CALIFORNIA
LAWYERS
ASSOCIATION

Vol 29, No. 2
Fall 2019

The Journal of the Antitrust, UCL and Privacy Section of the California Lawyers Association

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Lee F. Berger

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COMPETITION

The Journal of the Antitrust, UCL and Privacy Section of the
California Lawyers Association

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CHAIR'S COLUMN

Lee F. Berger[1]
U.S. Department of Justice
Washington, DC

At this year's Annual Meeting, the Antitrust, UCL and Privacy Section adopted its first Diversity and Inclusion Policy and Initiative ("Diversity Initiative"). One of the Section's purposes is to "develop professionalism among and advancement for members of the Section." Antitrust, UCL and Privacy Section Administrative Bylaws § II(c). Increasing the diversity in our Section is one way for us to meet this goal, both for the particular members of our Section and for our practices. In the areas of antitrust, UCL and privacy, courts, clients, and consumers benefit when the perspectives, arguments, and issues reflect the diversity of California's lawyers and consumers. Diversity leads to innovation. It helps our practices look and think more like the rest of California. A diverse and more inclusive legal profession makes for a stronger, more professional practice.

The Section's goals in establishing the Diversity Initiative are to increase the diversity of the Section's membership, the diversity in the Section's leadership and Executive Committee, the participation and visibility of diverse lawyers in Section activities, and the flow of diverse lawyers into the antitrust, UCL and privacy areas, in both private practice and government. The Diversity Initiative defines diversity to refer to race, color, ethnicity, gender, gender identity, sexual orientation, national origin, religion, age, disability, first generation professional, and veteran status.

The Diversity Initiative looks to six ways for the Section to meet these goals. First, the Section will seek to develop strategic partnerships with organizations that promote diversity, including minority or affinity bar associations. Second, the Section will ensure that all members have an opportunity to be considered for leadership roles, by adopting a goal of having at least 30% of its candidate pool for any leadership or governance position be comprised of diverse Section members. This 30% goal is consistent with similar policies that other professional and corporate organizations have adopted.

Third, the Section will actively create high-profile opportunities for diverse lawyers, including in its decisions regarding selection of panel speakers and articles for publication. Fourth, the Section will encourage the flow of diverse law students in the Section by working with law schools to expose diverse law students to the Section and its practice areas. Fifth, the Section will incorporate a diversity component into its Mentorship Program.

Finally, the Diversity Initiative establishes the Vice Chair for Diversity, a new Executive Committee position. The Vice Chair for Diversity will have the responsibility for strategic planning, developing programs and activities, and establishing other efforts to support the Section's diversity goals. The Vice Chair for Diversity will plan at least one diversity focused event a year, be in charge of reviewing the Executive Committee's various selection processes to ensure compliance with the Section's Diversity Initiative goals, travel to local schools

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1 Any views expressed in this column by Mr. Berger are his own and not those of the United States Department of Justice.

to meet with diversity affinity groups, and report to the Section's Executive Committee on progress under the Diversity Initiative. Additionally, the Vice Chair for Diversity will conduct an annual review of the Diversity Initiative to evaluate the success of the programs, identify areas for improvement, develop methods and strategies to collect relevant data, and assess new and existing policies to implement in furtherance of the Section's diversity goals. Abiel Garcia of Gibson Dunn LLP will serve as our inaugural Vice Chair for Diversity.

Much credit is due to the primary author and proponent of the Diversity Initiative, the Section's Vice Chair for Privacy Publications Lori Chang of Greenberg Traurig LLP, along with Advisors Lawrence Wu of NERA and Geoff Holtz of Morgan, Lewis & Bockius LLP, and Abiel Garcia. Their dedication, extensive outreach, and research resulted in a robust Diversity Initiative about which we can all be proud. I look forward to seeing each element of the Diversity Initiative being implemented this year.

