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Employer Update

A Renewed Look by the DOJ at No-Hire Agreements

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In This Issue

A civil antitrust suit filed last fall by the United States Department of Justice (DOJ) against eBay alleges that an unwritten agreement by eBay not to recruit or hire the employees of Intuit constitutes a "per se" violation of the federal antitrust laws. The DOJ alleges that the agreement was a "handshake" deal by senior executives of both companies, and that this agreement reduced the two competitors' incentives and ability to compete. The DOJ further alleges that the agreement restricted employee mobility by lowering salaries and benefits that the employees otherwise could have commanded.

Regardless of the merits (or lack thereof) of the DOJ's factual assertions or legal theories, the case is noteworthy to employers because employees may cite the case in support of challenges to employment practices that most businesses believed to be perfectly lawful. For example, employers frequently negotiate agreements with senior executives that prohibit the executive for some defined period from participating in post-employment hiring or recruiting of employees from the former employer. Similarly, in the context of a purchase of a business, the buyer may negotiate to prohibit the seller for some period of time from hiring employees of the business. In both of these circumstances, the parties enter into such agreements for the purpose of protecting the employer's goodwill or trade secrets, and in most cases would have had no reason to believe that the restrictions on hiring or recruitment could be construed as unreasonable.

In this article we examine the case law addressing the legality of agreements not to hire, and offer some suggestions as to ways in which employers might sharpen their drafting of such agreements to reduce the risk of a legal challenge to the restrictions.

Background

There are very few reported cases addressing the legality of agreements not to hire, and courts that have addressed the issue have rejected the theory that the DOJ espouses in the *eBay* case that such agreements are "per se" illegal. Rather, case law suggests that agreements not to hire should be analyzed for antitrust law compliance under a "rule of reason." For example, *Eichorn v. AT&T Corp.*, 248 F.3d 131 (3d Cir. 2001) involves a situation in which AT&T, in

an effort to make its affiliate, Paradyne, more attractive to potential buyers of the business, adopted a human resource plan prohibiting any employees who voluntarily left Paradyne from being hired by any other division of AT&T. After AT&T transferred ownership of Paradyne to Lucent Technologies (another AT&T affiliate) as part of a business reorganization, Lucent sold Paradyne to Texas Pacific Group. Before the sale closed, Lucent agreed, on behalf of itself and the other former AT&T affiliates, not to hire or recruit any Paradyne employee with an annual income exceeding $50,000, and after the closing the parties agreed to extend these terms for an eight-month period following the sale. A group of former Paradyne employees challenged these hiring restrictions as a "group boycott" and "horizontal price fixing conspiracy" in violation of Section 1 of the Sherman Act.

Employees may cite the *eBay* case in support of challenges to employment practices that most businesses believed to be perfectly lawful.

Plaintiffs argued that the no-hire agreement was "per se" illegal as a "naked restraint[] of trade" that had the sole purpose of stifling competition. *Id.* at 142. Under the "per se test," which Plaintiffs submitted should be the standard applied to the matter at hand, "agreements whose nature and necessary effect are so plainly anti-competitive that no elaborate study of the industry is needed to establish their illegality are found to be antitrust violations." *Id.* at 138. On the other hand, under the "rule of reason test," which the Third Circuit explained applies to "those activities not within the per se invalidity category," "plaintiffs have the burden of establishing that, under all the circumstances, the challenged acts are unreasonably restrictive of competitive conditions in the relevant market." *Id*. An analysis under the rule of reason test "includes the consideration of the facts peculiar to the business in which the restraint is applied, the nature of the restraint and its effects, and the history of the restraint and the reasons for its adoption." *Id*.

