Cassels

Raising a Red Flag - Competition Laws Being Used to Attach Non-Solicitation Clauses in US Franchise Agreements

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Is it Time for You to Consider Revising your Canadian Franchise Agreement to Remove the Risk?

For many years, standard franchise agreements in Canada and the United States have included provisions that prohibit a franchisee from hiring away the employees of the franchisor or employees of another franchisee of the franchisor. In Canada, these have historically been referred to as non-solicitation clauses, while in the US they are often called no-poaching clauses. The rationale behind these clauses seems straightforward enough, namely that the franchisor or a franchisee of the system should not absorb the cost of training good employees only to have those employees lured away by other franchisees of the same brand. So prohibiting the solicitation or luring away of employees by other franchisees was meant to keep the peace within the system. A typical non-solicitation clause in a Canadian franchise agreement may look like this:

The Franchisee shall not, directly or indirectly, without the prior written consent of the Franchisor, hire, solicit, interfere with or entice away, from the Franchisor, or any other franchisee of the Franchisor, any employee of the Franchisor or any employee of another franchisee of the Franchisor.

While these provisions have been in standard franchise agreements for many years, they have recently come under scrutiny in the US, resulting in various large franchisors being sued by a number of US State governments under the theory that these no poaching provisions are anti-competitive as they stand in the way of employees seeking a better paying job with another business (i.e., another franchisee of the same brand) because those other franchisees are not permitted to hire them. This effectively depresses wages amongst some of the already lowest wage earners in the US, namely employees of franchised fast food restaurants.

The reality is that while no-poach provisions were in many, if not most, franchise agreements, they were rarely used or enforced. So instead of fighting the legal issue, many of the big name US-based brands who have been sued by US State governments have settled these actions by undertaking not to enforce the no-poach clauses against franchisees that have them in their franchise agreements, and to undertake to remove them from future franchise agreements. (Some insight into the situation in the US, can be found here.)

We have been following these developments, because while the legal issue has not yet been litigated in

Canada there is every reason to believe that these same non-solicitation clauses may be similarly attacked under Canadian competition laws.

Under the criminal conspiracy provisions of the *Canadian Competition Act* (the Act), it is a criminal offence for competitors (and potential competitors) to enter into agreements to fix prices, allocate markets or restrict the supply of a product. The term “product” is defined quite broadly and includes services of any type. While there have been no enforcement actions taken under the criminal provisions of the Act in the context of non-solicitation, no-poach or wage-fixing agreements, the language of these provisions is potentially broad enough to apply to these types of agreements. In addition to significant criminal sanctions (significant fines and possible imprisonment), a violation of the criminal provisions of the Act also exposes companies to the risk of civil damages claims, which are often brought by way of class actions.

Even if the criminal provisions of the Act do not apply, the Canadian Competition Bureau (the Bureau) could challenge non-solicitation, no-poach or wage-fixing agreements under the non-criminal provisions of the Act that prohibit anticompetitive agreements between competitors. Although violations of these provisions do not result in criminal sanctions, they can result in significant negative consequences including prohibition orders, legal costs, reputational harm, among others.

Because the relevant provisions of the Act focus on agreements between competitors, there may be an argument that, in particular, where the franchisor does not operate corporate stores, it is not a “competitor” – in which case these provisions may not apply to no poach provisions in the franchise agreement. However, even if the no-poach clause may not be subject to attack under these provisions of the Act, the enforcement by the franchisor of no-poach provisions, if not handled with care, may be viewed as facilitating an unlawful agreement between competing franchisees or raise possible “hub-and-spoke” conspiracy issues.

While the Bureau does not have a formal position regarding how the Act may apply to non-solicitation, no-poach and wage-fixing agreements, it is clear that the Act includes both criminal and non-criminal provisions that could apply to no-poach provisions in franchise agreements. Given the close relationship between the Bureau and US antitrust enforcement agencies, it may only be a matter of time before the Bureau steps up its enforcement activities in this area as well.

The instances of these clauses being used in Canada appear to be rare. So, to avoid similar compliance issues or claims being raised, we similarly recommend they be removed from franchise agreements, before the problem makes its way to Canada. Please speak to a member of our Franchise Law Group about assisting you on this issue.
