of independent businesses operating under a common trademark.

The recent frontal assault on no-hire clauses in franchise agreements may advance state or federal labor policy, but it has no support in antitrust law. The absence of an antitrust predicate would not matter, except for the

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awkward fact that all federal court litigation challenging no-hire clauses to date stands on claimed violations of Section 1 of the Sherman Act.[1] A franchisee's promise not to hire employees from the franchisor or from franchisees operating under the franchisor's trademark does not violate Section 1 when the statute is properly applied. It is not per se illegal as the product of a conspiracy among franchisees, and it is not a violation under the rule of reason, whether using truncated or full analysis.

This article will show that courts have failed to address the unique context in which no-hire clauses arise—the business format franchise—and that, when correctly analyzed, a no-hire clause is valid and enforceable against the franchisee as a restraint ancillary to the franchise agreement, the core component of which is a trademark license.

In a product franchise or conventional dealership or distributorship, the trademark licensee is engaged in reselling a product manufactured by the owner of the trademark, and quality is under the direct control of the manufacturer. In a business format franchise, in contrast, goodwill associated with the franchisor's trademark is created by independent businesses selling goods or services under the franchisor's mark. The difference is crucial, because it means that the business format franchisor must regulate all aspects of a franchisee's operation to ensure sale of goods or services of uniform quality from one retail outlet to the next. The no-hire clause guards against franchisee free riding that could otherwise vitiate brand goodwill.

This article examines the no-hire clause which is the subject of all of the reported cases—a promise by the franchisee that it will not, during the term of the franchise, hire or solicit for employment an employee of the franchisor or another franchisee.[2] The clause previously found in the McDonald's standard franchise agreement is representative:

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1. 15 U.S.C. § 1. Section 1 declares illegal "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations . . . . "

2. For reported cases, see Arrington v. Burger King Worldwide, Inc., 448 F. Supp. 3d 1322, 1326-27 (S.D. Fla. 2020) (franchisee shall not induce a franchisor employee or an employee of another franchisee to leave employment and shall not employ any such person for six months after he or she has left such employment); Ogden v. Little Caesar Enters., 393 F. Supp. 3d 622, 628 (E.D. Mich. 2019) (franchise shall not employ or seek to employ any person in a managerial capacity who in the last six months has been employed by franchisor or another franchisee); Fuentes v. Royal Dutch Shell PLC, No. 18-5174, 2019 U.S. Dist. LEXIS 224708, at *2 (E.D. Pa. Nov. 25, 2019) (franchisee shall not hire another Jiffy Lube franchisee's employee); Robinson v. Jackson Hewitt, Inc., No. 19-9066 (SDW) (LDW), 2019 U.S. Dist. LEXIS 188962, at *3 (D.N.J. Oct. 31, 2019) (franchisee shall not during the term of the franchise agreement and for two years thereafter solicit for employment or hire any person who in the immediate past year was employed by franchisor or another franchisee); *In re* Papa John's Emp. & Franchisee Emp. Antitrust Litig., No. 3:18-CV-00825-JHM, 2019 WL 5386484, at *1 (W.D. Ky. Oct. 21, 2019) (franchisee shall not employ during the term of the franchise agreement or for one year thereafter any person employed by franchisor or another franchisee); Blanton v. Domino's Pizza Franchising LLC, No. 18-13207, 2019 U.S. Dist. LEXIS 87737, at *3 (E.D. Mich. May 24, 2019) (franchisee shall not solicit or employ any person who is employed by franchisor or another franchisee); Butler v. Jimmy John's Franchise, LLC, 331 F. Supp.3d 786, 790 (S.D. Ill. 2018) (franchisee may not solicit for employment or hire a person who has been employed in the last twelve months by franchisor or another franchisee); Yi v. SK Bakeries, LLC, No.

> *Interference With Employment Relations of Others.* During the term of this Franchise, Franchisee shall not employ or seek to employ any person who is at the time employed by McDonalds, any of its subsidiaries, or by any person who is at the time operating a McDonald's restaurant or otherwise induce, directly or indirectly, such person 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.[3]

To the extent the clause bars franchisee solicitation or employment of the franchisor's employees, it is assumed that the goal is the same as it is for franchisee employees—to prevent a franchisee from hiring operating personnel away from other store locations in the franchise, whether franchisor-owned or franchisee-owned.[4]

Courts have so far failed to recognize that such restraints have no exact counterpart in case law addressing either vertical or horizontal restraints, and, before the current litigation, no federal court had ever considered the competitive effects under Section 1 of a no-hire clause in a franchise agreement.[5] In the total absence of any judicial experience, the legality of the clause must be evaluated under the rule of reason. For simplicity, this article assumes that the agreement between a franchisor and its franchisee satisfies the joint conduct requirement of Section 1.[6]

This article will outline in Part I the use of the Sherman Act to challenge restraints on employee hiring, leading up to the present class-action litigation. In Part II, it will describe the business format franchise and explain why no-hire clauses must be understood as restraints ancillary to trademark license agreements. Part III will show why the restraints are not per se

18-5627 RJB, 2018 U.S. Dist. LEXIS 220966, at *3 (W.D. Wash. Nov. 13, 2018) (franchisee shall not employ or seek to employ any person who is employed by franchisor (Cinnabon) or another franchisee); Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2018 U.S. Dist. LEXIS 105260, at *5 (N.D. Ill. June 25, 2018) (franchisee shall not employ or seek to employ any person who has been employed in the last six months by franchisor or another franchisee).

3. *Deslandes*, 2018 U.S. Dist. LEXIS 105260, at *5 (italics in original). McDonald's discontinued use of the clause in 2017, but it remains in franchise agreements applicable to some 13,000 McDonald's brand restaurants. *Id.*

4. This article does not consider the antitrust implications of a provision, appearing in the Jimmy John's franchise agreement, making franchisees third-party beneficiaries of a no-hire clause and giving them an independent right to enforce it against other franchisees. *See Butler*, 331 F. Supp. 3d at 790.

5. The legality of a no-switching clause, as it was called, in a Jack-in-the-Box franchise agreement was at issue in *Williams v. I.B. Fischer Nevada*, 794 F. Supp. 1026 (D. Nev. 1992), *aff'd*, 999 F.2d 445 (9th Cir. 1993), a case brought by an employee seeking to move from one franchisee to another in the Jack-in-the-Box system. Holding that the franchisor and employee's franchisee were part of a unitary economic enterprise and, as such, could not conspire for purposes of § 1 of the Sherman Act, the court had no need to consider whether the no-switching clause violated § 1. *See id.* at 1331–32.

6. In *Arrington v. Burger King Worldwide, Inc.*, 448 F. Supp. 3d 1322, 1332 (S.D. Fla. 2020), *appeal pending*, No. 20-13561 (11th Cir.), the court held that a franchise is a unitary enterprise and that a franchisor and its franchisees are therefore incapable of conspiring for purposes of § 1. Relying on *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752 (1984), the court held that plaintiffs had failed to state a claim that Burger King Corporation had conspired with its franchisees to prevent them from hiring employees of it or of other franchisees in violation of § 1. *Arrington*, 448 F. Supp. 3d at 1332.

unlawful under Section 1, and Part IV will explain why they do not violate Section 1 under the rule of reason. Finally, Part V demonstrates why a truncated rule-of-reason analysis cannot be used.

I. Labor Market Antitrust—Litigation and Enforcement Landscape

Antitrust law has a role to play in labor markets, and the normal rules apply. Employees have invoked Section 1 in repeated challenges to enforcement of noncompetition covenants. These challenges have been futile, however, because the legality of the covenants is tested under the rule of reason.[7] As restraints ancillary to employment contracts, noncompetition covenants have no market effects. No matter how the relevant market is defined, a restraint impacting only a single employee has no anticompetitive effect on any market (other than the employee's own personal market).[8]

The situation changes dramatically when an agreement between two employers is the subject of a Section 1 challenge. A firm's promise that it will not solicit or hire a competitor's employees is a horizontal market allocation,[9] and a division of markets between competitors is presumptively illegal unless in furtherance of a joint venture or other procompetitive integration.[10] The Department of Justice (DOJ), beginning in 2010, initiated a series of civil

7. *See*, *e.g.*, Bradford v. N.Y. Times Co., 501 F.2d 51, 60 (2d Cir. 1974) (rejecting per se illegality under § 1 and holding that "rule of reason considerations continue to apply" to employee noncompetition covenants).

8. *See*, *e.g.*, Lektro-Vend Corp. v. Vendo Co., 660 F.2d 255, 269 (7th Cir. 1981) (holding that former employee had to prove more "than mere injury to a competitor" to establish that enforcement of noncompetition covenant had an adverse effect on a relevant market); Coleman v. Gen. Elec. Co., 643 F. Supp. 1229, 1243 (E.D. Tenn. 1986) (holding that covenant incident to sale of business division barring seller from soliciting division employees did not violate rule of reason, because "there is no more than a de minimis impact on the employment market and the anti-competitive impact, if any, is incidental to the effective transition of ownership from 3M to GE"), *aff'd per curiam*, 822 F.2d 59 (6th Cir. 1987). The fact that enforcement of an employee noncompetition covenant can have no measurable market impact means, in the blunt assessment of one recent commentator, that "antitrust law is a nullity for employment noncompetes." Eric A. Posner, *The Antitrust Challenge to Covenants not to Compete in Employment Contracts*, 83 Antitrust L.J. 165, 175 (2020).

9. *See*, *e.g.*, Markson v. CRST Int'l, Inc., No. 5:17-cv-01261-SB-SP, 2021 U.S. Dist. LEXIS 60368, at *13–14 (C.D. Cal. Feb. 10, 2021) (holding that agreement among rivals to divide markets by not hiring each's employees was a per se violation of § 1); *In re* Ry. Indus. Emp. No-Poach Antitrust Litig., 395 F. Supp. 3d 464, 480–85 (W.D. Pa. 2019) (holding that no-hire agreements among competitors constituted a market allocation that may be per se illegal under § 1 and collecting cases on same); United States v. Kemp & Assocs., No. 2:16CR403 DS, 2019 U.S. Dist. LEXIS 28231, at *6–9 (D. Utah Feb. 21, 2019) (holding that customer allocation agreement between competitors was per se illegal under § 1); United States v. eBay, Inc., 968 F. Supp. 2d 1030, 1038–40 (N.D. Cal. 2013) (acknowledging that no-hire agreement between defendants was a market allocation, but deferring until completion of discovery any ruling as to whether it should be deemed per se illegal under § 1).

10. *See*, *e.g.*, Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 229 (D.C. Cir. 1986) ("[A] naked horizontal restraint, one that does not accompany a contract integration, can have no purpose other than restricting output and raising prices, and so is illegal per se; an ancillary horizontal restraint, one that is part of an integration of economic activities of the a parties and appears capable of enhancing the group's efficiency, is to be judged according to its purpose and effect.").

enforcement actions against technology companies challenging such no-hire agreements.[11] In conjunction with the Federal Trade Commission (FTC), the DOJ released in October 2016 a guide on enforcement policy on hiring agreements between rivals,[12] announcing that it would proceed criminally against parties to such agreements, which it deems per se illegal.[13] No such agreements between competing employers are at issue in the franchise litigation that is the subject of this article.