Given the "judicial hesitance to extend the per se rule to new categories of antitrust claims," and the fact that "no Supreme Court cases nor any federal cases [had] applied the per se rule in similar factual circumstances[,]" the Third Circuit determined that the rule of reason test was appropriate for the agreement at issue. *Id.* at 143-44. Applying this test, the court stated that "covenants not to compete executed upon the legitimate transfer of ownership of a business" (such as the no-hire agreement at issue) are properly characterized as "ancillary" (as opposed to naked) "restraints on trade[,]" and "[s]o long as [they] are reasonable in scope, there is no antitrust violation under the rule of reason." *Id.* at 145. The no-hire agreement at issue, the court found, was a "legitimate ancillary restraint on trade" because its "primary purpose" – "to ensure the successful sale of Paradyne to Texas Pacific Group which required workforce continuity" – "was not anti-competitive[,]" and its eight-month restrictive period was "reasonable" given this purpose. *Id*. at 146.

Though relatively few courts since *Eichorn* have opined on the proper test for analyzing no-hire agreements, those that have confronted this question have followed suit in applying the "rule of reason" test instead of the "per se" test. For instance, in *Weisfeld v. Sun Chem. Corp.*, 210 F.R.D. 136, 143 (D.N.J. 2002), *aff'd*, 84 F. App'x 257 (3d Cir. 2004) the District of New Jersey relied on *Eichorn* in holding that a no-hire agreement should be analyzed under the rule of reason instead of the per se rule. Similarly, in *Frank Sexton Enterprises, Inc. v. Sodiaal N. Am. Corp.*, No. Civ. A. 97-7104, 2002 WL 47841, at *10-11 (E.D. Pa. Jan. 14, 2002), the Eastern District of Pennsylvania cited *Eichorn* for the proposition that "covenants not to compete which are ancillary to a larger business agreement are governed by the rule of reason."

DOJ Case Against eBay

On November 16, 2012, the DOJ filed a complaint against eBay that urges a legal standard different from *Eichorn* for analyzing no-hire agreements.[1] The DOJ alleges that eBay and Intuit, Inc. entered into a "handshake" no-hire agreement

which "for over a year, prevented at least eBay from hiring any employees from Intuit at all[,]" in exchange for which Intuit would refrain from recruiting eBay's employees. Compl. ¶¶ 1-2, 22. The DOJ alleges that eBay and Intuit, competitors in the technology industry, "called a truce in the 'war for talent' to protect their own interests at the expense of their employees." Compl. ¶ 12. Notably, the DOJ contends that "[t]his agreement between eBay and Intuit is a naked restraint of trade that is per se unlawful under Section 1 of the Sherman Act," meaning that "[n]o elaborate industry analysis is required to demonstrate [its] anticompetitive character[.]" Compl. ¶¶ 4, 28. The DOJ also asserts, alternatively, that the no-hire agreement is an "unreasonable restraint of trade" that would fail the "rule of reason analysis" because its "principal tendency … is to restrain competition, as the nature of the restraint is obvious and the agreement has no legitimate pro-competitive justification." Compl. ¶ 29.

Whatever the result in *U.S. v. eBay*, the case may clarify the contours of the sparse case law governing no-hire agreements.

Practice Suggestions

Employers who engage in hiring from the competition, or who have agreements in place preventing others from hiring their employees, should monitor the developments in the DOJ's case against eBay. Given the DOJ's contention that the alleged no-hire agreement between eBay and Intuit is a "naked restraint of trade" constituting a "per se" violation of antitrust law, unless the litigation is otherwise resolved before the Court addresses the issue, the Northern District of California may be asked to weigh in on the proper test to apply when analyzing no-hire agreements. Of course, the DOJ may argue that *Eichorn* was not correctly decided or that the alleged eBay/Intuit agreement is factually distinguishable from the agreement in *Eichorn*. Whatever the result in *U.S. v. eBay*, the case may clarify the contours of the sparse case law governing no-hire agreements.

As a prophylactic measure employers may consider to avoid challenges to their no-hire agreements, employers should identify the "primary purpose" of these agreements and how they would respond to a regulator or private plaintiff claiming that the agreements are unreasonably anti-competitive. Employers also should consider adding a specific acknowledgement in these agreements stating that the restrictive covenants are entered for the purpose of protecting legitimate interests of the employer, including, for example, its goodwill or trade secrets.

