Business Better (Episode 39): A Deep Dive into "No-Poach" Agreements

Speakers: James Mitchell, David Fryman, and John Wright

John Wright:

Welcome to Business Better, a podcast designed to help businesses navigate the new normal. I'm your host, John Wright. After serving nearly 15 years as Senior Vice President and General Counsel at Triumph Group Incorporated, a global aerospace component supplier, I'm now a member of the securities and M&A groups at Ballard Spahr, a national law firm with clients across industries and across the country. Today's episode features a discussion with no poach agreements, agreements between competitors that neither will hire the other's employees. We will discuss the different types of such agreements, their enforceability under antitrust and other laws and the possibility of criminal prosecution arising from their use and how to protect the business from poaching without running afoul of the law.

John Wright:

Joining me in this discussion are David Fryman partner at Ballard's Philadelphia office who represents employers in all types of labor and employment matters and Jim Mitchell, a partner in Ballard's New York office, who focuses on criminal and civil litigation in a broad range of areas, including criminal prosecutions under the antitrust laws. David and Jim, welcome to Business Better. So let's start this topic with the basics. David, what is a no poach agreement that we'll be talking about?

David Fryman:

John, it's essentially an understanding generally between competitors that each will not hire and or solicit for employment the other's employees. Such an agreement can be written. It could be verbal. In some instances, it might even be implied by the competitor's actions. It may consist of an agreement never to hire the other's employees or a subset of employees, or it can be an agreement not to target or solicit the competitors' employees but preserve the ability to hire if the competitor's employee independently applies for a position.

John Wright:

Got it. So to give our listeners a feel for how these issues come up, perhaps it would be helpful if each of you describe the circumstances in which these agreements and the related issues typically come to you. Jim, let's start with you.

Jim Mitchell:

Thanks John. So I'm a criminal defense lawyer at heart. I do a little litigation too, but typically I would say these types of cases like most criminal cases come to my attention or come to my office, if you will, in one or two ways. One, there's a call from a company counsel, internal counsel, who has become aware for example, that there's a complaint maybe a disgruntled employee or a whistleblower, somebody has raised an issue about being restricted in hiring or no poach type agreement. And I get the call from the general counsel about this issue. Usually that situation is one where the government itself has not yet been involved. So there's no investigation and undergoing, but they want to kind of get ahead of the game and see what can be done proactively. The other one is when the government is involved and in those situations, usually I get the call after an FBI agent shows up at an employee, your ex-employees door, usually at 6:00 in the morning, knocking on the door, wanting to ask questions or serve a subpoena.

Jim Mitchell:

And sometimes the agent may even just go to the company itself, go to the front desk and say we want to see the CEO or serve a subpoena, which can be a little disruptive and upsetting to the company itself. And obviously that trickles up to the

general counsel and I can get a quick call like what the heck's going on? Why'd do this? So those are your typical examples in my world.

John Wright:

Got it. So, David, your practices are quite so exciting. I don't think in that respect, but how do you come across these?

David Fryman:

Well, Exciting is in the eye of the beholder, John. I, of course I'm on the labor and employment side of the house. And I most often see the topic arise when a client calls upset that a competitor has either, well, one fell swoop or over a period of time poached its employees. And often in those situation, the client is upset because it finds itself in a situation where it does not have any of its own agreements with its employees containing restrictive covenants like non-compete provisions or non-solicitation provisions.

John Wright:

Well, for my general counsel days. I can tell you that is not an unfamiliar set of circumstances to me. So Jim, what's the problem? What is wrong with no poach agreements?

Jim Mitchell:

Good question. Well, so at bottom, I would say they are viewed by a lot of people as being anti-competitive. And if you think about the fact that there's a market for everything, employers are buyers, if you will, for the market of labor or employees. And when employers get together and they agree we're not going to hire each other's employees or put further restrictions on their ability to poach each other's employees, they're basically limiting the options of the employees to move from one company to the other and dividing the market. It's basically allocating the market for labor amongst themselves, which is a traditional sort of no-no in the world of antitrust law.