Economic reports on the impact of noncompetition agreements on wages and mobility of hourly workers brought attention to the use of no-hire clauses in franchise agreements,[14] and enforcement initiatives were launched against the franchising industry by early 2018. The Attorney General for the State of Washington began a program in early 2018 "to eliminate no-poach clauses in franchise agreements nationwide,"[15] and it had concluded commitments with over 225 franchisors by early 2020.[16] Other attorneys general subsequently initiated separate investigations into the use of no-hire clauses by franchisors.[17]

No-hire clauses in franchise agreements attracted the interest of Senators Cory Booker and Elizabeth Warren in the U.S. Senate at about the same time, and they sent letters in July 2018 to some ninety franchisors requesting information about their use of "no-poach clauses" in franchise

11. *See* Press Release, U. S. Dep't of Justice, Justice Department Requires Six High Tech Companies to Stop Entering into Anticompetitive Employee Solicitation Agreements (Sept. 24, 2010) (announcing consent decree with Adobe Systems Inc., Apple Inc., Google Inc., Intel Corp., Intuit Inc., and Pixar), https://www.justice.gov/opa/pr/justice-department-requires-six-high-tech-companies-stop-entering-anticompetitive-employee; U.S. Dep't of Justice, Press Release, Justice Department Requires Lucasfilm to Stop Entering into Anticompetitive Employee Solicitation Agreements (Dec. 21, 2010) (announcing consent decree with Lucasfilm Ltd. to discontinue agreement with Pixar not to cold call each other's employees), https://www.justice.gov/opa/pr/justice-department-requires-lucasfilm-stop-entering-anticompetitive-employee-solicitation. The Department of Justice filed an action against eBay, Inc. in 2012 challenging its agreement with Intuit not to hire each other's employees. *See eBay, Inc.*, 968 F. Supp. 2d at 1034.

12. U. S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Guidance for Human Resource Professionals (Oct. 2016), https://www.justice.gov/atr/file/903511/download [hereinafter Antitrust Guidance].

13. *Id.* at 3–4.

14. *See, e.g.*, Council of Econ. Advisors, Labor Market Monopsony: Trends, Consequences, and Policy Responses (Oct. 2016), https://obamawhitehouse.archives.gov/sites/default/files/page/files/20161025_monoposony_labor_mrkt_cea.pdf. For an influential study of the franchise industry, see Alan B. Krueger & Orley Ashenfelter, *Theory and Evidence on Employer Collusion in the Franchise Sector* (Princeton Univ., Indus. Relations Section, Working Paper No. 614, 2017), https://dataspace.princeton.edu/bitstream/88435/dsp014fl6c547g/3/614.pdf. For an overview of empirical studies and economic analyses of restraints on employee mobility, see generally Ioana Marinescu & Eric A. Posner, *Why Has Antitrust Law Failed Workers?* 105 Cornell L. Rev. 1343, 1349–62 (2020).

15. *See* Attorney Gen. of Wash., Labor and Antitrust (2021), https://www.atg.wa.gov/print/13119.

16. *Id.*

17. *See* John M. Piper & Erik Ruda, *Employee "No-Poaching" Clauses in Franchise Agreements: An Assessment in Light of Recent Developments*, 38 Franchise L.J. 185, 201 (2018).

agreements.[18] Referencing the FTC/DOJ's *Antitrust Guidance for Human Resource Professionals*,[19] the senators made no distinction between competitor no-hire agreements and no-hire clauses in franchise agreements. They urged the addressees to remove no-hire clauses from franchise agreements because doing so would, in their words, "rectify a violation of federal antitrust law" and increase employee wages. In his July 9, 2021, executive order on promoting competition, President Biden directed the Chair of the FTC to consider working with the rest of the Commission to exercise its rulemaking authority "to curtail the unfair use of non-compete clauses . . . that may unfairly limit worker mobility."[20]

The first federal court employee class action alleging Sherman Act violations by franchisors was filed in June 2017.[21] Despite subsequent discontinuance of the use of no-hire clauses by major franchisors, either as a result of settlements with state attorneys general or voluntarily, litigation has continued, as plaintiffs seek damages for past conduct.[22] District courts have denied motions for class certification in two of the actions[23] and, in the process, have begun to clear away some of the errors embedded in earlier orders denying motions to dismiss. Most of the cases remain active, however, and appeals from district court judgments are a certainty.

II. Architecture of the Business Format Franchise

Courts have struggled with how to evaluate claims that no-hire clauses violate Section 1 and, in the process, have largely ignored the commercial context in which they are used. Without exception, the cases challenge no-hire clauses in business format franchises, and this context matters. A business format franchise agreement imposes an array of obligations calculated to advance and protect the goodwill of the franchisor's trademark, and the success of the entire franchise system depends upon the reputation of the brand.

18. The form of letter can be found on Senator Elizabeth Warren's website, https://www.warren.senate.gov/imo/media/doc/No%20poach%20letter%20generic.pdf.

19. Antitrust Guidance, *supra* note 12.

20. Exec. Order No. 14036, 86 C.F.R. 36987 (July 9, 2021).

21. Deslandes v. McDonald's USA, LLC, No. 17 C 4857 (N.D. Ill. June 28, 2017). For a chronology of enforcement actions and litigation, see generally Brian Forgas & Rahul Rao, *Anti-Poaching Issues in Franchising*, Am. Bar Ass'n, 42nd Annual Forum on Franchising, W-18, at 9–12 (Oct. 2019).

22. McDonald's USA, LLC, for example, agreed with the State of Washington in an Assurance of Discontinuance filed in King County, Washington Superior Court on July 12, 2018, that it would not enforce the no-hire clause, Paragraph 14 in its standard-form franchise agreement, in any of its existing franchise agreements nationwide (Assurance §3.1.2) and that it would not include any such provision in any future franchise agreement nationwide (Assurance § 3.1.1). *See In re:* Franchise No Poaching Provisions, McDonald's USA, LLC Assurance of Discontinuance, No. 18-2-17229-2 SEA (Wash. Super. Ct. July 12, 2018), https://agportal-s3bucket.s3.amazonaws.com/uploadedfiles/Another/News/Press_Releases/20180712_McDonalds_SignedFiled_AOD%20%281%29.pdf.

23. *See* Conrad v. Jimmy John's Franchise, LLC, No. 18-CV-00133-NJR, 2021 U.S. Dist. LEXIS 142272 (S.D. Ill. July 23, 2021); Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2021 U.S. Dist. LEXIS 140735 (N.D. Ill. July 28, 2021).

In return for the grant of a trademark license and participation in the franchise, the licensee must conform its conduct to the franchisor's requirements for use of the mark, one of which is compliance with a no-hire clause.

Plaintiffs have alleged that inclusion of a no-hire clause in a franchise agreement is either per se illegal or facially illegal when evaluated using a quick-look analysis under the rule of reason, or both.[24] In two cases, plaintiffs have also alleged a violation of Section 1 under the rule of reason.[25] In every case, plaintiffs are employees of franchisees who have never themselves been party to a franchise agreement.

Most courts have deferred deciding on the correct Section 1 test until discovery has been concluded. In the process of postponing any determination, they have offered views, however, as to whether the per se rule should apply or whether no-hire clauses can be invalidated using a truncated rule of reason. Judicial analysis has fixated on labels—i.e., whether a franchise agreement with a no-hire clause is a "vertical" agreement or whether no-hire clauses are the product of a "horizontal" agreement between franchisees.[26] They are neither. Until courts recognize that no-hire clauses are restraints ancillary to license agreements establishing business format franchises, to which the label "horizontal" has no application and the adjective "vertical" is misplaced, proper Section 1 analysis is impossible. This issue is unexamined antitrust terrain.

Applying conventional vertical/horizontal taxonomy to weigh the competitive effects of no-hire clauses leads to an analytical dead end. Rule of reason treatment for "vertical" restraints has emerged out of dealer litigation involving restraints on how, where, and to whom a downstream buyer can resell goods.[27] There is no vertical relationship in this sense, however,

24. *See* Ogden v. Little Caesar Enters., 393 F. Supp. 3d 622, 631–36 (E.D. Mich. 2019) (granting motion to dismiss complaint for failure to state a claim for violation of § 1 under either per se rule or quick-look rule of reason); Blanton v. Domino's Pizza Franchising LLC, No. 18-13207, 2019 U.S. Dist. LEXIS 87737, at *12–13 (E.D. Mich. May 24, 2019) (holding that complaint stated claim for violation of § 1 under per se rule and quick-look rule of reason); Butler v. Jimmy John's Franchise, LLC, 331 F. Supp. 3d 786, 795–97 (S.D. Ill. 2018) (same); Yi v. SK Bakeries, LLC, No. 18-5627 RJB, 2018 U.S. Dist. LEXIS 220966, at *14–15 (W.D. Wash. Nov. 13, 2018) (holding that complaint stated claim for violation of § 1 under quick-look rule of reason; motion to dismiss granted as to per se claim); Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2018 U.S. Dist. LEXIS 105260, at *20–23 (N.D. Ill. June 25, 2018) (same).

25. *See* Robinson v. Jackson Hewitt, Inc., No. 19-9066 (SDW) (LDW), 2019 U.S. Dist. LEXIS 188962, at *16 (D.N.J. Oct. 31, 2019); *In re* Papa John's Emp. & Franchisee Emp. Antitrust Litig., No. 3:18-CV-00825-JHM, 2019 WL 5386484, at *8 (W.D. Ky. Oct. 21, 2019).

26. *See*, *e.g.*, *Deslandes*, 2018 U.S. Dist. LEXIS 105260, at *15–16 ("The Court agrees that the restraint [in the McDonald's franchise agreement] has vertical elements, but the agreement is also a horizontal restraint.").

27. *See*, *e.g.*, Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 907 (2007) (holding that vertical price restraints are subject to rule of reason, in case involving restrictions on resale of women's fashion accessories); NYNEX Corp. v. Discon, Inc., 525 U.S. 128, 136 (1998) ("[T]he case before us concerns only a vertical agreement and a vertical restraint, a restraint that takes the form of depriving a supplier of a potential customer," in a case involving providing removal services for obsolete telephone equipment); State Oil Co. v. Khan, 522 U.S. 3, 22 (1997) (holding that vertical maximum price fixing is subject to the rule of reason, in case involving retail sale of gasoline); Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 735–36

between a franchisor and franchisee because, in a business format franchise, the franchisor is not selling goods to a franchisee for resale. The franchisee makes the first sale of the trademarked goods or services, selling to the ultimate consumer. A business format franchise agreement creates a licensor-licensee relationship, not a buy-sell relationship in which the parties' respective rights and duties are subject to the Uniform Commercial Code.[28] Trademarked goods in a business format franchise do not originate with the franchisor; they are produced by the franchisee.

Calling restraints incident to a trademark license "vertical" does not, thus, align with use of the term *vertical* in the case law. In the case law, vertical restraints are those imposed by agreement between firms at different levels of distribution,[29] and they promote interbrand competition except in the rare case where they serve to further entrench a firm with market power.[30]

(1988) (holding that termination of dealer agreement for electronic calculators was subject to evaluation under rule of reason in absence of proof that it was pursuant to a price-fixing agreement between manufacturer and competing dealer); Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 46, 59 (1977) (holding that restraint on location from which a dealer could resell television sets was subject to the rule of reason and noting that such restrictions, identical to that which the Court had earlier held per se illegal in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), "allowed Schwinn and Sylvania to regulate the amount of competition among their retailers by preventing a franchisee from selling franchised products from outlets other than the one covered by the franchise agreement"); White Motor Co. v. United States, 372 U.S.253, 263–64 (1963) (reversing summary judgment for the government on claim that vertical territorial restraints imposed by truck manufacturer on its dealers were per se illegal and noting that "[w]e need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a 'pernicious effect on competition and lack . . . any redeeming virtue' . . . and therefore should be classified as *per se* violations of the Sherman Act." (citation omitted; italics in original)). Confinement of "vertical" terminology to the product distribution context, in which a manufacturer or other supplier sells goods to a dealer or distributor for resale, is evident in the commentary, as well. *See, e.g.*, Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L. J. 135 (1984) (proposing filters for rule of reason analysis of restricted distribution practices); Herbert J. Hovenkamp, *The Rule of Reason*, 70 Fla. L. Rev. 81, 161 (2018) ("Vertical nonprice restraints generally involve such things as assignment of dealer locations or territories and rules forbidding these dealers from making sales outside their appointed area. . . . Vertical nonprice restraints have been addressed under the rule of reason for most of the life of the antitrust laws.").

