

ABSTRACT:

The role of antitrust in promoting competition and protecting workers has garnered significant attention in recent months. The American Antitrust Institute (AAI) is a leading voice in this debate, advocating for stronger and more creative enforcement through substantive legal, economic, and policy analysis across a range of issues. This letter from AAI to the Antitrust Division of the Department Justice (DOJ) adds to AAI's growing body of advocacy on antitrust and labor.

AAI's letter critiques the DOJ's approach to analyzing intra-franchise no-poaching agreements covering entry level employees of fast-food chains, which were recently the subject of consolidated private antitrust class actions filed in the Eastern District of Washington. The DOJ filed a Statement of Interest in the case asserting its interest in the correct application of the federal antitrust laws. The Statement of Interest advocates that the challenged no-poaching agreements between franchisors and franchisees are vertical, that they are likely subject to the ancillary restraints doctrine, and that they therefore should be analyzed by courts under the full-blown rule of reason.

AAI's letter counters that, regardless of whether the challenged agreements are styled as "vertical," they are plainly anticompetitive and make no economic sense on their face. The agreements therefore almost certainly are not ancillary to the main franchise agreements, and it would be wasteful and inappropriate for courts to apply the full-blown rule of reason. A quick look standard is entirely appropriate, but at a minimum a quicker look is warranted given that the effect of the agreements invariably will be to harm labor-market competition. AAI's letter critiques the DOJ's approach on several grounds:

- **The law is clear that an anticompetitive agreement that happens to be appended to a legitimate business integration is not ancillary if it does not serve the lawful, legitimate ends of the integration. The defendant must establish a plausible connection between the two to even invoke the ancillary restraints test.**
- **Absent both (1) a plausible basis to believe the challenged no-poaching agreements serve the legitimate interests of the franchise and (2) a determination whether the agreements are necessary to make the broader franchise agreement effective, the application of the ancillary restraints defense cannot possibly be deemed "likely." Without more, the likelihood of the defense's application is unknowable at best.**
- **The full-blown rule of reason is inappropriate for vertical restraints that have horizontal anticompetitive effects and no known, cognizable efficiencies. Where restraints appear on their face to make "no economic sense," at a minimum a truncated effects analysis is warranted.**

- No-poaching agreements that have no plausible, legitimate justification, no cognizable efficiencies, and make no economic sense on their face are exceedingly *unlikely* to be ancillary and need not be reviewed under the full-blown rule of reason on that basis.
- The Statement of Interest does not properly instruct the district court on the applicable legal standards governing the challenged agreements. Even if the DOJ believed the quick look or per se standard does not apply, it should have recognized that the rule of reason nonetheless can be abbreviated to avoid unnecessarily elaborate effects analysis.



May 2, 2019

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Dear Assistant Attorney General Delrahim and Deputy Assistant Attorney General Murray:

The American Antitrust Institute (AAI) appreciates and applauds the efforts of the Antitrust Division of the Department of Justice (DOJ or the Division) to combat anticompetitive no-poaching agreements in labor markets through guidelines, enforcement actions, competition advocacy, and speeches. As part of these efforts, however, the Division recently filed what we believe is a misguided Statement of Interest in consolidated franchise no-poaching cases in the Eastern District of Washington.¹ AAI is concerned that the Statement of Interest threatens to lead district courts astray and discourage antitrust challenges to patently anticompetitive labor-market restraints that exploit the most vulnerable workers in the franchise sector.

In a published speech delivered recently at Santa Clara University, Deputy Assistant Attorney General Murray cited an AAI legal policy paper in support of the Division's approach to these cases.² We write to clarify that AAI disagrees with interpretations of the law offered in the Statement of Interest and Mr. Murray's speech, and to explain the basis for our belief that the Division's approach to franchise no-poaching cases is unsound. Although the aforementioned cases have since settled, AAI respectfully requests that the Division incorporate the views expressed in this letter in future enforcement actions and competition advocacy.

I. The DOJ Should Recognize that Some Vertical No-Poaching Agreements Can Be Easily Condemned

The aforementioned AAI policy paper encourages states or the federal government to consider legislative solutions to address collusion and exploitation of buyer power in labor markets by imposing blanket bans on no-poaching agreements, including agreements found in the franchise sector.³ The paper argues that a legislative approach is likely superior to individual antitrust suits in

¹ See Corrected Statement of Interest of the United States of America, *Stigar v. Dough Dough, Inc.*, No. 2:18-CV-00244-SAB (E.D. Wash. filed Mar. 8, 2019) [hereinafter "Statement of Interest"].

² Compare Michael Murray, Dep. Asst. Att'y Gen, Antitrust Div., U.S. Dep't of Justice, Antitrust Enforcement in Labor Markets: The Department of Justice's Efforts, Remarks Presented at Santa Clara University School of Law 12 (March 1, 2019), available at <https://www.justice.gov/opa/speech/file/1142111/download> ("[T]he American Antitrust Institute recently proclaimed that no-poach agreements between a franchisor and franchisee are vertical restraints that are subject to the rule of reason.") [hereinafter "Murray Speech"], with Randy M. Stutz, The Evolving Antitrust Treatment of Labor-Market Restraints: From Theory to Practice, *Am. Antitrust Inst.* (July 31, 2018) ("[U]nless the arrangement amounts to a hub-and-spoke conspiracy, an antitrust challenge likely would have to be won under the rule of reason, which is notoriously difficult for plaintiffs.") [hereinafter "AAI Paper"].