To further confirm and clarify the legitimate purpose of these agreements, employers may consider qualifying the no-hire covenant with a clause stating that the agreement applies "except as otherwise required by law." Such a clause may not be needed in most cases where the legality of the agreement is clear, but should a government regulator or a private litigant challenge the legality of the no-hire agreement, the clause would provide some evidence that the employer did not intend for the agreement to apply in any way that would be deemed unlawfully anti-competitive. As it may be difficult for the employer to predict the precise circumstances in which it would be seeking to enforce the no-hire agreement and whether enforcement of the agreement in such circumstances might be deemed unreasonably anti-competitive, the employer may benefit from being able to point to the clause as a basis to contend that the no-hire agreement had no nefarious purpose and was not intended to apply in that unanticipated circumstance.

Employers also should examine the duration of any hiring restrictions and consider whether the full time period of the restraint is absolutely necessary to effectuate the agreement's primary (and non-anti-competitive) purpose, as courts will be more likely to enforce restrictions of shorter durations. The eight-month duration of the no-hire agreement in *Eichorn* is one example of a duration at least one court has found to be appropriate.

Employers should be aware that the DOJ's Antitrust Division appears keenly focused on industries with a heavy technological focus. The action against eBay follows closely on the heels of a 2010 lawsuit by the government against Adobe, Apple, Google, Intel, Intuit, and Pixar, following an investigation of an alleged series of non-solicitation agreements between the companies, and resulting in a settlement preventing the six companies from entering into such agreements.[2] Also, a putative class action is currently pending against these six companies (plus Lucasfilm), arising out of the DOJ's investigation, in which former employees of the companies are seeking damages for alleged antitrust violations. The defendants' motion to dismiss was denied, as the court held that the plaintiffs "successfully pled a *per se* violation of the Sherman Act for purposes of surviving a 12(b)(6) motion" and that the question of "whether *per se* or rule of reason analysis applies" would be more appropriately decided at the summary judgment stage. *See In re High-Tech Employee Antitrust Litig.*, 856 F. Supp. 2d 1103, 1122 (N.D. Cal. 2012).

1 *United States of Am. v. eBay, Inc.*, No. 12-cv-5869 (N.D. Cal.). On the same day, the California Attorney General also filed a complaint against eBay, making similar allegations. *The People of the State of California v. eBay, Inc.*, No. 12-cv-5874 (N.D. Cal.).

2 *See* DOJ Press Release, "Justice Department Requires Six High Tech Companies to Stop Entering into Anticompetitive Employee Solicitation Agreements," (Sept. 24, 2010) *available at* http://www.justice.gov/opa/pr/2010/September/10-at-1076.html. The complaint against eBay noted that Intuit was not named as a defendant only because it is already subject to a federal court order resulting from this previous lawsuit. Compl. 9.

Recent and Future Developments in UK Employment Law

By Ivor Gwilliams, Katie Slater and Andrew Scott

Since coming into power, the UK's coalition government has set about reforming a number of aspects of UK employment law. The main developments that have occurred to date and those that are anticipated in the future are summarised below.

Unfair Dismissal/Tribunal Reform

Reforming the employment tribunal system to improve its efficiency and encourage early resolution of disputes has been identified as a priority to boost business confidence and the UK Government has announced a number of procedural changes aimed to streamline the tribunal process. There have also been some major changes to the unfair dismissal regime. Employees who commenced employment on or after 6 April 2012 must now have at least two years' continuous service (rather than one year's service) in order to bring a claim for unfair dismissal. The UK Government argued that this change was designed to encourage employers to take on new employees.