Jim Mitchell:

And the rationales behind that are that if you have such a no poach agreement, you can imagine that employees are and may feel like they are less mobile from moving from one company to another and have a less ability to maximize their salary or benefits or whatever compensation that they're looking for. And the sort of result of that, result, if you will, is that they don't feel that putting out their best effort is going to get them the best compensation. So the DOJ in particular feels like these types of agreements ultimately result in workers who don't provide the best goods or services that they would if there was a real competitive market for labor.

John Wright:

So are no poach agreements different than non-solicitation agreements that employees often sign?

David Fryman:

They are John. The no poach agreements we've been talking about are agreements between entities. Individual employees are not parties to these agreements. Our listeners no doubt are familiar with non-solicitation and non-competition agreements. Many employers require some of their employees to sign typically either at the commencement of employment or sometimes on departure as part of a severance agreement. To use a geometric analogy, the no poach agreement is horizontal between competing business entities while the non-solicitation non-compete agreement is vertical between the employer and its employee. As we'll see no poach agreements, these no poach agreements between competitive entities are subject to greater scrutiny due to their potential anti-competitive effects and their potential impact on these individuals who are not parties to the agreement.

John Wright:

Got it. So how are no poach agreements regulated?

Jim Mitchell:

I'll take that one. Okay. So a variety of ways. In the federal side, there's something called the Sherman Antitrust Act. It was enacted probably 120 years ago now. It's a federal statute that historically has provided private plaintiffs, litigants, the means to recover damages if they feel like they have been wrong by any kind of anti-competitive activity. And it has various provisions like allowing private plaintiffs potentially to recover treble or triple damages for whatever injury they suffered. Also each state, pretty much each state I would imagine, has their own set of antitrust laws that regulate the similar type of conduct. It's enforced by attorneys general in the states. And there may be provisions that allow private plaintiffs to sue under state law too. That's sort of the background to what I deal with mainly and I think is the main area of enforcement in this area, which is the federal government itself using the Sherman Antitrust Act to do basically civil and criminal enforcement of against antitrust, or actually anti-competitive non-poach agreements.

Jim Mitchell:

And in the past we have seen the antitrust division, and let me just backtrack for a second. The Department of Justice is the federal regulators, if you will, the federal law enforcement. An arm under that enforcement group is called the Department of Justice Antitrust Division and they do both civil and criminal enforcement. Historically they have, and you've seen them bring civil actions to enjoin and fine conduct that they see where there's no poach type agreements or no hire agreements and most employees. A couple of examples. There was one point they brought a civil action against a variety of tech companies: Google, Apple, Intel, I think Intuit that were sort of operating under a we won't poach your employees agreement. And also in the air brake industry, which is probably the lesser known to our listeners, but there was a similar no poach agreement there. Both of those cases the government bought significant civil cases that ultimately resulted in settlements and big fines and judgements. That was probably 10, 15 years ago now to the last five years.

John Wright:

And has that process changed recently?

Jim Mitchell:

Yes, it has. I just talked about some civil enforcements, but in October of 2016, the Antitrust Division issued something that they called, it was a document which was entitled "Anti-trust guidance for human resource professionals." It was issued also in conjunction with the Federal Trade Commission, but basically it was a statement to the world, if you will, in the anti-trust world that, hey, we really think these no poach agreements are evil. We think they are bad. We think that they're so bad that we are going to embark on a new policy and we're going to prosecute where we think appropriate these no poach agreement is criminal. They've never done it to date, but they were sort of serving notice that this could happen.

Jim Mitchell:

And to go back to that Sherman Act, the Sherman act has not only the civil penalties I've talked about it earlier, but it has some significant criminal penalties, chief being a felony that you could be convicted of and depending on the level of commerce involved, could result in significant jail time. There were also significant fines. A company could be fined I think $100 million for each violation. And an individual up to a 1 million for each violation. So they can add up. And the DOJ released it in 2016 was specific to say, we're going to be going after companies and individuals when we're looking at these no poach type agreements. Just an add in here to supplement what I just said. People wonder, I've been asked the question, has or is the new administration going to move this what direction now that we're under Biden's administration?