28. Under the great weight of authority, the relationship between a manufacturer and a dealership or distributorship is subject to Article 2 of the Uniform Commercial Code. *See, e.g.*, Specialty Beverages, L.L.C. v. Pabst Brewing Co., 537 F.3d 1165, 1173–74 (10th Cir. 2008) (holding that parties' rights under a beverage distributorship were subject, under Oklahoma law, to Article 2 governing transactions in goods and collecting cases supporting this conclusion); Sally Beauty Co. v. Nexxus Prods. Co., 801 F.2d 1001, 1005–06 (7th Cir. 1986) (holding that parties' rights under a distributor agreement for hair care products were subject, under Texas law, to Article 2 governing transactions in goods and collecting cases supporting this conclusion).

29. *E.g.*, Ohio v. Am. Express Co., 138 S. Ct. 2274, 2284 (2018) (vertical restraints are those "imposed by agreement between firms at different levels of distribution" (quoting Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 730 (1988))).

30. *See* Graphic Prods. Distribs. v. Itek Corp., 717 F.2d 1560, 1576–78 (11th Cir. 1983) (affirming judgment for terminated distributor claiming that manufacturer's imposition of exclusive territories violated § 1 under rule of reason where manufacturer controlled seventy percent of the national market for offset platemaking machines). In a survey of cases decided under the rule of reason between February 1999 and May 2009, many of which addressed vertical restraints, it was found that "plaintiffs almost never win" and that almost all cases were decided by finding that the plaintiff had failed to show any anticompetitive effect from the alleged restraint. *See*

Because vertical restraints are, in the usual case, intended to promote interbrand competition and have promotion of interbrand competition as their effect, they are subject to the rule of reason.[31]

Application of the "horizontal" label to licensing needed to create a business format franchise is similarly misplaced, because it obscures the fact that the franchisor determines the terms and content of a licensing agreement, not franchisees. Unless in furtherance of a legitimate joint venture or other procompetitive integration, restraints imposed by agreement between competitors—horizontal restraints—do not promote interbrand competition. They curtail it and are therefore per se illegal.[32] For the term *horizontal* to apply, there must be agreement between direct competitors on a restraint, and not even the most inventive drafters have alleged in any of the complaints that no-hire clauses are the product of a conspiracy among rival franchisees.[33]

To understand why conventional vertical/horizontal labeling fails to conform to the facts in the various cases, it is essential to examine the commercial context in which no-hire clauses are used (i.e., the business format franchise). The franchise systems at issue in the litigated cases are all business format franchises.[34] The business format franchise combines a trademark license with an array of goodwill protections intended to facilitate the success of a network of independent businesses operating under a single brand.

In a business format franchise, retail locations display uniform trade dress and signage, and all goods and services offered at the locations are associated exclusively with the franchisor's trademark. The FTC has described this type of franchise, which it called a "package franchise," as follows:

> In package franchising, the franchisee is licensed to do business under a prepackaged business format established by the franchisor and identified with the franchisor's trademark. While the franchisee is an independent businessman, *the franchisor usually controls the franchisee's method of operation to insure that the goods or services being sold meet the uniform quality standards imposed by the franchisor on all of its franchisees*. Additionally, the franchisor usually gives direct assistance to the franchisee in areas such as training, management technique, and promotional

Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 21 Geo. Mason L. Rev. 827, 829 (2009).

31. *E.g.*, *Cont'l T.V., Inc.*, 433 U.S. at 54 ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. . . . Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers.").

32. *E.g.*, Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 229 (D.C. Cir. 1986) ("[A] naked horizontal restraint, one that does not accompany a contract integration, can have no purpose other than restricting output and raising prices, and so is illegal per se . . . .").

33. Plaintiffs alleged in *Butler v. Jimmy John's Franchise, LLC*, 331 F. Supp. 3d 786, 795–96 (S.D. Ill. 2018), that Jimmy John's franchisees could, pursuant to the terms of the franchise agreement, enforce the no-hire clause against noncompliant franchisees and that there was, to this extent, tacit agreement among franchisees to enforce the clause. As indicated *supra* note 4, this provision is beyond the scope of this article.

34. Burger King, Cinnabon, Domino's Pizza, Jackson Hewitt, Jiffy Lube, Jimmy John's, Little Caesar, McDonald's, Papa John's.

> campaigns. The franchisee thus gets the benefit of the franchisor's established reputation, expertise, and superior resources; in return, he pays the franchisor for the privilege to operate the franchise.[35]

In a business format franchise, the franchisor sells a way of doing business to its franchisees.[36] The franchise includes "not only the product, service, and trademark, but the entire business format itself—a marketing strategy and plan, operating manuals and standards, quality control, and continuing two-way communication."[37] The franchise agreement creates an ongoing relationship between franchisor and franchisee regulating, among other matters, supplies, inspections, and quality standards in furtherance of maintaining the franchise's goodwill.[38]

The trademark is the "cornerstone" of a franchise system.[39] In licensing a trademark, the franchisor has a legal duty to maintain the goodwill inhering in it and to ensure the quality of goods or services associated with it.[40] Indeed, without effective control over licensee trademark use, the licensor may lose its exclusive rights in the mark.[41] The imperative for quality control was aptly explained nearly sixty years ago in an early business format franchise case, *Susser v. Carvel Corp.*:[42]

> . . . [A franchisor licensing a mark] must do so in a way that he maintains sufficient control over the nature and quality of the finished product, over the activities of the licensee, as will enable the licensor to sustain his original position of guarantor to the public that the goods now bearing the trademark are of the same nature and quality as were the goods bearing the trademark before the licensing, or, that the mark now has the same meaning as far as the public is concerned as it did before the licensing.[43]

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35. Fed. Trade Comm'n, Statement of Basis and Purpose Relating to Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 43 Fed. Reg. 59,613, 59,697 (Dec. 21, 1978) (footnotes omitted; emphasis added).

36. *See* Roger D. Blair & Francine Lafontaine, The Economics of Franchising 6 (2005).

37. *Id.* (citation omitted).

38. *See*, *e.g.*, Queen City Pizza v. Domino's Pizza, 124 F.3d 430, 440 (3d Cir. 1997) ("[A] franchise agreement regulating supplies, inspections, and quality standards structures an ongoing relationship between franchisor and franchisee designed to maintain good will.").

39. Susser v. Carvel Corp., 206 F. Supp. 636, 640 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964).

40. *See*, *e.g.*, Ky. Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 387 (5th Cir. 1977) ("Courts have long imposed upon trademark licensors a duty to oversee the quality of licensees' products. . . . The rationale for this requirement is that marks are treated by purchasers as an indication that the trademark owner is associated with the product. Customers rely upon the owner's reputation when they select the trademarked goods." (citation omitted)).

41. *See*, *e.g.*, Sheila's Shine Prods. v. Sheila Shine, Inc., 486 F.2d 114, 123–24 (5th Cir. 1973) ("The owner of a trademark has not only a right to license the use of his trademark to others, but also a concurrent duty to exercise control and supervision over the licensee's use of the mark . . . . Failure to exercise such control and supervision for a significant period of time may estop the trademark owner from challenging the use of the mark and business which the licensee has developed during the period of such unsupervised use.").

42. Susser v. Carvel Corp., 206 F. Supp. 636 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964).

43. *Id.* at 641 (quoting Morse-Starrett Prods. Co. v. Steccone, 86 F. Supp. 796, 805 (N.D. Cal. 1949)).

The strength and goodwill of a trademark provide a key inducement for a prospective franchisee to invest in a franchise, because, as a franchisee, the investor will "operate[] his outlet under a name that 'trades off' the franchisor's trademark."[44] A trademark license is an element of the definition of a franchise in the FTC's Franchise Rule,[45] and it is an element of the definition of a franchise in every state statute of general application regulating the sale, operation, or termination of franchises.[46]

The business format franchise is not the only type of franchise. The other major type is the product franchise, in which "the franchisor has already produced the goods and the franchisee merely provides an outlet for them."[47] Automobile and gasoline station dealerships are common examples of product franchises, and the franchisor "usually exercises significant control over the franchisee's operation to ensure proper marketing of the product, or gives the franchisee significant assistance in his business operation."[48] In the absence of such significant control or assistance, there is no franchise arrangement.[49] Most dealerships and distributorships are, for this and other reasons, not a *franchise* as the term is defined in state franchise protection statutes of general application,[50] even though a manufacturer may

44. Fed. Trade Comm'n, Statement of Basis and Purpose Relating to Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 43 Fed. Reg. 59,613, 59,701 (Dec. 21, 1978) (footnote omitted).

45. According to the Federal Trade Commission's franchise disclosure rule, a "franchise" means a continuing commercial relationship or arrangement (1) in which the "franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark," (2) as to which the franchisor will exercise a significant degree of control over the franchisee's method of operation, and (3) for which the franchisee is required to make a payment to the franchisor or its affiliate. *See* 16 C.F.R. § 436.1(h)(1)–(3).

46. *See*, *e.g.*, Franchise Practices Act, Ark. Code Ann. § 4-72-202(1)(A); Franchise Relations Act, Cal. Bus. & Prof. Code § 20001(b); Franchise Act, Conn. Gen. Stat. Ann. § 42-133e(b)(2); Franchise Investment Law, Haw. Rev. Stat. Ann. § 482E-2; Franchise Disclosure Act, 815 Ill. Comp. Stat. 705/3(1)(b); Deceptive Franchise Practices Act, Ind. Code Ann. § 23-2-2.5-1(a)(2); Franchise Act, Iowa Code Ann. § 537A.10(1)(c)(1)(a)(iii); Franchise Registration & Disclosure Law, Md. Code Ann., Bus. Reg. § 14-201(e); Franchise Investment Law, Mich. Comp. Laws Ann. § 445.1502(3)(b); Franchise Law, Minn. Stat. Ann. § 80C.01(4)(a); Franchise Act, Miss. Code Ann. § 75-24-51(6); Franchise Act, Mo. Ann. Stat. § 407.400(1); Franchise Practices Act, Neb. Rev. Stat. § 87-402(1); Franchise Practices Act, N.J. Stat. Ann. § 56:10-3(a); N.Y. Gen. Bus. Law § 681(3); Franchise Investment Law, N.D. Cent. Code § 51-19-02(5.a); Franchise Investment Act, R.I. Gen. Laws § 19-28.1-3(7); Retail Franchising Act, Va. Code Ann. § 13.1-559(A)(b); Franchise Investment Protection Act, Wash. Rev. Code Ann. § 19.100.010(4)(a)(2); Franchise Investment Law, Wis. Stat. Ann. § 553.03(4)(a).

47. Statement of Basis and Purpose Relating to Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 43 Fed. Reg. at 59,697 (footnote omitted).

48. *Id.* at 59,698.

49. *Id.*

50. To qualify as a franchise under most state franchise statutes of general application, a product supply relationship must also entail a requirement that the buyer pay a franchise fee to the supplier. A franchise fee is defined variously under the statutes, but it does not include a payment made by the buyer to the supplier for the purchase of goods at a bona fide wholesale price. *See*, *e.g.*, Franchise Relations Act, Cal. Bus. & Prof. Code § 20007(a); Franchise Investment Law, Haw. Rev. Stat. Ann. § 482E-2; Franchise Disclosure Act, 815 Ill. Comp. Stat. 705/3(14(c); Ind. Code Ann. § 23-2-2.5-1(i)(3); Iowa Code Ann. § 537A.10(1)(d)(3); Franchise Investment Law, Mich. Comp. Laws Ann. § 445.1503(1)(a); Minn. Stat. Ann.

have granted the dealer or distributor a license to use its trademark to signify affiliation or sponsorship.