³ AAI Paper at 19.

this sector because, among other reasons, the franchisor-franchisee relationship may open the door to fallacious defense arguments that rely on the vertical orientation of the franchise agreement or specious assertions of the ancillary restraints doctrine to discourage or raise the cost of prosecuting even patently harmful hiring restraints.⁴

AAI stopped short of articulating the appropriate scope of such a ban because the answer arguably requires some nuance to the extent courts have found that short-term, narrowly tailored no-hiring agreements can sometimes be ancillary to, for example, the legitimate sale of a business.⁵ However, AAI has no doubt that no-poaching agreements included in the basic governing agreements between large franchisors and their franchisees, which last for the entire duration of the franchise agreement (or beyond) and cover workers in low-skill, low-wage, high-turnover positions, can be safely banned without running any risk of sacrificing cognizable efficiencies. For reasons explained later in this letter, neither should the DOJ.

Particularly when such agreements are pervasive in labor markets, they also deserve strict antitrust scrutiny, because they have a clear tendency to harm horizontal labor-market competition and have no known, cognizable efficiencies.⁶ Contrary to the positions adopted in the Statement of Interest and Mr. Murray's speech, AAI believes it would be wasteful and inappropriate for antitrust courts to apply the full-blown rule of reason to vertical no-poaching agreements based on the *possibility* that they could be ancillary to the broader franchise agreement. It is entirely appropriate to apply at least a truncated rule of reason to facially indefensible no-poaching agreements like the ones at issue in these cases.

As we explain in Part II, the Statement of Interest errs in suggesting that the no-poaching agreements at issue are likely subject to the ancillary restraints doctrine solely because they are part of the broader franchise agreement. First, before a restraint can even qualify for the ancillary restraints test, there must be some basis to believe it serves a legitimate interest of the integrating parties. Otherwise it does not hold any promise of promoting the procompetitive benefits of the integration. Second, even if a restraint does hold such promise, it is not ancillary if it is not necessary to make the broader agreement effective.

On any given set of facts, then, the likelihood that the ancillary restraints doctrine will necessitate the full-blown rule of reason is unknowable until a legitimate basis for the restraint is identified and the necessity question is addressed. Without more, the fact that a no-poaching agreement is included in an otherwise lawful franchise agreement does not predict that the no-poaching agreement is ancillary or will warrant the full-blown rule of reason.

⁴ See *id.* at 18-19.

⁵ See *id.* at 19 n.62 (citing limited eight-month no-hire agreement that Third Circuit upheld as facilitating a business sale in *Eichorn v. AT&T Corp.*, 248 F.3d 131, 146 (3d Cir. 2001)). The presence of any meaningful nuance is debatable, however. Some argue that all no-poaching agreements should be per se illegal, including because less-restrictive alternatives (such as offering bonuses to employees to stay with the company) are always available. See Alan B. Krueger & Eric A. Posner, A Proposal for Protecting Low-Income Workers from Monopsony and Collusion 13, *The Hamilton Project* (Feb. 2018) (noting that “there is even less economic justification for a no-poaching agreement among franchisees in the same chain than among other unrelated employers,” because training investments in workers “would not be lost to the franchise if no-poaching agreements were illegal”).

⁶ See *infra* Part III.B.

As we explain in Part III, the Division should have recognized, at a minimum, that the no-poaching agreements at issue here do not require any complex effects analysis under the rule of reason. Part of the problem is that the Statement of Interest fails to adequately differentiate between the effects of intrabrand hiring restraints on interbrand competition in the labor market and on interbrand competition in downstream product markets. Even if cognizable product-market benefits would otherwise “offset” harmful labor-market effects (which they would not), procompetitive effects in a product market cannot be used to justify a *hiring* restraint.

If the per se rule does not apply to the challenged agreements, then a “quick look” or otherwise truncated rule of reason inquiry is appropriate because these agreements have “collusive effects” and have no known, cognizable efficiencies in the labor market. Indeed, they appear on their face to make “no economic sense,” as the Division defines the term.

For the same reasons, the Division should have recognized that the agreements are exceedingly *unlikely* to be ancillary to the broader franchise agreements to which they are appended. Agreements that fit the aforementioned description effectively stand no chance of promoting the beneficial elements of franchise agreements or being necessary to their main purpose.

II. The Fact that a Restraint Is Included in a Broader, Efficient Agreement Cannot, By Itself, Predict Its Appropriate Classification

The Statement of Interest correctly notes that naked horizontal no-poaching agreements and hub-and-spoke agreements among franchisors and franchisees are properly classified as per se illegal.⁷ It also notes that, where neither condition is satisfied and a franchisor-franchisee agreement is otherwise “vertical,”⁸ courts must decide whether antitrust liability should be determined by applying a “full-blown” or a “quick (or at least quicker) look” rule of reason.⁹ And it states that “where a court concludes” that a challenged no-poach agreement is ancillary, something more than a quick-look analysis is necessarily required.¹⁰

However, the Statement of Interest makes two erroneous statements. First, it wrongly instructs the district court that “[f]ranchise no-poach agreements that are ancillary fall outside the scope of this [quick look] category because they may provide procompetitive benefits and promote interbrand competition.”¹¹ From this incorrect premise, it then wrongly concludes that “a full rule of reason analysis is *likely* necessary to weigh any anticompetitive effects against potential justifications for these restraints.”¹² Fundamentally, these statements ignore that a restraint could only be removed from the quick look category if a court were to “*conclude*” that the restraint *is* ancillary. And

⁷ Statement of Interest at 11, 13 (noting that two franchisees in the same chain, or franchisors and franchisees who compete for the same labor, are horizontal competitors in the labor market); *id.* at 15 (noting that a “vertical market participant” can “participate in [a] horizontal conspiracy” and become liable for hub-and-spoke claims). This letter does not address the dispute between the Division and the plaintiffs as to whether plaintiffs sufficiently pled a hub-and-spoke conspiracy, nor the factual dispute over whether the restraints were among horizontal competitors in the labor market.