Jim Mitchell:

Because if you think back, the original policy was issued in October of 2016, sort of just right before the 2016 presidential election. So nothing really happened under the Obama administration, which was the one who engineered the program to begin with. And then when you got to the Trump administration, let's just say antitrust law was not an enforcement priority under Trump, to maybe speak a little bit lightly on that. But now with Biden, I think with Biden obviously being the vice-president under Obama, when he came in, Biden's administration and the people he has a task to be taking over the enforcement areas of Antitrust Division have all given every indication that they are going to provide a greater focus on enforcing antitrust laws, particularly mergers.

Jim Mitchell:

But certainly I think that will bleed over to this area of no poach. And I would really expect there to be something of an uptick in this area, particularly since it's such a new area. That uptick, it's only one or two prosecutions, so uptick is not going to be a lot. But what I do think, you're going to see much more of this in the next three or four years.

John Wright:

Well, all of that's pretty sobering. David, is that ever acceptable for companies to reach such agreements among themselves?

David Fryman:

Well, John, the DOJ guidance is that the so-called naked no poach agreements we've been discussing, that is agreements between competitors in which the agreement not to poach is the sum and substance of the agreement, those are prohibited. But the flip side of that is that agreement may be appropriate in the DOJs view if they're ancillary to a larger agreement that is promoting efficiency and or competition.

David Fryman:

In other words, one of these no poach agreements or provisions in a larger agreement, it has to be subordinate and collateral to a legitimate business collaboration and it's got to be "reasonably necessary" to achieving the pro competitive purpose of the business collaboration. For example, a non-solicitation or no poach agreement between companies that are part of a divestiture or acquisition or in advance of such a transaction during the due diligence process, that may be acceptable because no poach agreements in that context would be viewed as an appropriate pro competitive part of the transaction. Because without such an agreement, a buyer and or seller might fear key employees would go to the other party to the transaction, to the point that they wouldn't want to do the deal in the first place. So under those circumstances, it would be viewed as reasonably necessary to achieving this pro competitive purpose of the business collaboration.

John Wright:

Well, those are certainly circumstances I've seen and it makes a lot of sense. But let's turn back to the more problematic circumstances. Has the DOJ actually prosecuted anyone criminally for an anti-poaching agreement?

Jim Mitchell:

The answer is yes, John and the answer is one. There's one instance that it started I think January of this year when the DOJ indicted a company down in Texas. The company was involved in the operation of outpatient medical care services. And they are alleged to have been in agreement with other similar providers of those services to not hire each other's employees. And if you look at the indictment, it's pretty interesting because it gives you some pretty specific examples of the types of conduct that at least in that case, the DOJ is saying, hey, this is outside of the bounds of what's appropriate. And just examples, cited in the indictment or a couple of emails where a prospective candidate solicited his, or put his or her application for employment in to be interviewed with one company and there's some internal emails where one of the potential hiring company employee who says to the other, well, given our "verbal agreement" with the candidates current company to "not poach their folks", what should we do?

Jim Mitchell:

Which is a pretty explicit description of what they had. Also in this case, it's alleged that one of the parts of the agreement they had was if somebody wanted to move from one company to another, in this industry, you could interview them in fact, but only if they were able to certify and show you that before they were seeking employment at a company Y, they had actually told their employer at their current company X that they were looking for a job and that they were out interviewing, which as you can imagine, could probably put a crimp on their interest in going and looking into the labor market.

Jim Mitchell:

So that indictment happened back in January and without sort of going into too deeply into it, the events since then have been kind of interesting from antitrust wonk, if you will, the perspective that the defendants have moved to dismiss the case, because they have said, look, this area of law, this area of criminal prosecution is so brand new that it's not fair to prosecute us criminally because we didn't have the appropriate notice. And due process, constitutional violation has occurred by you prosecuting us criminally, so you should dismiss the case. But the thing they argue is that, hey, it's brand new and even if you issued that, release back in October, 2016, that's not enough because frankly, if you look back at even the civil cases that have been going on for the last five, 10 years, it's never clear these no poaching agreements or actually even violating the antitrust laws at all because they sort of go both ways.