Because of the nature of the business format franchise, the restraints needed to ensure uniformity of goods and services and quality control among franchisees are necessarily more extensive than those incident to a product franchise or to a simple trademark license in a dealer or distributor agreement. In a product franchise, the trademark identifies a product,[51] and it is typically affixed during manufacture by the licensor. The manufacturer controls product quality and resulting goodwill. In a business format franchise, the trademark identifies an enterprise.[52] Goodwill inhering in the mark identifying a business format franchise comes from operation of individual retail outlets by franchisees and depends upon uniformity of operation and delivery of goods and services of consistent quality. The franchise agreement in a business format franchise confers a constellation of rights and obligations on the franchisee, all of which are anchored in protection of trademark value and goodwill.

The competitive effects of restraints incident to a trademark license agreement establishing a business format franchise are indistinguishable from those of restraints incident to a dealer or distributor agreement. While there is not perfect equivalence between the two types of agreement, intrabrand restraints incident to either have the same economic significance: they strengthen the marketing and sale of goods or services against interbrand competitors. At least one court has observed that, because intrabrand restrictions incident to a franchise could potentially increase interbrand competition, they should be deemed "vertical."[53] This view is incorrect, as they are not restraints imposed on a downstream reseller, and they are not, thus, "vertical."[54] Despite this fundamental distinction, the legality under Section 1 of

§ 80C.01(9)(a); Franchise Practices Act, Neb. Rev. Stat. § 87-402(5); Retail Franchising Act, Va. Code Ann. § 13.1-559(A)(3); Franchise Investment Protection Act, Wash. Rev. Code Ann. § 19.100.010(8)(a). In the typical product dealership or distributorship, the manufacturer does not exact a franchise fee, however it may be statutorily defined, from the dealer or distributor.

51. *See*, *e.g.*, Krehl v. Baskin-Robbins Ice Cream Co., 664 F.2d 1348, 1354 (9th Cir. 1982) (noting that the trademark "serves merely as a representation of the end product" marketed in what the court referred to as a distribution franchise system).

52. *See*, *e.g.*, *id.* at 1353 ("the trade-mark simply reflects the goodwill and quality standards of the enterprise it identifies" (quoting Siegel v. Chicken Delight, Inc., 448 F.2d 43, 49 (9th Cir. 1971))).

53. *See* St. Martin v. KFC Corp., 935 F. Supp. 898, 905 (W.D. Ky. 1996) ("KFCC's restrictions could potentially increase interbrand competition and thus should be considered vertical in nature.").

54. The Department of Justice has taken the position that no-hire restraints are vertical because a franchisor and franchisee "normally conduct business at different levels of the market structure." *See* Corrected Statement of Interest of the United States of America, at 11, Stigar v. Dough Dough, Inc., No. 2:18-cv-00247-SAB (E.D. Wash. Mar. 8, 2019), Dkt. No. 34, https://www.justice.gov/atr/case-document/file/1141731/download. The statement is based on a false premise. There are not two levels of marketing in a business format franchise. *All* of the marketing occurs through the franchisee and at the franchisee's level. To the extent a franchisor may be deemed to be marketing licenses, as opposed to branded goods or services, any analogy to downstream distribution restraints fails, because franchisees are not in the business of selling licenses.

restrictions incident to a franchise agreement is properly subject to the same rule-of-reason test as vertical distribution restraints, because both promote interbrand competition.

III. No-Hire Clauses Are Not Per Se Violations of Section 1

Plaintiffs allege in several cases that the no-hire restriction is per se illegal under Section 1.[55] This core claim has been variously formulated. One case alleged that, by signing the franchise agreement, franchisees "tacitly agreed not to hire one another's employees."[56] It is alleged in another case that the no-hire clause is per se illegal as a "market allocation agreement."[57] Another set of plaintiffs alleged that the franchisor "orchestrated an agreement amongst the franchisees not to hire each other's employees," the effects of which were felt "strictly at the horizontal level" between franchisees.[58] Some courts have declined to grant motions to dismiss the claim of per se illegality.[59] The motions should have been granted, however, because the claim has no support in the law.

Since the Supreme Court's holding in *Leegin Creative Leather Products v. PSKS, Inc.*[60] that resale price maintenance agreements are not per se illegal, only horizontal restraints "qualify as unreasonable *per se*."[61] The rule of reason is the accepted standard for testing whether a practice restrains trade in violation of Section 1,[62] and not even horizontal restraints will be deemed per se unlawful "until we have amassed 'considerable experience with the type of restraint at issue' and 'can predict with confidence that it would be invalidated in all or almost all circumstances.'"[63] The per se test should not apply to no-hire clauses. They are not the product of agreement among horizontal competitors, and the fact that they have horizontal effects is irrelevant.

55. *See* Ogden v. Little Caesar Enters., 393 F. Supp. 3d 622, 631–36 (E.D. Mich. 2019) (granting motion to dismiss complaint for failure to state a claim for violation of § 1 under either per se rule or quick-look rule of reason); Blanton v. Domino's Pizza Franchising LLC, No. 18-13207, 2019 U.S. Dist. LEXIS 87737, at *12–13 (E.D. Mich. May 24, 2019) (holding that complaint stated claim for violation of § 1 under per se rule and quick-look rule of reason); Butler v. Jimmy John's Franchise, LLC, 331 F. Supp. 3d 786, 795–97 (S.D. Ill. 2018) (same); Yi v. SK Bakeries, LLC, No. 18-5627 RJB, 2018 U.S. Dist. LEXIS 220966, at *14–15 (W.D. Wash. Nov. 13, 2018) (holding that complaint stated claim for violation of § 1 under quick-look rule of reason; motion to dismiss granted as to *per se* claim); Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2018 U.S. Dist. LEXIS 105260, at *20–23 (N.D. Ill. June 25, 2018) (same).

56. *Blanton*, 2019 U.S. Dist. LEXIS 87737, at *12.

57. *In re* Papa John's Emp. & Franchisee Emp. Antitrust Litig., No. 3:18-CV-00825-JHM, 2019 WL 5386484, at *8 (W.D. Ky. Oct. 21, 2019).

58. *Butler*, 331 F. Supp. 3d at 795.

59. *See Blanton*, 2019 U.S. Dist. LEXIS 87737, at *12; *Butler*, 331 F. Supp. 3d at 797; *In re Papa John's*, 2019 WL 5386484, at *9; Robinson v. Jackson Hewitt, Inc., No. 19-9066 (SDW) (LDW), 2019 U.S. Dist. LEXIS 188962, at *17 (D.N.J. Oct. 31, 2019).

60. Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877 (2007).

61. Ohio v. Am. Express Co., 138 S. Ct. 2274, 2284 (2018) (italics in original).

62. *Leegin*, 551 U.S. at 885.

63. NCAA v. Alston, 141 S. Ct. 2141, 2156 (2021) (quoting *Leegin*, 551 U.S. at 886–87).

No horizontal conspiracy. Nothing about a promise by a franchisee not to solicit or hire another franchisee's employees could be characterized as the product of a horizontal agreement. There is no agreement between competing independent entities.[64] There is, instead, a separate agreement between the franchisor and each franchisee. To date, no one has argued, nor could they realistically argue, that a no-hire clause was included in a franchise agreement pursuant to a separate conspiracy between the franchisor and one or more franchisees. The no-hire clause in a franchise agreement is uniform from one franchisee to the next, as one would expect in a document unilaterally formulated by the franchisor for regional or national application,[65] filed with multiple state regulators, and delivered to all prospective franchisees. Any claim that the franchisor sits at the center of a hub-and-spoke conspiracy[66] fails, because there is no agreement between any of the spokes.[67] There is no claim in any of the pending cases that franchisees in any local market agreed among themselves not to hire each other's employees.

No exclusion of the possibility of independent action. Plaintiffs allege in some of the cases that franchisees conspired among themselves not to compete for labor,[68] but, to survive summary judgment and reach a jury, evidence of an agreement or conspiracy under Section 1 must tend to exclude the possibility of independent action.[69] Evidence of franchisees executing identical franchise agreements does not exclude the possibility of independent

64. This is to be distinguished from agreements between competitors not to solicit or hire each other's employees. *See supra* notes 9–13 and accompanying text.

65. A franchise agreement is the product of the franchisor, and provisions in the agreement restricting franchisee activity are unilaterally imposed. They are not the product of negotiation between an individual franchisee and the franchisor. *See*, *e.g.*, St. Martin v. KFC Corp., 935 F. Supp. 898, 906 (W.D. Ky. 1996) ("KFCC's company town policy and non-KFC clause were unilaterally formulated and implemented by KFCC itself.").

66. For such a claim, see *Butler v. Jimmy John's Franchise, LLC*, 331 F. Supp. 3d 786, 795 (S.D. Ill. 2018) ("Jimmy John's headquarters orchestrated an agreement amongst the franchisees not to hire each other's employees, and while the contract in question may have been vertical, the *effects* are felt strictly at the horizontal level: Between the franchisees, not between any given franchisee and Jimmy John's corporate. . . . Some circuits refer to this as a 'hub-and-spoke' conspiracy. . . ." (italics in original)).

67. *See*, *e.g.*, PSKS, Inc. v. Leegin Creative Leather Prods., 615 F.3d 412, 420 (5th Cir. 2010) (no hub-and-spoke conspiracy, because plaintiff had not alleged agreement among retailers to implement resale price maintenance (RPM). "In the absence of an assertion that retailers agreed to RPM among themselves, there was no wheel and therefore no hub-and-spoke conspiracy . . .".)

68. *E.g.*, *In re* Papa John's Emp. & Franchisee Emp. Antitrust Litig., No. 3:18-CV-00825-JHM, 2019 WL 5386484, at *7 (W.D. Ky. Oct. 21, 2019) ("Plaintiffs allege that the Defendants conspired to not compete for labor among their franchisees" and that franchisees had opportunities to conspire at annual meetings.).

69. *E.g.*, Bell Atl. Corp. v. Twombly, 550 U.S. 544, 556–57 (2007) (explaining conspiracy pleading requirements under § 1 needed to survive motion to dismiss); Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 588 (1986) ("To survive a motion for summary judgment or for a directed verdict, a plaintiff seeking damages for a violation of § 1 must present evidence 'that tends to exclude the possibility' that the alleged conspirators acted independently." (citing Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 764 (1984)); Quality Auto Painting Ctr. v. State Farm Indem. Co., 917 F.3d 1249, 1261–72 (11th Cir. 2019) (en banc) (noting that allegations of horizontal price fixing and group boycott did not exclude possibility of independent action by insurers).

action. The no-hire clause to which each franchisee has agreed is embodied in the franchise agreement that it received and potentially negotiated with its franchisor; it is not the product of franchisee collusion. Nor is it the result of collusion with a franchisor, which undoubtedly included the clause in the franchise agreement without attention to the needs or wants of any specific franchisee. Even if plaintiffs could point to evidence of agreement among franchisees to refrain from hiring each other's employees, that evidence would not tend to exclude the possibility that a franchisee acted independently in both executing a franchise agreement containing a no-hire clause and in deciding to comply with its provisions, including the no-hire clause.

The fact that a franchisor may be party to hundreds, or even thousands, of separate agreements with individual franchisees provides no evidence of any agreement between franchisees not to hire each other's employees. This is parallel conduct, not an agreement between franchisees.[70] Agreement between franchisees not to hire each other's employees would be superfluous, in any event, as it would add nothing to a franchisee's obligation to comply with the terms of its own franchise agreement.