EDITOR'S NOTE

Elizabeth C. Pritzker
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Antitrust, Unfair Competition and Privacy—In Labor and Employment

For the third year in a row, the Antitrust, Unfair Competition and Privacy Section has elected to present a topically-themed edition of *Competition*. This year's theme centers on labor and employment and the ways in which they intersect with antitrust enforcement, unfair competition, and privacy. As an attorney who does not regularly practice in the employment space, it has been my great privilege to learn from this edition's team of authors—all of whom provide unique perspectives on a range of topics surrounding our core theme. I am sure you will find, as I did, that the articles that follow offer helpful and informative insights on these issues.

Our first article by **Jason Hartley** and **Fatima Brizuela** addresses the issue of "no poach" labor agreement in the franchise context and discusses, in particular, the complexities of litigating a no poach class claim in the courts.

In their article, **Daniel Bitton**, **David Pearl** and **Patrick Shaw** consider the ride-hailing industry, and the gig economy more generally, and the extent to which antitrust principles apply, or should apply, to pricing algorithms employed by gig economy companies. They argue that a rule of reason antitrust analysis (as opposed to a per se rule) is necessary to enable antitrust enforcers to consider the pro-competitive industry and consumer advantages, and potentially greater worker flexibility, that can be derived from pricing algorithms like those used by Uber and Lyft.

Next, **Caroline Corbitt** tackles the question of whether worker wages should be considered by antitrust enforcers as they undertake merger and consolidation review. Her article provides a survey and thoughtful analysis of the recent scholarship and debate on the issue of whether, and if, antitrust law can address rising income inequality and falling wages in the United States.

Robert Connolly and **Kimberly Justice**, in their article, discuss the current options for being a whistleblower for criminal antitrust cartels and the anti-retaliation protections that may exist for whistleblowers in this context. They include a proposal for antitrust whistleblower reform that they believe would further the goal of antitrust enforcement, by creating criminal cartel whistleblowing opportunities similar to those now offered by the Securities and Exchange Commission.

Economists **Daniel Rasher** and **Andrew Schwarz** invite us into the specialized arena of sport-labor economics. Their article explores, from a labor economics standpoint, the stated pro-competitive objectives of professional, amateur and college sports leagues; the extent to which those objectives impact or drive consumer demand; and the efficacy of rules that limit player revenue sharing, provide salary caps, or limit the ability of college athletes with athletic scholarships to receive additional compensation, to achieve the desired competitive balance.

An article by **Robert Milligan**, **Daniel Hart**, and **Sierra Chin-Liu** looks at the pervasive use of social media by Americans—both on and off the job—and the ways in which 26 states have enacted social media privacy laws to balance employees' rights to personal privacy, on the one hand, with the needs of companies, on the other, to protect their intellectual property, comply with regulatory reporting mandates, or maintain appropriate data management practices. The article ends with a chart that summarizes the key features of each state's social media law—providing a handy reference tool for anyone interested in this issue.

Next, we are fortunate to have as contributors two experts on the recently enacted California Consumer Privacy Act (CCPA), which goes into effect on January 1, 2020. In their article, **Lydia de la Torre** and **Lauren Kitces** give an informative analysis of the CCPA's regulatory framework, and discuss how the CCPA will impact employers' privacy obligations under California law. The authors also identify steps employers should take to minimize regulatory risks under the new law.

The issue concludes with an article by **Bradford Newman**, in which he addresses the question of how to protect corporate intellectual property from misappropriation by former employees in California—a state with a long-standing public policy of encouraging employee mobility. His article lays out some of the steps companies may wish to consider using to protect their valuable trade secrets when employees leave, and explains a very recent but important change in the law regarding the enforceability of employee non-solicitation agreements.

This edition of *Competition* would not have been possible without the many individuals who lent their time and talent to the terrific range of articles being published here. Additional (and greatly appreciated) editorial assistance and cite-checking was provided by members of the Publications and Privacy Committees. I thank each and every one of you.

This issue of *Competition* goes to press at the time of our 29th Annual Golden State Institute and Antitrust Lawyer of the Year Dinner, which is being held on November 14, 2019 at the Julia Morgan Ballroom in San Francisco. The Section is especially pleased to honor Penelope A. Preovolos as the 2019 Antitrust Lawyer of the Year. We acknowledge and thank our event sponsors listed at the end of this publication.

Finally, on behalf of the Executive Committee, I would especially like to thank our outgoing Section Chair, **Lee Berger**, for his extraordinary leadership over the past year!