Jim Mitchell:

Sometimes the judge or jury says there's sufficient pro-competitive reasons for it, that it shouldn't be a violation and the other side is sometimes they do. So when you have that kind of mixed bag, it really is unfair to say, okay, this type of conduct is so obviously bad that we can prosecute people criminally for it. And that's the argument down there. And frankly, I think it's a pretty good argument, but we'll see if it gets any traction.

John Wright:

So David are government actions the only source of concern here?

David Fryman:

In a word, John, no. If we have an ancillary no poach agreement. In other words, one that is not a naked, as they say, and per se illegal, but part of a larger business collaboration, one of the parties to such an agreement of course still can sue to enforce the agreement if they believes the other party to the agreement has poached its employees in violation of that agreement.

David Fryman:

And that is what happened in a case that made its way recently to the Pennsylvania Supreme Court. The case involved an agreement between two freight firms that had entered into a business relationship. The plaintiff, Pittsburgh Logistics is a third party logistics provider that arranges for the shipping of its customers freight with selected trucking companies. One of those companies, the defendant Beemac Trucking is the shipping company that entered into an agreement with Pittsburgh Logistics to transport the Pittsburgh Logistics customers' freight. Consequently, the no poach provision of this agreement was ancillary to a legitimate business collaboration, a services contract. The Pennsylvania Supreme Court therefore assessed the no poach provision using what we call the rule of reason as that rule is outlined in the restatement of contracts.

David Fryman:

And under that test the no poach provision would be invalid if the no poach restraint was greater than needed to protect Pittsburgh Logistics legitimate interest or Pittsburgh Logistics need for the protection was outweighed by the hardship to Beemac and the likely injury of this restraint of trade to the public. So what happened? Well in a classic case of bad facts can often lead to bad law, Pittsburgh Logistics no poach provision was incredibly broad. It sought to forbid Beemac from hiring or soliciting any Pittsburgh Logistics employees, whether or not they had any contact with Beemac as part of their scope of

employment with Pittsburgh Logistics, anywhere in the world and for the length of the contract, which could be renewed indefinitely plus two years.

David Fryman:

So applying this rule of reason test, the Pennsylvania Supreme Court found this no poach or no hire provision greater than needed to protect Pittsburgh Logistics interests. The court noted, as I mentioned a moment ago that the length of the restriction was incredibly long and that the provision precluded Beemac from hiring or soliciting all Pittsburgh Logistics employees, regardless of whether they had worked with Beemac during the term of the contract. Now the court could have stopped there, but it went further. It went on to find injury to the public because the provision impaired the employment opportunities and job mobility of Pittsburgh Logistics employees who are not parties to this contract without their knowledge or consent and without providing them anything, any consideration in exchange. And it's these points that to my mind, prove most troubling going forward. While not explicitly adopting a consideration standard, the court's opinion suggests that not providing some benefit to the employees impacted in exchange for the restriction can jeopardize the enforceability of that no poach provision.

John Wright:

So can companies on their own choose to follow a no poaching policy? Jim?

Jim Mitchell:

The answer is yes. The Sherman Act, the general guidance here and regulatory standard does not regulate a company's own independent decision on how it wants to run this company. In this instance, whether it decides for example, we just don't want to hire our competitors employees for one reason or another. You can do that as a company and you can do it voluntarily, but if you choose to do it, you want to be careful that if you have such a policy, it's well-documented and not to be viewed as some sort of tacit agreement with your competitors who might be doing the same thing. So document it, document the reasons for it, make sure that the employees that are implementing that policy do not discuss it with competitors or competitors' employees. It should be something purely internal and something that you can support and justify if someone comes calling and says, I think you actually have some sort of agreement with your competitor. That's just not your own voluntary policy. So, yes, but be careful.