The Enterprise and Regulatory Reform Bill includes proposals to reduce the limit on the compensatory award in unfair dismissal claims from its current level of £74,200 to a new reduced limit (expected to be between one and three times median earnings, which is currently £26,500 – £79,500 or (if lower) 12 months' remuneration). It is also proposed that the limit may be reduced further for small businesses. Considering that the average annual wage for full time workers in the UK is £26,500,[1] the limit to 12 months' remuneration could represent a significant drop in the potential liability for unfair dismissal claims. A reduced cap is likely to have most impact in relation to senior executives for whom 12 months' pay will invariably exceed the proposed cap.

The UK Government intends to encourage the use of settlement agreements in order to reduce the number of disputes that the employment tribunal system

has to deal with. The UK Government is exploring the possibility of model settlement agreements and letters. The UK Government is also proposing legislation to provide that, with some exceptions, an offer made or discussion held with an employee concerning termination of employment, even before a dispute has arisen, cannot be used in a subsequent unfair dismissal case. It is hoped that this will facilitate conversations regarding performance and behaviour without the need for protracted performance review meetings. It remains to be seen how this legislation (if implemented) will work in practice. However, it is likely that employers will have to be careful to ensure that, during such a conversation, they do not inadvertently link allegations of poor performance to, say, the childcare obligations or disability of the employee. To do so would take the conversation into the realm of discrimination and the conversation will cease to be protected.

There have been some major changes to the unfair dismissal regime. Employees who commenced employment on or after 6 April 2012 must now have at least two years' continuous service (rather than one year's service) in order to bring a claim for unfair dismissal.

The UK Government is also consulting on whether it should introduce guideline tariffs for settlements that would reflect the reality of actual tribunal awards rather than the inflated expectations of employees. The aim of this is to create a faster track to settlement and reduce the number of cases brought to the employment tribunals.

In addition, from Summer 2013, part of the "cost burden" of tribunal proceedings is to be transferred to claimants, who will need to pay a fee at the issue of their claim and a hearing fee if the claim proceeds to a full tribunal hearing. This should deter individuals from bringing nuisance claims that stand little chance of success.

Transfer of Undertakings (Protection of Employment) Regulations 2006 (the "TUPE Regulations")

The UK's TUPE Regulations implement the European Acquired Rights Directive and have effect so as to (i) preserve the continuity and terms and conditions of employment of employees on a relevant transfer, (ii) protect employees from dismissal in connection with a relevant transfer, and (iii) require the parties to inform and consult with affected employees. This means that employees automatically transfer and become employees of the new employer (transferee) on the same terms and conditions (except for certain occupational pensions rights) as they had with their previous employer. The UK Government is aiming to address concerns that the TUPE Regulations "gold-plate" the Acquired Rights Directive and that the regulations are overly bureaucratic. The UK Government recently issued a consultation proposing a number of changes including:

- repealing the "service provision change" provisions (these are the provisions that provide that the TUPE Regulations apply where, for example, a client engages a service provider (outsourcing) or a client changes its service provider). The impact of these changes may be felt by service providers who have entered into existing contracts on the assumption that the TUPE Regulations will apply on the termination of the contract and may now have to bear unexpected redundancy costs. As a result of this, the UK Government is seeking views on the lead-in period before these provisions are amended or repealed;
- repealing the requirement to provide information about transferring employees (so-called "employee liability information") no more than 14 days before the transfer and instead providing that a transferor should give such information to a transferee at such time and in such detail as is necessary to assist the parties in complying with their duties to inform and consult. The UK Government believes that the exchange of information should be left to the parties;