Intrabrand restraints produce horizontal effects. The per se rule has no application to vertical agreements,[71] and it can have no application to a trademark license restraint having the same economic effect as a vertical restraint (i.e., enhancement of interbrand competition).[72] No-hire clauses have horizontal

70. On analogous facts, the Seventh Circuit affirmed dismissal of conspiracy claims against distributors that had entered into supply contracts with allegedly anticompetitive terms. The fact that individual distributors each agreed with their common supplier on identical contract terms evidenced parallel conduct, not a conspiracy among the distributors. *See* Marion Healthcare, LLC v. Becton Dickinson & Co., 952 F.3d 832, 843 (7th Cir. 2020) ("These allegations, whether taken alone or together, do not suffice to establish a hub-and-spokes conspiracy. All the Providers have alleged is that the distributors buy and sell the devices [manufactured by defendant, Becton Dickinson] in accordance with the terms of the contracts that the GPOs [group purchasing organizations] have negotiated [with Becton Dickinson]. They have made no argument that the distributors played any role in setting the anticompetitive pricing or that there was any *quid pro quo* according to which Becton compensated them for participating in the alleged antitrust conspiracy." (italics in original)). *Accord, e.g.*, *In re* Musical Instruments & Equip. Antitrust Litig., 798 F.3d 1186, 1198 (9th Cir. 2015) ("Plaintiffs have indeed provided a context for the manufacturers' adoption of [allegedly unlawful] MAP policies, but not one that plausibly suggests they entered into illegal horizontal agreements. Instead, the complaint tells a different story, one in which Guitar Center used its substantial market power [as a high-volume purchaser] to pressure each manufacturer to adopt similar policies, and each manufacturer adopted those policies as in its own interest.").

71. *See* Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 893, 898–99 (2007) (rejecting per se illegality for resale price maintenance agreements while observing that a "horizontal cartel among competing manufacturers or competing retailers that decreases output or reduces competition in order to increase price is, and ought to be, *per se* unlawful" (italics in original)); Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58–59 (1977) (rejecting per se treatment for non-price vertical restraints).

72. The equivalence of economic effect has led to occasional description of franchise agreement restraints as "vertical." *See supra* note 53 and accompanying text; Randy M. Stutz, *The Evolving Antitrust Treatment of Labor-Market Restraints: From Theory to Practice* 18 Am. Antitrust Inst. (July 31, 2018), https://www.antitrustinstitute.org/wp-content/uploads/2018/09/AAI-Labor-Antitrust-White-Paper_0.pdf (noting that "franchisor/franchisee no-poaching

effects insofar as they reduce intrabrand competition between retailers, but this is equally true for purely benign vertical restraints. The very purpose of vertical restraints is to limit competition between downstream resellers, and the presence of horizontal effects provides no basis for applying the per se rule.[73] Only horizontal restraints are per se illegal,[74] and horizontal restraints involve agreements between rival firms not to compete.[75]

Horizontal effects incident to a vertical restraint are not evidence of any agreement between competitors to fix prices, rig bids, allocate territories or customers, or otherwise restrain trade. They are the intended consequence of a vertical restraint. A reduction in intrabrand competition by, for example, prohibiting out-of-territory sales may strengthen the manufacturer's position as against other brands. Economically, a no-hire clause serves the same purpose—to strengthen the franchisor's interbrand competitive standing—and it does so by reducing competition between franchisees for labor.

Dual distribution restraints are subject to the rule of reason. Nor is the per se rule applicable insofar as a no-hire clause bars a franchisee from soliciting or hiring workers employed at competing stores owned by the franchisor. The restraint is not implemented pursuant to agreement between franchisees. A trademark owner is free to control the scope of rights granted under a license, and there is no Sherman Act violation, for example, in confining a licensee to an exclusive territory.[76] Limiting a franchisee, pursuant to a license agreement, in the firms from which it can solicit and hire employees is, similarly, exercise of control over the scope of the license grant. Although such a no-hire restraint limits intrabrand competition between firms selling

agreements are vertical"). The Department of Justice applied the same label in a *Statement of Interest* filed in the no-hire clause litigation. *See supra* note 54.

73. *See*, *e.g.*, Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 730 n.4 (1988) (Even though vertical restraints have horizontal effects, they are not horizontal: "[A] restraint is horizontal not because it has horizontal effects, but because it is the product of a horizontal agreement."); *Cont'l T.V., Inc.*, 433 U.S. at 54 ("Vertical restrictions reduce intrabrand competition by limiting the number of sellers of a particular product competing for the business of a given group of buyers.").

74. *See*, *e.g.*, Ohio v. Am. Express Co., 138 S. Ct. 2274, 2283–84 (2018) ("'Typically only 'horizontal' restraints—restraints 'imposed by agreement between competitors'—qualify as unreasonable *per se*." (citation omitted; italics in original)); NYNEX Corp. v. Discon, Inc., 525 U.S.128, 135 (1998) (noting that "precedent limits the *per se* rule in the boycott context to cases involving horizontal agreements between direct competitors" (italics in original)).

75. *E.g.*, *Am. Express Co.*, 138 S. Ct. at 2285 n.7 ("[H]orizontal restraints involve agreements between competitors not to compete in some way."); Bus. Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 730 (1988) ("Restraints imposed by agreement between competitors have traditionally been denominated as horizontal restraints . . . ."); Valley Liquors, Inc. v. Renfield Imps., Ltd., 678 F.2d 742, 744 (7th Cir. 1982) ("[A] horizontal conspiracy is one between two or more competing sellers.").

76. *See*, *e.g.*, Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403, 409 (5th Cir. 1962) ("A trademark owner may extend the territory in which he has the right to exclusive use of his trademark, either by expanding his own operations, or he may introduce his trademark and create a demand for his variety of goods in new territory, by licenses subject to his control. . . . [S]pring-Air . . . had a right to license its trademark to exclusive dealers. . . . It is our opinion that the provision of the contract with respect to a division of trade territory in the circumstances of this case is not offensive to the antitrust laws.").

at the same distribution level, it is subject to the rule of reason as a dual distribution restraint. Dual distribution restraints imposed by a business format franchisor are subject to the rule of reason,[77] in common with dual distribution restraints imposed by manufacturers on independent dealers and distributors.[78] They limit intrabrand competition in furtherance of promotion of interbrand competition.

Trademark licensing agreements are subject to the rule of reason. Attempts to apply the per se rule to restraints in franchise agreements or other agreements licensing trademarks have repeatedly been rejected. The Fifth Circuit, for example, rejected a claim that an approved-source requirement in a Kentucky Fried Chicken franchise agreement was per se illegal.[79] It refused to apply the per se rule because, in the franchise context, such a requirement might be procompetitive:

> We are not prepared to say . . . that approved source requirements are so universally devoid of redeeming virtue that they warrant per se treatment. . . . [T]ies themselves are not as completely objectionable in the franchise context as in the contexts in which tying law originally developed. Moreover, franchise arrangements may sometimes create better competitive markets than would otherwise exist. A system under which an independent franchisee's choices are somewhat restricted may nevertheless prove superior to a system in which retail outlets are owned by the national firm. . . .
>
> . . . [T]he potential pro-competitive effects of franchising lead us to proceed cautiously lest we unduly shackle franchisors without achieving discernible competitive benefits. We must encourage business ingenuity so long as it is not competitively stifling.[80]

77. *See*, *e.g.*, Krehl v, Baskin-Robbins Ice Cream Co., 664 F.2d 1348, 1356–57 (9th Cir. 1982) (holding that territorial restraints imposed by trademark owner and franchisor on licensees (referred to as "area franchisors") were subject to rule of reason even though owner/franchisor competed at the same distribution level, through a wholly owned subsidiary, with the area franchisors); St. Martin v. KFC Corp., 935 F. Supp. 898, 904–06 (W.D. Ky. 1996) (holding that prohibition in franchise agreement against franchisee operation of a store in a geographic market served by a franchisor-owned store is a dual distribution restraint subject to the rule of reason).

78. *See*, *e.g.*, Jacobs v. Tempur-Pedic Int'l, 626 F.3d 1327, 1340 n.15 (11th Cir. 2010) (noting that the "recent trend" has been to view dual distribution restraints as vertical subject to the rule of reason); PSKS, Inc. v. Leegin Creative Leather Prods., 615 F.3d 412, 421 n.8 (5th Cir. 2010) (observing that "eight other circuits have applied the traditional rule of reason to dual distribution systems" (citations omitted)); AT&T Corp. v. JMC Telecom, LLC, 470 F.3d 525, 531 (3d Cir. 2006) ("Vertical restraints are generally not *per se* violations of the Sherman Act, even where a distributor and manufacturer also compete at the distribution level, *i.e.*, have some form of horizontal relationship (a/k/a dual distributor arrangement), as is the case here." (italics in original)); Elecs. Commc'ns Corp. v. Toshiba Am. Consumer Prods., 129 F.3d 240, 243 (2d Cir. 1997) (holding that dual distribution restraints are vertical and subject to the rule of reason); Smalley & Co. v. Emerson & Cuming, Inc., 13 F.3d 366, 368 (10th Cir. 1993) (holding that rule of reason was properly applied to a claim of horizontal market allocation because "dual distribution systems like that utilized by E & C are in fact vertical, not horizontal restraints on competition"); Ill. Corp. Travel, Inc. v. Am. Airlines, 889 F.2d 751, 753 (7th Cir. 1989) ("Dual distribution therefore does not subject to the per se ban a practice that would be lawful if the manufacturer were not selling direct to customers; antitrust laws encourage rather than forbid this extra competition.").

79. *See* Ky. Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368 (5th Cir. 1977).

80. *Id.* at 379; *accord*, *e.g.*, *St. Martin*, 935 F. Supp. at 905 (rejecting per se treatment for provisions in franchise agreement prohibiting franchisee from operating a store in a market in

Challenging a requirement in a trademark license for mattresses that innersprings and other components be purchased from approved sources, a licensee of the Spring-Air trademark contended that the requirement was a per se illegal tying agreement.[81] The court refused to apply the per se test, because the licensor was not supplying any of the components. It noted that the sourcing requirement served a salutary purpose in protecting the value of the licensor's mark: "The trademark would be of no worth unless the public could be sure that every mattress which bore that mark was uniform both in exterior design and interior quality."[82]

Because no-hire clauses are not the product of a horizontal agreement among competing franchisees, their creation and enforcement are not per se illegal under Section 1. They have not previously been subjected to judicial scrutiny and, on this ground alone, should not be deemed per se illegal.[83] They must be evaluated under the rule of reason.

IV. Evaluating No-Hire Clauses Under the Rule of Reason

Employees bringing no-hire clause cases do not challenge the legality of the franchise agreements to which their employers are party. There is no hint that there is any antitrust violation in the fact that their employer executed a franchise agreement (nor could there be). The litigation is aimed, instead, at a specific provision in the agreement—the no-hire clause. As a restraint appurtenant to the main agreement between a franchisee and its franchisor, the legality under the Sherman Act of a no-hire clause is subject to the ancillary restraint doctrine.

An ancillary restraint is lawful, because it is subordinate to a legitimate transaction and "serves to make the main transaction more effective in accomplishing its purpose."[84] To be ancillary, the restraint must "contribute to the success of a cooperative venture that promises greater productivity and output"[85] and be related to "the efficiency sought to be achieved."[86]

which the franchisor operated a store and prohibiting a franchisee from having an interest in a fast food outlets other than KFC, since the restrictions "could potentially increase interbrand competition").

81. *See* Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403 (5th Cir. 1962).

82. *Id.* at 410–11; *see also, e.g.*, Evans v. S.S. Kresge Co., 544 F.2d 1184, 1193 (3d Cir. 1976) (rejecting claim by licensee of K-Mart trade name that restriction against handling goods competitive with those sold by the licensor, S.S. Kresge Co., in K-Mart stores in which licensee sold groceries was per se illegal, since this and other license restraints "had as their purpose the stimulation of business and efficiency for both the department store and the supermarket" within a single K-Mart store).

83. *See, e.g.*, White Motor Co. v. United States, 372 U.S. 253, 263 (1963) ("We need to know more than we do about the actual impact of these arrangements on competition to decide whether they have such a 'pernicious effect on competition and lack . . . any redeeming virtue' . . . and therefore should be classified as *per se* violations of the Sherman Act." (citation omitted; italics in original)).

84. Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 224 (D.C. Cir. 1986).

85. Polk Bros., Inc. v. Forest City Enters., 776 F.2d 185, 189 (7th Cir. 1985).

86. *Rothery Storage & Van Co.*, 792 F.2d at 224.