John Wright:

Well, that's helpful. So I guess we're coming to the end of our discussion. Before we go, could you each offer some tips or guidance for our listeners? Jim, let's start with you.

Jim Mitchell:

Sure. I'll take off what I took from what I was just saying before. The first one is simple. You should not, or your employees should not be communicating at all with their competitors about soliciting or hiring employees from each other. That's just going to lead to problems and even avoid the suggestion that some agreement exists with your competitor. You do that by not having such conversations. If, for example, and it certainly will happen, I think you've probably all experienced something like this before, an employee of a competitor approaches one of your employees or vice versa, where the topic of sort of leaving my employees alone and I'll leave yours alone or something like that is discussed, the recipient of that needs to be conscious of the fact that they need to decline that request vigorously and report it to whomever internally they should be in whatever the sort of reporting structure is for any kind of potential legal activity.

Jim Mitchell:

It's important. And if you learn for example, that the conduct has already occurred and you maybe you're the internal counsel, you should probably be getting some outside counsel help or somebody with antitrust experience to deal with immediately either undoing the problem as quickly as possible and addressing the potential that it may have enforcement repercussions.

Last thing I'll say is that the other thing that companies should be certainly focused on in this no poach area is holding regular anti-trust training programs for their employees that include all antitrust type issues but also this new one, this no poach area and also sort of developing and making sure they have the kind of important structural reporting mechanism or compliance structure in place so the issues that do come up can be raised promptly through the company's structure up to the right people.

Jim Mitchell:

And having that kind of training and that kind of a reporting structure serve a lot of purposes. One, they hopefully avoid ever having a problem in the first place because the employees learn what they're supposed to and not supposed to do and they follow the rules. It also allows them, if something does happen, to get the information about a problem quickly to the right people who can address it properly, which obviously is quite helpful.

Jim Mitchell:

And finally, if all hope is lost and you're actually being prosecuted, or some enforcement action is coming as a result of this type of conduct, just the fact that a company has in place a very good or a good training program and reporting structure can help in getting it better resolution with the government because one of the factors they always look at is, were you a good corporate citizen? Did you have in place a good antitrust program to educate your employees and even despite the fact that you had it, this problem still arose. But you still get credit for what you tried to do. And that could help get a good resolution at the end of the road, if you have to deal with the government, so.

John Wright:

Thanks, David, what would you have to add?

David Fryman:

Not much, John. From a labor and employment lawyer perspective, the guidance is also quite simple as this Pittsburgh Logistics, Beemac Trucking case, I think instructs employers should consider entering into non-solicitation and or non-compete agreements with their key employees and use that as either a supplement to or an alternative to these horizontal no poach agreements that, as Jim has demonstrated, can get you into trouble.

Jim Mitchell:

Let me add one thing I just wanted to... I mean, one of the things people who are listening to this should appreciate, at least from the criminal perspective, is it's not been clear already. This is a really new evolving area of investigation and analysis by the government. So it's important to be aware and keeping tabs through whatever mechanism you can of the current state of the law, because it's changing pretty quickly.

John Wright:

Yeah, it sounded as though from each of the cases that you guys had reviewed that there are things to watch as we go forward. So that will be interesting. But this has been a terrific introduction to the topic and really appreciate your taking the time and I hope our listeners have gotten a lot out out of this. So David, Jim, thanks very much for being guests on Business Better.

Jim Mitchell:

Thank you, John. Much appreciate it.

David Fryman:

Thanks for having us John.

John Wright:

Thanks again to David Fryman and Jim Mitchell. Make sure to visit our website www.ballardspahr.com where you can find the latest news and guidance from our attorneys. Subscribe to the show in Apple Podcasts, Google Play, Spotify or your favorite podcast platform. If you have any questions or suggestions for the show, please email podcast@ballardspahr.com. Stay tuned for a new episode coming soon. Thank you for listening.