⁸ *Id.* at 12.

⁹ *See id.* at 16-17.

¹⁰ *Id.* at 17.

¹¹ *Id.* at 17. The Division has used different language to describe the quick-look classification. *Compare id.* (characterizing quick-look as a “category” with a “scope”) *with* Murray Speech at 14 (“quick look doctrine is not supposed to be an intermediate third category of analysis”). This letter refers to quick (or quicker) look as a “category” but recognizes that the full-blown rule of reason can be abbreviated in different ways. *See infra* Part III.

¹² *Id.* at 16 (emphasis added).

ancillary restraints both (1) hold the promise of procompetitive benefits and (2) are necessary to a procompetitive integration.¹³

The Statement of Interest falters in discussing both elements of the ancillarity inquiry. First, it fails to recognize that defendants are required to identify a plausible basis to believe that a franchise no-poach agreement holds the promise of procompetitive benefits. The Statement of Interest seems to assume that the satisfaction of the first element of the ancillary restraints test can be conclusively presumed from the fact that the no-poaching agreements are inserted into broader franchise agreements.¹⁴ But if that were true, then *every* restraint included in a broader, efficient agreement could be said to hold the promise of procompetitive benefits solely because the broader agreement holds such promise. The law is clear that this circular logic does not drive ancillary restraints analysis.

An ancillary-restraints defense does not come into play at all if “the organic connection between the restraint and the cooperative needs of the enterprise that would allow us to call the restraint a merely ancillary one is missing.”¹⁵ Before a claim of ancillarity can even be invoked, there must be a “plausible connection between the specific restriction and the essential character of the [main transaction].”¹⁶ A facially anticompetitive restraint that lacks such a plausible connection should be condemned in the first instance under either the per se rule or a quick look, without further inquiry. Otherwise, courts would be assuming away the central factual determination that allows a restraint to be capable of ancillarity in the first place.

Second, the Statement of Interest ignores the implications of the requirement that a restraint must be “necessary” to a broader, efficiency-enhancing integration. Even if the Division or the defendants had pointed to a plausible connection between the no-poaching agreements and “the legitimate fruits”¹⁷ of the main franchise agreement (which they either did not or could not), a restraint that is otherwise fit for quick-look analysis would not be moved out of that category on grounds that it satisfies *half* the ancillarity test. Rather, a determination would first have to be made “whether the challenged agreement is an essential part of the arrangement, whether it is important but perhaps not essential, or whether it is completely unnecessary.”¹⁸ This “essentiality” query made at this early stage considers whether the challenged restraint is an inherent feature of the joint venture at all, or simply an unnecessary, output-limiting appendage.¹⁹

¹³ XI Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law*, ¶ 1908b (2d. ed. 2000); *see also* Statement of Interest at 3.

¹⁴ *See* Statement of Interest at 16 (“these cases are distinguishable . . . because the typical franchise relationship itself is a legitimate business collaboration. No-poach agreements would thus qualify as ancillary restraints if they are reasonably necessary to the legitimate franchise collaboration and not overbroad”). The Division argues separately that, regardless of ancillarity, the quick look standard *never* applies to a vertical agreement between a franchisor and a franchisee, *id.* at 17, which is a different contention we address later in this letter. *See infra* Part III.A.

¹⁵ *Gen. Leaseways, Inc. v. Nat'l Truck Leasing Asso.*, 744 F.2d 588, 595 (7th Cir. 1984) (Posner, J.); *cf.* *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282 (6th Cir. 1898) (Taft, J.) (restraints can be ancillary only if they protect “the legitimate fruits” of the main transaction (emphasis added)).

¹⁶ *Gen Leaseways*, 744 F.2d at 595 (condemning a horizontal market division as per se illegal after taking a quick look, because “no reason has been suggested” why otherwise procompetitive agreement to provide reciprocal truck-leasing services required participants not to compete with each other in actual leasing of trucks).

¹⁷ *Addyston Pipe & Steel Co.*, 85 F. at 282.

¹⁸ Areeda & Hovenkamp, *supra* note 13, ¶ 1908b, at 227; *see also* Statement of Interest at 8.

¹⁹ *Id.* at 228.

The Areeda & Hovenkamp treatise gives the example of a hypothetical joint venture agreement among automobile manufacturers where, “on the same piece of paper,” the parties agree (1) to construct and jointly operate a research laboratory to develop superior engines, (2) to sell all automobiles containing the new engine for \$1,000 more than the equivalent model with the old engine, and (3) that each firm will refrain from building dealerships in towns where the others compete. The treatise concludes that “clearly it would be silly to describe agreements (2) and (3) as ancillary *merely* because they are a part of the same document creating the joint research laboratory, which we presume to be efficient.”²⁰ It explains, “a restraint is not saved from the ‘naked’ *classification* simply because it is included in some larger joint venture arrangement that is clearly efficient.”²¹

As far as “classification” is concerned, a no-poaching agreement written on the same piece of paper as a franchise agreement is no different. If the only basis for predicting whether such agreements will satisfy (or even trigger) the ancillary restraints test is that they are inserted into broader, efficiency enhancing franchise agreements, then *a fortiori* the no-poaching agreements are not “likely” to prove ancillary or to be moved out of the quick look category. The likelihood of either outcome is unknowable at best, and to conclude otherwise would be bootstrapping.

Indeed, if courts adopted this approach, defendants could shield even the most transparently harmful agreements known to antitrust law “from the heightened scrutiny attending naked restraints” by employing “the simple device of attaching [the agreement] to some other, independently lawful transaction.”²² And as the Division readily acknowledges elsewhere in the Statement of Interest, that is not the law.²³

In sum, the Statement of Interest should have recognized that the mere *potential* for ancillarity, unlike ancillarity itself, has no bearing on the appropriate analysis or burden of proof.