Agreements that would otherwise be per se illegal naked restraints between competitors are ancillary if, for example, they limit competition by members of a joint venture with the venture itself;[87] prevent free riding by a party to an agreement creating a jointly operated retail outlet;[88] prevent the seller of a business from hiring employees from the business after its sale to a third party;[89] prevent a party to an agreement for supplying traveling nurses to hospitals from soliciting the other party's employees;[90] restrict the sources from which a trademark licensee can buy components for the manufacture of finished goods to be sold under the licensor's mark;[91] or require members of a joint venture to authorize the joint venture to act as the exclusive licensor for all members' intellectual property rights.[92]

If a restraint is ancillary, it thereby escapes condemnation as a per se violation of Section 1.[93] Some case law suggests that an ancillary restraint is, *ipso*

87. *See*, *e.g.*, *id.* at 229–30 (approving rule adopted by joint venture prohibiting members from competing against it for their own account).

88. *See Polk Bros., Inc.*, 776 F.2d at 190 (holding that agreement between competing firms to allocate products each could sell within a single retail outlet that they had agreed to build and jointly occupy was ancillary to the joint venture and therefore subject to rule of reason).

89. *See* Cesnik v. Chrysler Corp., 490 F. Supp. 859, 868 (M.D. Tenn. 1980) (noting that covenant prohibiting Chrysler from hiring employees from its Airtemp Division after selling the division to Fedders was "reasonably calculated to protect the legitimate interests of the purchaser in what he has purchased" (citation omitted)).

90. *See* Aya Healthcare Servs. v. AMN Healthcare, Inc., 2021 U.S. App. LEXIS 24794, at *13–14 (9th Cir. Aug. 19, 2021) ("We agree with the district court that the challenged restraint is reasonably necessary to the parties' procompetitive collaboration. The purpose of the parties' contract was to supply hospitals with traveling nurses. The non-solicitation agreement is necessary to achieving that end because it ensures that AMN will not lose its personnel during the collaboration.").

91. *See* Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403, 410–11 (5th Cir. 1962) ("[I]t is our duty to determine whether the general primary purpose of the contract under consideration was to protect Spring-Air in its product, and then determine whether the provisions of the contract complained of here violate any antitrust law.").

92. *See* Major League Baseball Props., Inc. v. Salvino, Inc., 542 F.3d 290, 340 (2d Cir. 2008) (Sotomayor, J., concurring) ("In this case, the exclusivity and profit-sharing provisions of the MLBP [joint venture] agreement are reasonably necessary to achieve MLBP's efficiency-enhancing purposes because they eliminate several potential externalities that may otherwise distort the incentives of individual [baseball] Clubs and limit the potential efficiency gains of MLBP. . . . Most notable of these externalities is the so-called free-rider problem. . . . Under such circumstances, the challenged restraints must be viewed as ancillary to the joint venture and reviewed under the rule of reason in the context of the joint venture as a whole." (footnote omitted)).

93. *See*, *e.g.*, *Aya Healthcare Servs.*, 2021 U.S. App. LEXIS 24794, at *13 ("Accordingly, the restraint qualifies as an ancillary restraint, which triggers a rule-of-reason analysis." (footnote omitted)); Rothery Storage & Van Co. v. Atlas Van Lines, Inc., 792 F.2d 210, 224 (D.C. Cir. 1986) (holding that restraint was ancillary "and hence exempt from the per se rule"); *Polk Bros., Inc.*, 776 F.2d at 190 ("The reason for discriminating between 'ancillary' and 'naked' restraints is to determine whether the agreement is part of a cooperative venture with prospects for increasing output. If it is, it should not be condemned *per se*. . . . The Rule of Reason therefore applies."); Staley v. Gilead Scis., Inc., 446 F. Supp. 3d 578, 594–98 (N.D. Cal. 2020) (holding that ancillary restraints are subject to evaluation under the rule of reason).

facto, lawful under Section 1,[94] but the fact that a restraint is ancillary is not enough. The restraint is still subject to evaluation under the rule of reason.[95]

The procedure for testing the legality of a restraint under the rule of reason is now largely settled,[96] and evaluation is a three-step process.[97] First, it must be determined whether the restraint has a substantial anticompetitive effect in a relevant market—that is, does it harm consumers by raising prices or limiting output? In a labor market, does it harm employees by depressing wages and benefits? This is the plaintiff's burden of proof. Without market power, a firm will not, in most cases, have the power to control prices or restrain output. In the case of a buyer-sided market such as hiring by franchisees, it must be determined whether the buyer has monopsony power.[98]

Preliminary, however, to any showing of market power or monopsony power, a plaintiff must prove the metes and bounds of the relevant product or service market and the relevant geographic market. Economic power cannot be measured until the relevant market is defined.[99] This first step—showing anticompetitive effects in a relevant market—operates as a filter, and there is no need to go to the second step in rule-of-reason analysis if a firm lacks market power or monopsony power.[100]

If a restraint does have substantial anticompetitive effects, the second step in rule-of-reason analysis is to determine whether there is a procompetitive justification for it—that is, does it strengthen the manufacturer's position

94. *See*, *e.g.*, Texaco Inc. v. Dagher, 547 U.S. 1, 7 (2006) ("Under the [ancillary restraints] doctrine, courts must determine whether the nonventure restriction is a naked restraint on trade, and thus invalid, or one that is ancillary to the legitimate and competitive purposes of the business association, and thus valid."); *Rothery Storage & Van Co.*, 792 F.2d at 224 ("If [Judge] Taft's formulation [in *United States v. Addyston Pipe & Steel Co.*, 85 F. 271 (6th Cir. 1898), *aff'd*, 175 U.S. 211 (1899)] is the law today, it is obvious that the Atlas agreements are legal, for *Addyston Pipe & Steel's* analysis of ancillary restraints fits this case exactly.").

95. *See*, *e.g.*, *Aya Healthcare Servs.*, 2021 U.S. App. LEXIS 24794, at *16 ("Given that the restraint is ancillary to the parties' broader agreement, the district court correctly subjected it to the rule-of-reason standard."); Princo Corp. v. ITC, 616 F.3d 1318, 1336 (Fed. Cir. 2010) (en banc) ("The 'ancillary restraints' that are often important to collaborative ventures, such as agreements between the collaborators not to compete against their joint venture, are also assessed under the rule of reason."); Polk Bros., Inc. v. Forest City Enters., 776 F.2d 185, 190 (7th Cir. 1985) (since restraint was ancillary, its legality was tested under the rule of reason).

96. The Supreme Court applied the rule of reason to vertical restraints in *Ohio v. Amercian Express Co*., 138 S. Ct. 2274 (2018), using a "three-step, burden-shifting framework," *id.* at 2284. It followed the same framework in applying the rule of reason to restraints incident to a joint venture in *NCAA v. Alston*, 141 S. Ct. 2141, 2160–62 (2021).

97. *E.g.*, *Am. Express Co.*, 138 S. Ct. at 2284.

98. *See*, *e.g.*, Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312, 320 (2007) ("Monopsony power is market power on the buy side of the market.").

99. *See*, *e.g.*, *Am. Express Co.*, 138 S. Ct. at 2285 n.7 (noting that market power "cannot be evaluated unless the Court first defines the relevant market").

100. *E.g.*, SCFC ILC, Inc. v. Visa USA, Inc., 36 F.3d 958, 965 (10th Cir. 1994) ("Proof of market power, then, for many courts is a critical first step, or 'screen' or 'filter,' which is often dispositive of the case." (footnote omitted)); Valley Liquors, Inc. v. Renfield Imps., Ltd., 822 F.2d 656, 666 (7th Cir. 1987) ("A threshold inquiry in any Rule of Reason case is whether the defendant had market power, that is, the 'power to raise prices significantly above the competitive level without losing all of one's business.'" (citation omitted)).

in relation to competitors? This showing is the defendant's burden.[101] If the restraint does have a procompetitive justification, the third step is to determine whether the same benefits and efficiencies could be achieved through less restrictive means. This showing is the plaintiff's burden.[102] If the plaintiff shows that less restrictive means are available, the restraint violates Section 1.[103]

When no-hire clauses are tested under the rule of reason, there is no cognizable restraint of trade.

Economic power in a relevant market. Once a relevant market has been defined for purposes of measuring the competitive impact of a no-hire clause—as it must be for the first step in rule-of-reason analysis—it becomes apparent that none of the franchisors in the reported cases has monopsony power. The restriction on solicitation and hiring is limited to franchisees under a single trademark, and a single brand of goods or services cannot, with isolated exceptions not pertinent here, constitute a relevant market.[104]

The relevant product or service market for measuring franchisor monopsony power comprises companies that actively compete for the services of a specific employee (i.e., the universe of employers to which the employee can turn for work).[105] No-hire clauses prevent an employee from going to work for an employer operating under the same brand as his or her employer, but an employee is free to sell his or her services to any employer other than one operating under the trademark used by the current employer. The no-hire clause has no effect on the ability of an employee to seek work outside the franchise system. The relevant labor market for plaintiffs suing fast-food franchisors includes, thus, not merely hiring by franchisees or franchisor-owned stores operating under the same brand but also hiring by other quick-serve restaurants.[106]

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101. *See Am. Express Co.*, 138 S. Ct. at 2284.

102. *See id.*

103. *See*, *e.g.*, NCAA v. Alston, 141 S. Ct. 2141, 2162 (2021) (affirming finding by district court that substantially less restrictive rules could have been implemented by the NCAA to regulate education-related benefits offered by colleges to student athletes).

104. *See*, *e.g.*, PSKS, Inc. v. Leegin Creative Leather Prods., 615 F.3d 412, 418 (5th Cir. 2010) (noting that district court "also correctly rejected the claim that Brighton products constitute their own market"); Todd v. Exxon Corp., 275 F.3d 191, 200 (2d Cir. 2001) (noting that dismissal for failure to allege a relevant market is appropriate when plaintiff has attempted "to limit a product market to a single brand, franchise, institution, or comparable entity that competes with potential substitutes" (footnote omitted)); Generac Corp. v. Caterpillar, Inc., 172 F.3d 971, 977 (7th Cir. 1999) ("Product markets are not defined in terms of one trademark or another; trademarks simply identify the origin of a product.").

105. *See*, *e.g.*, *Todd*, 275 F.3d at 202 (relevant market in labor monopsony case comprised employers that are seen by plaintiff employees as "reasonably good substitutes"); Eichorn v. AT&T Corp., 248 F.3d 131, 147–48 (3d Cir. 2001) ("We agree with the District Court that the relevant market is not limited to AT&T and its affiliates but rather includes all those technology companies and network services providers who actively compete for the employees with the skills and training possessed by plaintiffs.")

106. *See*, *e.g.*, Conrad v. Jimmy John's Franchise, LLC, No. 18-CV-00133-NJR, 2021 U.S. Dist. LEXIS 142272, at *39 (S.D. Ill. July 23, 2021) ("[T]he relevant labor market includes not merely Jimmy John's franchisees but also other quick-serve restaurants. . . .").

The boundaries of the other component of market definition, the relevant geographic market, will vary by franchisee, but they can be expected to correspond to a radius described by the distance that an employee will travel to a place of employment.[107] Within any such geographic market, an individual can turn to multiple potential employers, and the opportunities for employment can be expected to increase in proportion to an increase in the population density within the travel radius.