- amending the TUPE Regulations to ensure that a change of location of the workplace is capable of constituting an economic, technical, or organisational reason entailing changes in the workforce thereby avoiding certain problems caused by the rules that protect employees against variations to their terms of employment in the context of a TUPE transfer;
- amending the TUPE Regulations to provide that the transferee can consult with the transferring employees prior to the transfer about proposed collective redundancies. This change is designed to deal with a practical problem: currently, a transferee employer cannot consult collectively prior to the transfer with transferring employees about possible post-transfer redundancies (or at least not without risk), as technically the transferee employer does not yet employ the employees;
- replacing the provision in the TUPE Regulations concerning a substantial change to working conditions to the material detriment of an employee, with a provision that reflects the wording of the Acquired Rights Directive. An employee currently has a right under the TUPE Regulations to resign (but treat themselves as dismissed) if a transfer involves or would involve a substantial and detrimental change in their working conditions. This is in addition to their right to object to the transfer regardless of any adverse impact and to resign and claim constructive dismissal in response to a fundamental breach of their contract. The UK Government proposes to replace the current wording with a provision that would remove the scope for unfair dismissal claims where the change in working conditions is not a breach of contract or a fundamental change, i.e. not one that would entitle the employee to resign and claim constructive dismissal outside the context of a TUPE transfer.

Redundancy

As part of the UK Government's reforms of the collective redundancy regime, the minimum 90-day consultation period will, from April 2013, be reduced to 45 days for redundancies of 100 or more employees. The aim is to allow employers to restructure more quickly, to save on administration and wage costs, and to reduce the uncertainty felt by employees during such protracted redundancy exercises. Unfortunately, it is not clear that the corresponding "protective award" for failure to inform and consult in relation to such collective redundancies will reduce from a maximum of 90 days' pay per employee to 45 days' pay.

The new employee-shareholder contract may provide interesting tax planning opportunities in certain situations.

The Employee-Shareholder Contract

The UK Government has announced the introduction of a new type of employment contract and a new employment status, known as "employee-shareholder." Under this new type of contract, employees may contract out of some employment rights and protections in exchange for at least £2,000 (at the time of acquisition) of newly issued, fully paid-up shares in their employer or its parent company. Any growth in the value of the first £50,000 worth of shares (as at the time of acquisition) will be exempt from capital gains tax (CGT). Employee-shareholders will not be exempt from CGT if they hold a material interest in the employer company or its parent at the time the shares are acquired, had a material interest in the year prior to the date of acquisition, or are connected with an individual who has a material interest. The UK Government is aiming to enact legislation to enable the use of the new employment contract from April 2013, although given the questions and complexities thrown up by the proposed legislation, this timetable may be optimistic.

An employee who enters into such a contract will give up the following rights and protections:

- the right to a statutory redundancy payment;
- the right to claim unfair dismissal (except where the dismissal is automatically unfair or is discriminatory);
- the right to request flexible working (unless the employee is returning from parental leave and the

request is made within a specific period, currently the proposal is within four weeks of return); and

- the right to give eight weeks' notice of return from maternity, paternity or adoption leave (instead 16 weeks' notice will be required).

Although the employee-shareholder status may not be forced upon existing employees, it is currently proposed that employers will be able to insist that new recruits sign up to these new arrangements, a proposal which has caused considerable controversy.

The UK Government's proposal is that all types of shares would be able to be used for this type of arrangement and that employers would be able to apply restrictions on the shares and require the employee-shareholder to surrender the shares when they leave, are dismissed, or made redundant.

The aim is to reduce employer's costs and the uncertainty associated with those costs on terminating the employment of individuals who are granted employee-shareholder status. The consultation paper suggested that the employer will be required to buy back the shares at a "reasonable value" when the employee leaves, which many employers may find unattractive where values rise significantly between acquisition and termination, even more so where the employee resigns or is dismissed for misconduct. However, in response to consultation, the UK Government has suggested that forfeiture conditions should be left to contractual agreement between the parties, which may suggest that the employer may not be required to pay a "reasonable value."

Questions also remain as to the income tax liability of the employee on acquisition of the shares and whether credit will be given to the employee for the value of the employment rights given up by the employee in return for the right to acquire the shares. Valuation of unquoted shares for employee share schemes is already a complex issue and valuation issues are likely to arise in this context as well. These and other issues may reduce the appeal of these proposals for employees and employers alike and, as a result, the reaction to these proposals from many commentators has (to date) been rather negative. However, we believe that the new employee-shareholder contract may provide interesting tax planning opportunities in certain situations.

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