III. The Enquiry Meet for the No-Poaching Agreements at Issue Is More Truncated than the Full-Blown Rule of Reason

Under the “traditional,” full-blown rule of reason, plaintiffs must prove that the defendant had market power in a relevant market and that the challenged restraint caused anticompetitive effects in that market.²⁴ But courts reject attempts “to locate the appropriate analysis, and the concomitant burden of proof, by reference to the vestigial line separating per se analysis from the

²⁰ *Id.* at 228-29.

²¹ *Id.* at 230 (emphasis added); see also Fed. Trade Comm’n & U.S. Dep’t of Just., Antitrust Div., Antitrust Guidelines for Collaborations Among Competitors § 2.3, at 6-7 (April 2000) (“[T]he Agencies assess the competitive effects of the overall collaboration *and* any individual agreement or set of agreements within the collaboration that may harm competition.” (emphasis added)).

²² Areeda & Hovenkamp, *supra* note 13, ¶ 1908b, at 228; see also *Gen. Leaseways*, 744 F.2d at 595 (“The per se rule would collapse if every claim of economies from restricting competition, however implausible, could be used to move a horizontal agreement not to compete from the per se to the Rule of Reason category.”).

²³ *Cf.* Statement of Interest at 18 (well pleaded “horizontal hub-and-spoke conspiracies among each franchisor and its franchisees” would be subject to per se rule); see also Areeda & Hovenkamp, *supra* note 13, ¶ 1908b, at 232 (“[C]learly some restraints are ‘part’ of efficiency-creating joint ventures and yet not sufficiently integral to the venture so as to be classified as ancillary.” (citing *NCAA v. Board of Regents*, 468 U.S. 85 (1984) (agreement among NCAA teams limiting broadcasting rights of their games was “naked restraint”))).

²⁴ See *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877, 885-86 (2007).

rule of reason.”²⁵ “[I]here is generally no categorical line to be drawn between restraints that give rise to an intuitively obvious inference of anticompetitive effect and those that call for more detailed treatment. What is required, rather, is an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint.”²⁶ As Judge Ginsburg explained in *Polygram*, a truncated rule of reason is called for, and a “rebuttable presumption of illegality arises,” when there is a “close family resemblance between the suspect practice and another practice that already stands convicted in the court of consumer welfare.”²⁷

A. Some Vertical Restraints Have a Close Family Resemblance to Per Se Illegal, Horizontal Restraints

The Statement of Interest makes the conclusory statement that “quick-look analysis does not apply to a vertical agreement between a franchisor and a franchisee.”²⁸ However, it does not include a citation with this statement, and we are aware of no rule of law that would unambiguously support it. Regardless, the Supreme Court has squarely rejected the circular proposition that the vertical orientation of a restraint determines the proper mode of analysis required under the rule of reason. Rather, “a departure from the [‘traditional’] rule-of-reason standard must be based upon demonstrable economic *effect* rather than upon formalistic line drawing.”²⁹ And a formalistically vertical restraint that has no known, cognizable efficiencies can have a close family resemblance to a per se illegal, horizontal restraint in its *effects*, even if the parties to the restraint operate at different levels of distribution.

1. *Vertical Restraints Can Have Horizontal Anticompetitive Effects*

Antitrust law has long recognized that vertical restraints can have “collusive” anticompetitive effects in addition to “exclusionary” anticompetitive effects.³⁰ The Antitrust Division acknowledged this explicitly in its Second Circuit brief in the *Amex* case. It explained that “horizontal and vertical restraints do not always threaten competition in different ways, or call for different analysis.”³¹ Rather, “the ‘horizontal-vertical distinction’ is ‘relevant only insofar as it helps identify competitive effects.’”³²

Much like a cartel, a vertical restraint that has collusive effects “directly impairs the market’s mechanisms for determining output, price, product quality and characteristics, and innovation.”³³ As relevant here, the no-poaching agreements in the consolidated franchise cases directly impair the market’s mechanism for determining wages and mobility in the labor market, which is equally bad.³⁴

²⁵ *Polygram Holding, Inc. v. FTC*, 416 F.3d 29, 36 (2005) (Ginsburg, J.).

²⁶ *Cal. Dental Ass’n v. FTC*, 526 U.S. 756, 780-81 (1999).

²⁷ *Polygram*, 416 F.3d at 37.

²⁸ Statement of Interest at 17.

²⁹ *Leegin*, 551 U.S. at 887 (emphasis added).

³⁰ See, e.g., Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, *Antitrust Law in Perspective* 355 (2d ed. 2008).

³¹ Redacted Final Form Brief of Plaintiffs-Appellees 50, *United States v. American Express Co.*, No. 15-1672 (2d. Cir. filed Oct. 21, 2015) (quoting 7 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1503, at 392 (3d ed. 2010)).

³² *Id.* (quoting same).

³³ Gavil et al., *supra* note 30, at 46.

³⁴ Cf., e.g., Dep’t of Just. Antitrust Div. & Fed. Trade Comm’n, *Antitrust Guidance for Human Resource Professionals* 4 (2016) (naked labor market restraints eliminate competition in “same irredeemable way” as naked product restraints).

Just like a horizontal no-poaching agreement or a wage-fixing cartel, the agreements prevent market forces from determining who works where and for how much.