Without regard to any specific market, it is apparent that no franchisor could have monopsony power in a relevant market thus defined. Assuming, for example, a geographic market with twenty McDonald's restaurants, a no-hire clause restraining the movement of employees from one McDonald's restaurant to another would have no effect on their access to employment at other fast-food restaurants selling hamburgers (let alone fast-food restaurants generally) within the geographic market (e.g., Burger King, Wendy's, Arby's, Hardee's, Carl's, Big Boy). While the switching costs to an employee would be minimized by simply transferring to another employer within the same franchise system,[108] the skill sets of employees affected by no-hire clauses, whether managerial or hourly, are readily transferable to restaurants operating under competing brands, not to mention to other types of quick-service restaurants (e.g., Jimmy John's, Papa John's, Little Caesar, Domino's Pizza). Even if employees are categorized at the six-digit occupation level used in the Standard Occupational Classification Manual—like Cooks, Fast Food (35-2011); Fast Food and Counter Workers (35-3023)[109]—the employment alternatives within a geographic market will almost certainly greatly exceed the number of franchised locations affected by a no-hire clause.

The defendant's expert in the *Jimmy John's* case calculated that the vast majority of Jimmy John's branded restaurants have at least ten other quick-service restaurant brands within a ten-mile radius and that, on average, each store has 53 such nearby brands at 257 locations.[110] Given the number of employment alternatives within the relevant market, the no-hire clause would not, in the expert's judgment, produce any adverse competitive effects.[111] No matter which local geographic market were selected, it could be expected that the availability of out-of-franchise employers would be

107. It has been proposed that the geographic market should be defined by the employee's commuting zone. *See* Marinescu & Posner, *supra* note 14, at 1352–53, 1389. In denying class certification in the McDonald's litigation, the court observed that the evidence "bears out the intuition that the proposed class members sell their labor in local geographic markets, generally within easy commuting distance." Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2021 U.S. Dist. LEXIS 140735, at *34 (N.D. Ill. July 28, 2021).

108. For discussion of switching costs as a barrier to employee mobility, see Marinescu & Posner, *supra* note 14, at 1353–54.

109. U. S. Office of Mgmt. and Budget, Standard Occupational Classification Manual 123, 124 (2018), https://www.bls.gov/soc/2018/soc_2018_manual.pdf. For use of the SOC system in defining a labor market, see Marinescu & Posner, *supra* note 14, at 1352–53.

110. *See* Conrad v. Jimmy John's Franchise, LLC, No. 18-CV-00133-NJR, 2021 U.S. Dist. LEXIS 33933, at *23 (S.D. Ill. Feb. 16, 2021).

111. *Id.* at *23–24.

comparable. A franchisee would face competition from multiple employers outside the franchise in its efforts to hire workers.

In the absence of market power—here, monopsony power—there is no possibility that a restraint will have a substantial anticompetitive effect. Without it, there is no basis for advancing to the second step in rule-of-reason inquiry—that is, whether there is a procompetitive justification for the restraint. But considering that step supports this article's conclusion, because it demonstrates that, in a business format franchise, a no-hire clause is procompetitive.

Procompetitive justifications for no-hire clauses. Entirely separate from the fact that a franchisor could have no economic power in any relevant market, there are obvious procompetitive justifications for a no-hire clause. Even though a court should never advance to this second step in rule-of-reason analysis in a no-hire clause case, the procompetitive effects underscore the fallacy of Section 1 claims aimed at no-hire clauses in franchise agreements.

The justification for an ancillary restraint is measured at the time that it is entered, not at the time that it has competitive effects. Comparing a restraint ancillary to a joint venture agreement to an employee noncompetition covenant, the Seventh Circuit held in *Polk Bros., Inc. v. Forest City Enterprises*[112] that the legality of the restraint must be "viewed at the time it was adopted."[113] In reliance upon a noncompetition covenant, a firm will invest in and train an employee for its benefit.[114] When the employment is over, "there is nothing left but restraint—but the aftermath is the wrong focus" for measuring legality.[115]

When the restraint at issue in *Polk Bros.* was analyzed for effects as of the time that it was adopted, the court found it to be ancillary to a "productive cooperation."[116] There, an appliance retailer, Polk Brothers, and a building supplies retailer, Forest City, agreed to operate at a single retail location in the interest of providing a full range of goods for furnishing and maintaining a home. In furtherance of the collaboration, they negotiated a covenant restricting the type of goods that each could sell at the location. The legality of the covenant under Section 1 was subject to the rule of reason:

> Polk Bros. and Forest City were cooperating to produce, not to curtail output; the cooperation increased the amount of retail space available and was at least potentially beneficial to consumers; the restrictive covenant made the

112. Polk Bros., Inc. v. Forest City Enters., 776 F.2d 185, 189 (7th Cir. 1985).

113. *Id.*; *see also* Blackburn v. Sweeney, 53 F.3d 825, 828 (7th Cir. 1995) ("*Polk* teaches that courts must look to the time an agreement was adopted in assessing its potential for promoting enterprise and productivity . . . ."); *accord* Aya Healthcare Servs. v. AMN Healthcare, Inc., 2021 U.S. App. LEXIS 24794, at *15 (9th Cir. Aug. 19, 2021) (holding that restraint was ancillary because, among other reasons, it "was entered into at the same time the parties agreed to collaborate on a joint venture").

114. *Polk Bros., Inc.*, 776 F.2d at 189 ("Knowing that he is not cutting his own throat by doing so, the employer will train the employee, giving him skills, knowledge, and trade secrets that make the firm more productive.")

115. *Id.*

116. *Id.* at 190.

> cooperation possible. The Rule of Reason therefore applies. Discriminating analysis is necessary.[117]

When the effects of a no-hire clause are viewed as of the time a firm or individual executes a franchise agreement, they are demonstrably procompetitive. In a business format franchise, the success of the enterprise depends upon elimination of the free rider—the franchisee that cuts its costs by exploiting the investment of other franchisees. The no-hire clause protects against a franchisee avoiding the cost of training by, instead, hiring trained workers away from other stores in the franchise. The cost savings enable a free rider to undercut pricing by its intrabrand competitors, thereby driving all pricing down within a market and leading to reduced profits for those franchisees that have incurred the cost of employee training. The prospect of losing employees to competing franchisees not only may deter franchisees from investing in training but also may discourage firms or individuals from even buying a franchise in the first place. Without confidence that its franchise opportunity will be safeguarded against predation from other franchisees, a firm or individual will have little incentive to make the investment.

The need for a no-hire clause and other restraints arises from the inherent economic tension between the interests of a franchisor and its individual franchisees. The incentives of a franchisee and the franchisor are not aligned, because the franchisee's interest in increased profits can lead to conduct that, in the absence of contractual restraints, may undermine the goodwill of the franchise itself.[118] The conduct can range from saving on food costs by sourcing from non-approved suppliers, to ignoring franchisor requirements for service of fresh products, to deviating from required menu offerings, to saving on labor costs by understaffing or scrimping on training.

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117. *Id.* Judge Easterbrook's invocation of an employee noncompetition covenant as an ancillary restraint analogous to the joint venture restraint under review in *Polk Bros.* was not entirely apt, since enforcement of the former is subject to a range of equitable criteria not relevant to ancillary restraint analysis under § 1. Whether the covenant is necessary to protect the legitimate interests of the covenantee is the only common criterion. *See, e.g.*, Reliable Fire Equip. Co. v. Arredondo, 965 N.E.2d 393, 396 (Ill. 2011) ("A restrictive covenant, assuming it is ancillary to a valid employment relationship, is reasonable only if the covenant: (1) is no greater than is required for the protection of a legitimate business interest of the employer-promisee; (2) does not impose undue hardship on the employer-promisor; and (3) is not injurious to the public."); BDO Seidman v. Hirshberg, 93 N.Y.2d 382, 388–89 (N.Y. 1999) ("The modern, prevailing common-law standard of reasonableness for employee agreements no to compete applies a three-pronged test. A restraint is reasonable only if it: (1) is *no greater* than is necessary for the protection of the *legitimate interest* of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public." (emphasis in original)); Raimonde v. Van Vlerah, 325 N.E.2d 544, 547 (Ohio 1975) ("A covenant restraining an employee from competing with his former employer upon termination of employment is reasonable if it is no greater than is required for the protection of the employer, does not impose undue hardship on the employee, and is not injurious to the public.").

118. For discussion of the tension between franchisor and franchisee incentives, see generally Blair & Lafontaine, *supra* note 36, at 118–21. "[T]he individual franchisee's incentives are not aligned with those of the franchisor: the profit-maximizing behavior of an individual franchisee can have adverse external effects on the franchisor and other franchisees as well." *Id.* at 118 (footnote omitted).

The damage to goodwill resulting from such profit-maximizing conduct is readily foreseeable:

> [I]t would be expected that in the absence of [intra]brand restrictions, franchisees would cut corners on investments in brand quality, for example by reducing food quality or customer service to reduce costs. For any individual franchisee, the short-run cost to the overall brand reputation of such deviations is small because the store is just one of many stores, while the benefit in profit can be significant. However, if all stores behave this way, then the overall quality of the brand will deteriorate in the long-run, which will harm all stores.[119]

Crediting the analysis of McDonald's expert economist in *Deslandes v. McDonald's USA, LLC*,[120] the court there described the benefits of a no-hire clause in limiting free riding by individual franchisees:

> [T]he hiring restriction encourages franchisees to train their employees without fear that other outlets will free-ride on this training by hiring away employees trained in the McDonald's way. It also encourages cooperation among franchisees. For example, franchisees are required to manage their restaurants personally and are required to complete significant training . . . before signing a franchisee agreement. That training sometimes involves on-the-job training at an existing franchise restaurant. Absent the hiring restriction, current franchisees would be reluctant to allow potential franchisees to train in their restaurants for fear they would use the opportunity to recruit employees.[121]

The no-hire clause contributes to increased output in the hamburger market, "because it encourages the very training that enhances the brand (by ensuring uniform food quality, customer service and building cleanliness)."[122] A strong brand leads, in turn, to additional franchise outlets. New outlets must be staffed, and new restaurants thus increase output in the labor market by increasing demand for labor.[123]

Case law bears out the procompetitive benefits of restraints, such as a no-hire clause, incident to trademark licensing. Such restraints in licenses granted by single-firm licensors have consistently been validated under the rule of reason.[124] Even though they may prevent a licensee from engaging

119. Conrad v. Jimmy John's Franchise, LLC, No. 18-CV-00133-NJR, 2021 U.S. Dist. LEXIS 33933, at *26–27 (S.D. Ill. Feb. 16, 2021).

120. Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2021 U.S. Dist. LEXIS 140735 (N.D. Ill. July 28, 2021).

121. *Id.* at *23–24.

122. *Id.* at *24.

123. *Id.* at *25.

124. The fact that licensing is by an entity existing independently of any licensees is crucial, because use of trademark licensing to allocate territories or customers among horizontal competitors has been deemed per se illegal where the trademark is owned by a licensor under control of the licensees. *See*, *e.g.*, United States v. Topco Assocs., 405 U.S. 596, 608–12 (1972) (purchasing association whose stock was owned by grocery store chain members violated § 1 by granting members exclusive territories in which to sell Topco-brand products and prohibiting members from selling Topco-brand products at wholesale); United States v. Sealy, Inc., 388 U.S. 350, 354 (1967) (noting that trademark owner licensed its stockholders to make and sell mattresses under the Sealy brand in exclusive territories in violation of § 1: "The territorial arrangements must be regarded as the creature of horizontal action by the licensees. It would violate reality to treat them as equivalent to territorial limitations imposed by a manufacturer upon independent dealers as incident to the sale of a trademarked product. Sealy, Inc., is an

in activity that would otherwise be available to it, there is no Sherman Act violation. In furtherance of a trademark license, a requirement, for example, that the franchisee refrain from selling goods under any mark other than that of the franchisor does not violate Section 1.[125] Nor is Section 1 violated by a prohibition against a franchisee operating a competing business in the territory in which it has been licensed to use a mark.[126] There is no violation in prohibiting a licensee from selling goods under brands competitive with that of the licensor.[127] For example, restraints on operation of grocery stores under the K-Mart trade name and service mark did not violate Section 1 where they were necessary for protection of the K-Mart image.[128] A restriction allocating geographic markets between the trademark owner and its licensee did not violate Section 1 where "both parties restricted their actions somewhat in the interest of more efficient promotion of the covered products and better sales."[129]

Trademarks are non-exclusionary, and agreements to protect trademark interests are "common, and favored, under the law."[130] If a licensee deems the restrictions of a license too onerous, it is free to end the license and market goods or services under another brand.[131] In the case of a business format franchise, a firm or individual is free to walk away from investing in

instrumentality of the licensees for purposes of the horizontal territorial allocation."); Timken Roller Bearing Co. v. United States, 341 U.S. 593, 597–99 (1951) (license of Timken trademark to British and French affiliates of license owner held to be subsidiary to main purpose of the parties' agreement to allocate territories in violation of § 1); *In re* Blue Cross Blue Shield Antitrust Litig., 308 F. Supp. 3d 1241, 1279 (N.D. Ala. 2018) (since licensor of Blue Cross and Blue Shield service marks was owned and controlled by licensees, licenses granting exclusive service areas to individual licensees effectuated a scheme of horizontal restraints in violation of § 1: "Defendants' aggregation of a market allocation scheme together with certain other output restrictions is due to be analyzed under the *per se* standard of review." (italics in original)).