2. *Vertical Restraints that Make No Economic Sense on Their Face Almost Certainly Do Not Promote Interbrand Competition*

The operative rationale for adjudicating vertical intrabrand restraints under the rule of reason is that they may generate efficiencies that promote interbrand competition notwithstanding that they may reduce intrabrand competition. In *Leegin*, the Supreme Court did not adopt the rule-of-reason standard for the resale price maintenance (RPM) policy at issue because it had blind faith that intrabrand vertical restraints are generally more likely to produce net benefits, but rather because cognizable procompetitive justifications for that RPM policy were identified at length in the economics literature. Among other things, the Court was persuaded by “recent studies *documenting* the competitive effects of resale price maintenance,” which “cast doubt” on the conclusion that the RPM policy qualified for the per se rule.³⁵

At the same time, the Court unambiguously acknowledged that not *all* instances of RPM necessarily require the full-blown rule of reason. On the contrary, it invited the lower courts to establish a structured analytical framework for RPM.³⁶ And as the FTC has observed, “The *Leegin* decision may be read to suggest a truncated analysis, such as the one applied in *Polygram Holding*[], might be suitable for analyzing minimum resale price maintenance agreements, at least in some circumstances.”³⁷

This kind of logic would seem to apply most forcefully in circumstances involving vertical intrabrand restraints that, on their face, appear to meet the Division’s test for making “no economic sense.” Such restraints “cost the defendant something” but “cannot possibly confer an economic benefit on the defendant other than by eliminating competition.”³⁸ As we explain in the next section, the agreements at issue in the present cases fit this description: They appear to be naked vertical wage restraints that have collusive effects similar to a naked horizontal wage restraint.

The Division’s Statement of Interest does not offer any effects-based rationale for why such restraints do not “facially appear[] to be ones that would always or almost always tend to restrict competition and decrease output.”³⁹ Indeed, there is no evident, plausible efficiency justification in

³⁵ *Leegin*, 551 U.S. at 890; *see also id.* at 889 (“economics literature is replete with procompetitive justifications for a manufacturer’s use of resale price maintenance”).

³⁶ *Id.* at 898-99.

³⁷ *In re Nine West Group, Inc.*, FTC Dkt. C-3937, Order Granting in Part Petition to Reopen and Modify Order Issued April 11, 2000, at 12, 14, 2008 WL 2061410 (May 6, 2008).

³⁸ Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The “No Economic Sense” Test*, 73 Antitrust L.J. 413, 414-15; *see* Brief for the United States and the Fed. Trade Comm’n as Amici Curiae Supporting Petitioner 15, *Verizon Commc’ns Inc. v. Law Offices of Curtis v. Trinko*, No. 02-682 (filed May 23, 2003). The “no economic sense test,” although typically applied to vertical restraints with exclusionary rather than collusive effects, has been said to be “universally viewed as defendant friendly,” but it “offers an economic test to determine whether a [firm’s] sole motive was to impair competition” and allows for “anticompetitive intent” to be “unambiguously inferred.” Michael A. Carrier & Steve D. Shadowen, *Product Hopping: A New Framework*, 92 Notre Dame L. Rev. 167, 211 (2016) (internal quotation omitted).

³⁹ *Broadcast Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979).

the economics literature for a naked vertical wage restraint, and we are at a loss to imagine one.⁴⁰ For the reasons we explain in the next section, the Division should have at least taken the position that the no-poaching agreements in the consolidated franchise cases warrant no more than a truncated effects analysis. To the extent any such analysis is required, it “could not be simpler.”⁴¹

B. The No-Poaching Agreements at Issue have No Known, Cognizable Efficiencies and Make No Economic Sense on Their Face

1. *On Their Face, the No-Poaching Agreements Do Not Promote Interbrand Competition in Relevant Labor Markets*

One of the most problematic aspects of the Statement of Interest is that it fails to adequately account for the fact that the no-poaching agreements’ direct effects on competition occur in labor markets, not in downstream product markets. In the consolidated complaints, the competition alleged to be harmed is buyer competition for workers’ services in labor markets. Even if an economist could conjure a theory whereby the challenged no-poaching provisions could promote interbrand competition in franchise *product* markets in some otherwise cognizable way, those efficiencies would be “out-of-market benefits,” which do not excuse anticompetitive conduct in the alleged relevant labor markets.⁴² As the Division rightly explained in its *Anthem* brief, “Allowing an otherwise anticompetitive [agreement] because it makes some better off at the expense of others makes little sense”⁴³

The Statement of Interest compares the vertical no-poaching agreements at issue to the vertical nonprice territorial restrictions in *Sylvania*,⁴⁴ but the analogy is inapt. Whatever their implications in labor markets, vertical territorial agreements directly restrain intrabrand competition in *product* markets and are reviewed under the traditional rule of reason insofar as they may promote interbrand competition in those same product markets. The alleged vertical no-poaching agreements at issue here directly restrain intrabrand competition *only* in relevant labor markets, and for the reasons explained below, it is difficult to fathom how they could possibly promote interbrand competition in those markets.

2. *Both Economically and Under the Clayton Act, “Cost Savings” Generated by Agreements to Devalue Employment are Not “Efficiencies”*

⁴⁰ One leading economist, asked to speculate on a plausible efficiencies story, considered whether the no-poaching agreements at issue could reduce “free riding by one franchisee on the franchise-specific training costs borne by another franchisee,” which might otherwise reduce the amount of training provided by a franchisee. But this theory is a non-starter because, among other reasons, training for entry level employees is minimal and unavoidable. And the agreements as written would not reduce free-riding by rival franchises. E-mail from Steve Salop, Prof. of Econ. & Law, Georgetown Univ. Law Center, to author (Apr. 20, 2019, 7:49 AM EST) (on file with the author).

⁴¹ Werden, *supra* note 38, at 415; *see id.* at 414-15 (explaining why *Dentsply* “was an easy case”).

⁴² *See, e.g.*, U.S. Dep’t of Justice & Fed. Trade Comm’n, Horizontal Merger Guidelines § 10, at 30 n.14 (2010); *see also* United States v. Phila. Nat’l Bank, 374 U.S. 321, 371 (1963) (effects analysis is not based on “some ultimate reckoning of social and economic debts and credits” because “[a] value choice of such magnitude is beyond the ordinary limits of judicial competence, and in any event has been made for us already, by Congress”).

⁴³ Brief of Appellees the United States of America and Plaintiff States 60, United States v. Anthem, Inc., Nos. 17-5024, 5028 (D.C. Cir. filed Mar. 13, 2017) [hereinafter “Anthem Br.”]

⁴⁴ Statement of Interest at 12.

Even if one were to impermissibly analyze the effects of the no-poaching agreements outside the alleged relevant labor market (which, for the reasons stated, are not to be “balanced” under Supreme Court precedent and the principles articulated in the Horizontal Merger Guidelines), the lower input costs the agreements achieve are not “efficiencies.” Rather, this kind of cost savings is just a pecuniary gain to the franchisees at the expense of workers. As the government explained in its *Anthem* brief:

Economics distinguishes between a “real” savings and a “pecuniary” savings. The former enlarges the pie shared by all members of society. The latter enlarges one slice by shrinking one or more other slices. A savings is real when the same output is produced using fewer resources or more output is produced using the same resources.⁴⁵

The no-poaching agreements here do not reduce the resources brought to bear in making fast food. They simply allow the franchise to capture a proportionally larger share of the surplus created by such resources than the worker, despite not having to invest in meaningful training.⁴⁶

In addition, the Department of Justice must account for the congressional pronouncement in Section 6 of the Clayton Act that “the labor of a human being is not a commodity or article of commerce.”⁴⁷ Congress’s decision to confer a labor antitrust exemption on otherwise vulnerable workers provides an independent basis to conclude that a restraint’s artificial reduction of an employee’s wages and mobility can not be treated as a “beneficial” effect that supports an “efficiencies” claim. To suggest otherwise would contravene the congressional policy laid down in Section 6 that elevates society’s interest in vulnerable workers achieving satisfactory working conditions over the national interest in fostering competition among such workers for the benefit of employers. Indeed, the Division has often emphasized that this kind of trade-off is better suited to Congress than antitrust enforcers,⁴⁸ and that enforcers should “remain humble in [their] pursuit of justice” as stewards of “the only agency in the federal government with a moral imperative in its name.”⁴⁹

3. *Even if the No-Poaching Agreements Generated “Real” Cost Savings, They Would Not Be Cognizable Efficiencies*

⁴⁵ *Anthem Br.* at 59-60 (citing F.M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 130 (3d ed. 1990)); *see id.* at 60-61 (“pecuniary savings increase the profitability of the firm” but “are not a gain to society and should not be properly included in the trade-off of cost savings and deadweight loss. The benefit to the . . . firm that can extract lower input prices from its suppliers is offset exactly by the loss to the suppliers[.]” (quoting 4A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 970e, at 37 (4th ed. 2016))).

⁴⁶ *Cf.* Alan B. Krueger & Orley Ashenfelter, *Theory and Evidence on Employer Collusion in the Franchise Sector* 18 (Princeton Univ., Industrial Relations Section, Working Paper No. 614, Sept. 2017) (noting that net increases in investments in skilled workers’ training are what would otherwise tend to render no-hiring agreements’ effects on workers ambiguous).

⁴⁷ Clayton Antitrust Act, 15 U.S.C. § 17 (2018).

⁴⁸ *See, e.g.*, Makan Delrahim, Asst. Att’y Gen, Antitrust Div., U.S. Dep’t of Just., Don’t Stop Believin’: Antitrust Enforcement in the Digital Era, Keynote Address at the University of Chicago’s Antitrust and Competition Conference (Apr. 19, 2018) (explaining why it is “dangerous” to ask antitrust enforcers “to make trade-offs between competition and non-competition goals on a case-by-case basis”).

⁴⁹ Makan Delrahim, Asst. Att’y Gen, Antitrust Div., U.S. Dep’t of Just., The Pursuit of Justice: Lessons in Competition from Judaism, Remarks at the Beverly Hills Jewish Community Speaker Series (Dec. 8, 2018) (second quotation attributed to Attorney General John Ashcroft).

Putting aside the nature of the cost savings they engender, and the tension they create with Section 6 of the Clayton Act, the alleged no-poaching agreements do not otherwise appear to provide any efficiency benefits that would be cognizable. In *Leegin*, the Court explained that intrabrand restraints can generate efficiencies by “aid[ing] the manufacturer’s position as against rival manufacturers.”⁵⁰ It noted that RPM “has the potential to give consumers more options so that they can choose among low-price, low-service brands; high-price, high-service brands; and brands that fall in between.”⁵¹

However, the no-poaching agreements at issue do not help franchisees compete for workers, whether on wages or by providing choices that workers value. The direct and primary effect of the agreements is to reduce wages and mobility, which unambiguously diminishes the attractiveness of selling employment services to the buyer, much as price fixing unambiguously diminishes the attractiveness of buying products from the seller.

In a competitive labor market, the artificially reduced wages would only make it harder, not easier, to attract and retain workers.⁵² On balance a rational worker would self-evidently prefer to seek employment at a fast-food franchise that permits intrabrand rivalry on wages than one that does not. And if the franchisees collectively enjoy buyer power or monopsony power in the labor market, economic logic predicts that the lower input costs the power generates typically will induce them to purchase less in the way of quality-adjusted employment services from workers.⁵³ On their face, then, the challenged agreements will invariably tend to reduce output in the labor market, if they have any effect there at all.⁵⁴

To the extent the no-poaching agreements afford workers a lower-wage, lower-quality employment “alternative,” it would be a farce to treat the agreements as promoting “choice.” While consumers may value the opportunity to buy lower-price, lower quality goods because of the savings they reap, sane workers do not value unconditionally inferior employment opportunities in the same line of business, because they reap nothing in exchange for their sacrifice. No rational fast-food worker looking to sell his services would choose to have fewer choices.