125. *See* Susser v. Carvel Corp., 206 F. Supp. 636, 647–48 (S.D.N.Y. 1962) (approving exclusive dealing requirement), *aff'd*, 332 F.2d 505 (2d Cir. 1964).

126. *See* St. Martin v. KFC Corp., 935 F. Supp. 898, 902–04 (W.D. Ky. 1996) (approving a prohibition against a KFC franchisee operating a restaurant under another brand in the territory granted in the trademark license).

127. *See, e.g.*, Denison Mattress Factory v. Spring-Air Co., 308 F.2d 403, 412 (5th Cir. 1962) (rejecting claim by mattress manufacturer that trademark licensor's requirement that it refrain from selling mattresses under competing national brands was a per se violation of § 1).

128. *See* Evans v. S.S. Kresge Co., 394 F. Supp. 817, 846 (W.D. Pa. 1975) (rejecting per se treatment for restraints intended to ensure that licensee, an independent grocery store owner, operated stores under the K-Mart mark consistently with the trademark owner's objective of "attracting customers into the K-Mart stores by providing convenient one-stop shopping and quality merchandise at low prices"), *aff'd*, 544 F.2d 1184 (3d Cir. 1976).

129. Generac Corp. v. Caterpillar, Inc., 172 F.3d 971, 978 (7th Cir. 1990) (rejecting per se treatment for territorial allocation in trademark license pursuant to which plaintiff manufactured power generators under defendant's mark, sold part of the production to the licensor for resale in territories reserved to licensor, and sold the balance through dealers in territories reserved to licensee).

130. 1-800 Contacts, Inc. v. F.T.C., 1 F.4th 102, 119 (2d Cir. 2021) (quoting Clorox Co. v. Sterling Winthrop, Inc., 117 F.3d 50, 55, 57 (2d Cir. 1997)).

131. *See, e.g.*, *Clorox Co.*, 117 F.3d at 57 ("[A]ll that is required of a defendant in order to escape the clutches of an alleged trademark monopoly is to market his product under a different name." (quoting Seven-Up Co. v. No-Cal Corp., 183 U.S.P.Q. 165, 166 (E.D.N.Y. 1974)).

the franchise in the first place if the license restrictions are objectionable.[132] There is no compulsion to accept a trademark license, and protection of a trademark provides a procompetitive justification for restrictions incident to a trademark agreement.[133]

V. Resort to Quick-Look Analysis Under the Rule of Reason Is Foreclosed

Plaintiffs alleged in nearly all of the reported cases that quick-look rule of reason analysis is appropriate and that a no-hire clause violates Section 1 under this standard. Several courts agreed, denying motions to dismiss on this basis.[134] There is no basis for any such holding, as at least two courts have now acknowledged.[135]

The Supreme Court rejected in *Ohio v. American Express Co.* any departure from full rule of reason analysis for vertical restraints,[136] and quick-look analysis, which has been considered or applied by the Court only in cases involving horizontal conspiracies,[137] should have no application to no-hire

132. *See*, *e.g.*, Queen City Pizza v. Domino's Pizza, 124 F.3d 430, 441 (3d Cir. 1997) ("Plaintiffs need not have become Domino's franchisees. If the contractual restrictions in . . . the general franchise agreement were viewed as overly burdensome or risky at the time they were proposed, plaintiffs could have purchased a different form of restaurant, or made some alternative investment." (footnote omitted)).

133. *See*, *e.g.*, *1-800 Contacts*, 1 F.4th at 120 n.12 ("[W]e hold that protecting trademarks is a valid procompetitive justification for the restrictions" in a trademark infringement settlement agreement.).

134. *See* Blanton v. Domino's Pizza Franchising LLC, No. 18-13207, 2019 U.S. Dist. LEXIS 87737, at *12–13 (E.D. Mich. May 24, 2019) (holding that complaint stated claim for violation of § 1 under per se rule and quick-look rule of reason); Butler v. Jimmy John's Franchise, LLC, 331 F. Supp. 3d 786, 795–97 (S.D. Ill. 2018) (same); Yi v. SK Bakeries, LLC, No. 18-5627 RJB, 2018 U.S. Dist. LEXIS 220966, at *14–15 (W.D. Wash. Nov. 13, 2018) (holding that complaint stated claim for violation of § 1 under quick-look rule of reason; motion to dismiss granted as to per se claim); Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2018 U.S. Dist. LEXIS 105260, at *20–23 (N.D. Ill. June 25, 2018) (same).

135. *See* Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2021 U.S. Dist. LEXIS 140735, at *18–19 (N.D. Ill. July 28, 2021) ("This Court cannot say that it has enough experience with no-hire provisions of franchise agreements to predict with confidence that they must always be condemned, which means, under [*NCAA* v.] *Alston* [141 S. Ct. 2141 (2021)], that the Court must apply rule of reason analysis to this case."); Conrad v. Jimmy John's Franchise, LLC, No. 18-CV-00133-NJR, 2021 U.S. Dist. LEXIS 142272, at *35 (S.D. Ill. July 23, 2021) ("*Alston* thus answers a question this Court punted at the motion-to-dismiss stage: The rule of reason applies in this monopsony case challenging a nationwide franchise's use of intrabrand restraints that were arguably 'designed to help (the company) more effectively compete with other brands by ensuring cooperation and collegiality among franchisees, and by encouraging investment in training.'" (citation omitted)).

136. *See* Ohio v. Am. Express Co., 138 S. Ct. 2274, 2285 n.7 (2018) (refusing to accept evidence of anticompetitive effects as a proxy for proof of the relevant market and market power in a case alleging an unlawful vertical restraint).

137. *See* NCAA v. Alston, 141 S. Ct. 2141, 2155–60 (2021) (rejecting quick look for review of horizontal price fixing by joint venture); Cal. Dental Ass'n v. F.T.C., 526 U.S. 756, 778 (1999) (application of quick look rejected); F.T.C. v. Ind. Fed'n of Dentists, 476 U.S. 447, 460–64 (1986) (quick look applied); NCAA v. Bd. of Regents, 468 U.S. 85, 109 (1984) (quick look applied).

clause cases, in which an intrabrand restraint has procompetitive effects comparable to those of vertical restraints.

The Court cleared away much of the analytical underbrush surrounding quick-look review in *NCAA v. Alston*,[138] holding that it is available only "for restraints at opposite ends of the competitive spectrum."[139] At one end of the spectrum are restraints "so obviously incapable of harming competition that they require little scrutiny."[140] At the other end are "agreements among competitors [that] so obviously threaten to reduce output and raise prices that they might be condemned as unlawful *per se* or rejected after only a quick look."[141] The Court noted that, as to the latter class of restraints, "we take special care not to deploy these condemnatory tools until we have amassed 'considerable experience with the type of restraint at issue' and 'can predict with confidence that it would be invalidated in all or almost all instances.'"[142] There is no such judicial experience with no-hire clauses in franchise agreements, as one court has already acknowledged.[143]

Because vertical restraints typically pose no risk to competition[144] and have procompetitive effects,[145] quick-look analysis of vertical restraints has been held to be improper.[146] Similarly, quick-look analysis of restraints incident to a trademark agreement has been rejected. The Second Circuit recently reversed the Federal Trade Commission's holding that such restraints are "inherently suspect" and therefore not requiring full rule-of-reason analysis.[147] Since trademarks are nonexclusionary and agreements to protect them should be presumed to be procompetitive, the appellate court rejected truncated rule-of-reason analysis for use restrictions incident to a trademark settlement agreement.[148]

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138. *Alston*, 141 S. Ct. 2141.

139. *Id.* at 2155.

140. *Id.*

141. *Id.* at 2156 (italics in original).

142. *Id.* (quoting Leegin Creative Leather Prods. v. PSKS, Inc., 551 U.S. 877, 886–87 (2007)).

143. *See* Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2021 U.S. Dist. LEXIS 140735, at *18–19 (N.D. Ill. July 28, 2021) ("This Court cannot say that it has enough experience with no-hire provisions of franchise agreements to predict with confidence that they must always be condemned, which means, under *Alston*, that the Court must apply rule of reason analysis to this case.").

144. *See*, *e.g.*, Ohio v. Am. Express Co., 138 S. Ct. 2274, 2285 n.7 (2018) ("Vertical restraints often pose no risk to competition unless the entity imposing them has market power . . . .").

145. *See*, *e.g.*, Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 54 (1977) ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products.").

146. *See*, *e.g.*, Physician Specialty Pharm. v. Therapeutics, No. 18-cv-1044 (MJD/TNL), 2019 U.S. Dist. LEXIS 53115, at *11–12 (D. Minn. Jan. 24, 2019) (magistrate's report and recommendation rejecting quick-look analysis for allegedly unlawful vertical restraints); Hannah's Boutique, Inc. v. Surdej, 112 F. Supp. 3d 758, 770 (N.D. Ill. 2015) (quick-look analysis rejected because "vertical restraints, including vertical agreements setting minimum resale prices, can have both pro-competitive and anti-competitive justifications" (citations omitted)).

147. *See* 1-800 Contacts, Inc. v. F.T.C., 1 F.4th 102, 116–17 (2d Cir. 2021).

148. *Id.* at 116 (rejecting truncated analysis for restraints incident to trademark infringement settlement agreement because trademarks are "by their nature non-exclusionary" and precedent "tells us instead to presume they are *procompetitive*" (citation omitted; emphasis in original)).

Truncated rule-of-reason analysis for no-hire clauses is barred, thus, not only because courts have had no experience analyzing the competitive effects of no-hire clauses in business format franchise systems but also because, as a trademark license, an agreement granting a business format franchise should be presumed to be procompetitive. A no-hire clause ancillary to the agreement must be evaluated under the full rule of reason.

VI. Conclusion

District court rulings on motions to dismiss in the no-hire litigation reflect an embarrassing mix of errors and naïveté, some of which may be laid at the feet of the requirement, under Federal Rule of Civil Procedure 12(b)(6), that a complaint is to be liberally construed in ruling on a motion to dismiss. Recent decisions denying motions for class certification[149] offer some promise that errors may be rectified in due course, but there is no certainty that other courts will get it right. Until it is recognized that no-hire clauses play a valuable role in protection of brand goodwill in the licensing of business format franchises, franchisors will continue to bear the cost and burden of defending against groundless Sherman Act claims advanced in a misguided effort to implement through the courts structural change in state and federal labor policy.

149. *See* Conrad v. Jimmy John's Franchise, LLC, No. 18-CV-00133-NJR, 2021 U.S. Dist. LEXIS 142272 (S.D. Ill. July 23, 2021); Deslandes v. McDonald's USA, LLC, No. 17 C 4857, 2021 U.S. Dist. LEXIS 140735 (N.D. Ill. July 28, 2021).