⁵⁰ *Leegin*, 551 U.S. at 890.

⁵¹ *Id.* at 890.

⁵² See Krueger & Ashenfelter, *supra* note 46, at 9 (“At first blush, a basic franchise no-poaching agreement appears to fly in the face of the goal of retaining any human capital specific to the franchise company’s workers. Having invested in specific skills, why compel workers to leave the franchise in order to take another job?”). That’s assuming the workers even know such agreements exist. Unlike an employee who must sign a non-compete clause, workers injured by franchise no-poaching agreements are not parties to the agreements, and may not even know such agreements govern their choices. *See id.* at 18.

⁵³ See AAI Paper at 2 n.5 (discussing economic phenomenon whereby exercise of buyer power in input markets leads to less quality-adjusted output in such markets (citing Alan Devlin, *Questioning the Per Se Standard in Cases of Concerted Monopsony*, 3 *Hastings Bus. L.J.* 223, 230-232 (2007); Peter C. Carstensen, *Competition Policy and the Control of Buyer Power* 40-43, n.5 (2017)); *see also* Carstensen, *supra*, at 40-43 (discussing “all-or-nothing” strategies whereby powerful buyers can “extract the same quantity of output that would have been produced at a competitive price without paying that price,” because the employee still needs the work despite reduced wages (and may even need more work) to earn the minimum necessary income).

⁵⁴ As with wage-fixing, the degree of harm caused by a no-poaching agreement may be larger or smaller depending on the competitiveness of the relevant labor market.

Some economists believe narrowly tailored no-hiring agreements are sometimes capable of promoting added training investments in skilled workers.⁵⁵ Likewise, some courts have upheld narrowly tailored no-hiring agreements that had a limited scope and duration connected to a particular procompetitive purpose, such as to facilitate an efficient business sale.⁵⁶ But the complaints here involve ongoing no-poaching agreements in the basic governance agreements between franchisors and franchisees, and they cover workers occupying low-skill, low-wage, high-turnover employment positions.⁵⁷ The economics literature is clear that the latter do not generate any of the efficiencies sometimes associated with the former.⁵⁸ The only apparent way the agreements at issue can generate “efficiency benefits” for franchises is by eliminating labor-market competition and reducing quality-adjusted output. Any conceivable benefits thus would be out-of-market or non-cognizable.⁵⁹

4. *There is No Evidence the No-Poaching Agreements at Issue Generate Even Non-Cognizable Efficiencies*

Perhaps most tellingly, the defendants confronted with complaints in these cases did not (or could not) cite even speculative efficiencies, or allude to efficiencies *arguments*, in responding to the plaintiffs’ allegations. The defendants in all three cases filed substantially similar motions to dismiss arguing only that (1) franchisors and franchisees are incapable of “conspiring” because they are a single entity, (2) the agreements are not between horizontal competitors, and (3) the relevant market is broad and competitive.⁶⁰ They do not suggest or imply at all that the no-poaching agreements are efficient or somehow necessary to the broader franchise agreements.

The Statement of Interest, likewise, does not identify any actual, conceivable efficiencies that could be functionally related to the no-poaching agreements themselves. Like the defendants’ motions to dismiss, the Statement of Interest rests the prospect of efficiencies entirely on the

⁵⁵ See Krueger & Ashenfelter, *supra* note 46, at 18 (citing Paul A. Grout, *Investment and Wages in the Absence of Binding Contracts: A Nash Bargaining Approach*, 1984 *Econometrica* 449-60 (1984)).

⁵⁶ *Eichorn*, 248 F.3d at 146 (limited no-hiring agreement ancillary to business sale insofar as primary purpose was to “retain the skilled services of [the buyer’s] employees”); *Cesnik v. Chrysler Corp.*, 490 F.Supp. 859, 868 (M.D. Tenn. 1980) (primary purpose of limited agreement was to “retain the skilled services of management-level employees”).

⁵⁷ The complaints allege no-poaching agreements covering crewmembers who twist and bake soft pretzels at Auntie Annie’s, Plaintiff’s Antitrust Class Action Complaint 7, *Stigar v. Dough Dough, Inc.*, No. 2:18-cv-00244-SAB (E.D. Wash. filed Aug. 3, 2018), crewmembers working at Arby’s fast food sandwich shops, Plaintiff’s First Amended Antitrust Class Action Complaint 3-4, *Richmond v. Bergey Pullman, Inc.*, No. 2:18-cv-00246-SAB (E.D. Wash. filed Aug. 22, 2018), and shift leaders at Carl’s Jr. fast food sandwich stores, Plaintiff’s Antitrust Class Action Complaint 4, *Harris v. CJ Star, LLC*, No. 2:18-cv-00247-TOR (E.D. Wash. filed Aug. 3, 2018).

⁵⁸ See, e.g., Krueger & Ashenfelter, *supra* note 46; Krueger & Posner, *supra* note 5. Of course, even if they did, there remains the question of whether less restrictive alternatives are usually or always available for any no-poaching agreement. See *supra* note 5.

⁵⁹ See, e.g., *Polygram Holding*, 416 F.3d at 38 (a claimed “procompetitive” justification” premised on the elimination of competition is “nothing less than a frontal assault on the basic policy of the Sherman Act” (quoting *Nat’l Soc’y of Prof’l Engineers*, 435 U.S. at 695.)); see generally *United States v. Anthem, Inc.*, 855 F.3d 345, 369-71 (2017) (Millett, J., concurring); see also Horizontal Merger Guidelines, *supra* note 42, § 10, at 30 (2010) (cognizable efficiencies “do not arise from anticompetitive reductions in output or service”).

⁶⁰ See generally Defendant’s Motion to Dismiss, *Stigar v. Dough Dough, Inc.*, No. 2:18-cv-00244-SAB (E.D. Wash. filed Oct. 22, 2018); Defendant’s Motion to Dismiss, *Richmond v. Bergey Pullman, Inc.*, No. 2:18-cv-00246-SAB (E.D. Wash. filed Oct. 22, 2018); Defendant’s Motion to Dismiss, *Harris v. CJ Star, LLC*, No. 2:18-cv-00247-TOR (E.D. Wash. filed Oct. 22, 2018).

prospect of ancillarity, which, for the reasons explained in the next section, almost certainly does not exist.

C. By Definition the Challenged Agreements Are Not Ancillary if They Have No Functional Relationship to the Broader Franchise Agreement and No Efficiencies

The complete absence of plausible justifications and cognizable efficiencies attending the no-poaching agreements also belies the Statement of Interest’s conclusory assertion that the alleged conspiracies are “likely subject to the ancillary restraints doctrine.”⁶¹ Agreements that have no plausible justifications or cognizable efficiencies are *never* ancillary, because by definition they do not hold the promise of procompetitive benefits and are not “necessary” to the broader integration. Indeed, this is simply the flip side of the *a fortiori* conclusion drawn in Part II above.⁶² It re-illustrates why it would be inappropriate bootstrapping to predict that a restraint likely promotes the procompetitive benefits of a larger integration simply because it is included on the same piece of paper.

If the Division still doubted that the agreements at issue were exceedingly unlikely to prove ancillary, it should have considered that the Attorney General of Washington, who filed an amicus brief siding with the plaintiffs in these cases, has persuaded 57 franchise chains to voluntarily eliminate similar kinds of no-poaching agreements in franchise contracts without even filing a complaint.⁶³ Indeed, at the time the Statement of Interest was filed, all of the defendants in the consolidated cases were already among the 57, and they had agreed to end use of the no-poaching provisions not just in Washington, but throughout the United States.⁶⁴ Insofar as the firms had already *demonstrated* that the no-poaching agreements could be easily abandoned, what was left to suggest to the Division that they were necessary to the broader franchise agreement for purposes of the ancillary restraints test?

The fact that a vertical restraint may have zero plausible justifications or efficiencies also independently illustrates why the Statement of Interest is wrong to imply that the vertical orientation of the restraint, rather than the restraint’s likely effects, informs the proper mode of analysis required under the rule of reason.⁶⁵ Because the ancillary restraints doctrine is exceedingly *unlikely* to apply when a vertical restraint has no plausible justifications or cognizable efficiency benefits, there is no reason to suspect a quick look is any more or less appropriate in these cases than it would be in a case involving any other naked restraint.

⁶¹ Statement of Interest at 13.

⁶² See *supra* Part II, at 5 (“If the only basis for predicting whether such agreements will satisfy the ancillary restraints test is that they are inserted into broader, efficiency enhancing franchise agreements, then *a fortiori* the no-poaching agreements are not “likely” to prove ancillary or to be moved out of the quick look category. The likelihood of either outcome is unknowable at best”)

⁶³ See Washington State Off. of the Att’y Gen., *AG Ferguson’s Initiative to End No-Poach Clauses Nationwide Secures End to Provisions at Seven More Corporate Chains* (Feb. 15, 2019), <https://www.atg.wa.gov/news/news-releases/ag-ferguson-s-initiative-end-no-poach-clauses-nationwide-secures-end-provisions-0>.

⁶⁴ See Washington State Off. of the Att’y Gen., *AG Ferguson Announces Fast-Food Chains Will End Restrictions on Low-Wage Workers Nationwide* (July 12, 2018), <https://www.atg.wa.gov/news/news-releases/ag-ferguson-announces-fast-food-chains-will-end-restrictions-low-wage-workers>.

⁶⁵ See *supra* Part III.A.

IV. Conclusion

AAI believes the idea that a fast-food franchise's success depends in any way on its ability to restrict entry level employees from seeking better employment terms from intrabrand rivals should not be taken seriously. Whether or not the Division agrees, it should have advised the district court that naked vertical no-poaching agreements that have collusive effects in labor markets and no plausible efficiency justifications tend to be unambiguously anticompetitive. And they stand almost no chance of proving ancillary to the broader, efficiency enhancing franchise agreement.

The Division should not have advised the district court to apply the full rule of reason to these agreements. If the per se rule does not apply, a quick look analysis seems entirely appropriate. But at the very least, it is plain that a quicker look is warranted with regard to effects analysis.⁶⁶ A Statement of Interest that “describes the legal standards”⁶⁷ applicable to vertical no-poaching agreements also should acknowledge that “the categories of analysis of anticompetitive effect are less fixed than terms like ‘per se,’ ‘quick look, and ‘rule of reason’ tend to make them appear.”⁶⁸ And not “every case attacking a less obviously anticompetitive restraint . . . is a candidate for plenary market examination.”⁶⁹

Thank you for considering the views of the American Antitrust Institute.

Respectfully,

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⁶⁶ A DOJ official was recently quoted as stating, “In our view, the quick-look test should be rarely invoked.” MLex Market Insight, MLex in Washington: Report from the 67th ABA Antitrust Law Spring Meeting (March 26-29, 2019) (quoting William Rinner, acting chief of staff to Assistant Attorney General for Antitrust Makan Delrahim).

⁶⁷ Statement of Interest at 1.

⁶⁸ *Cal. Dental*, 526 U.S. at 779.

⁶⁹ *Id.*