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THE COMPLEXITIES OF LITIGATING A NO-POACH CLASS CLAIM IN THE FRANCHISE CONTEXT

By Jason Hartley and Fatima Brizuela[1]

After a week of training at Returns R Us ("RRU"), Paloma Navarro was excited to start her new job as a tax preparer. Although her starting hourly wage was not very high, she saw a future with RRU, a nationwide tax services company with nearly 1,000 stores in 30 states. At least it was a big improvement over her prior work as an executive assistant who did little more than run menial errands for an arrogant senior law partner. RRU presented Paloma with the opportunity to start a career and grow. After all, Paloma knew that RRU had hundreds of locations around the country. She could build her experience at her local branch, work hard, and eventually move to a store near the coast, fulfilling her dream of living by the ocean.

Paloma applied to location after location in her favorite coastal cities. But she could not even get an interview despite responding to advertisements from RRU franchises that were specifically looking for workers with her precise skills, and each advertising a nearly identical compensation range for Paloma's position. It was not until she followed up with a call to one of those places that she learned the real reason for her rejections. "We can't hire you," said the manager of that RRU store. "There is a no-poaching provision in our franchise agreement. We aren't allowed to solicit or hire anyone who works at another RRU location. Sorry." This was devastating news to Paloma. She could not believe that her years of hard work for RRU meant that she had to work for that same RRU franchise or change companies. She decided to see a lawyer.

Karen Danielle was an accomplished trial lawyer. She had scored some of the largest verdicts for her employment clients, both individually and in class actions. Paloma came to her distraught. After some consoling, Karen answered Paloma's first question, "What, exactly, is a no-poach agreement?"

I. WHAT ARE NO-POACH AGREEMENTS?

A no-poach agreement is made between two or more entities (including franchisees of the same company or competitors within an industry) not to compete for each other's employees, either during their active employment or for a period after termination of their employment. No-poach agreements may include agreements not to recruit, solicit, hire or do anything that could create opportunities for an employee to move from one company to another, or even from one location to another.

"Do I have a case and if so, can you take it?" asked Paloma. Karen paused. Paloma could have a case, and Karen could conceivably take it, but Karen had to evaluate this developing area of law. She had not litigated a no-poach case before, and was unsure how courts were treating them. In particular, whether no-poach provisions were legal

1 Jason Hartley is the managing partner of Hartley LLP in San Diego. Jason represents plaintiffs in commercial contingency representation, class action litigation, antitrust and unfair competition. He has represented a number of Fortune 500 companies as plaintiffs and served as lead counsel and in senior litigation roles in numerous class actions. Fatima Brizuela is an associate at Hartley LLP in San Diego. Fatima's practice is focused on antitrust and consumer protection class action litigation.

in the franchise context seemed a potentially thorny question. Plus, she was not terribly experienced with antitrust law. Karen promised to do some research and get back to Paloma very soon. She started with the standard that a court would use when reviewing these antitrust claims.

II. ANTITRUST STANDARD OF REVIEW

Section 1 of the Sherman Act prohibits every contract, combination, or conspiracy, in restraint of trade or commerce among the several States.[2] These restraints can be "horizontal" in nature, such as a conspiracy between competitors to jointly raise the prices of the commodity product they sell, or "vertical," such as agreements to restrain trade between companies at different levels of distribution.

There are three major standards of review in federal Section 1 antitrust cases. The first is the *per se* standard, which is a bright-line test that holds that certain conduct is automatically illegal if it is proven to have occurred such that no further inquiry into the effect on the market or intent of those engaged in the violative conduct is necessary. Most horizontal restraints, such as price-fixing, market allocation agreements, tying agreements, bid-rigging, and certain group boycotts are subject to *per se* antitrust liability.[3] These horizontal agreements between separate and unrelated competitors have "such predictable and pernicious anticompetitive effect and such limited potential for procompetitive benefit that they are deemed unlawful *per se*."[4]

The second standard of review is the rule of reason—a multi-factored reasonableness test designed to evaluate the purpose and effect of the challenged conduct.[5] Many vertical agreements are subject to the rule of reason standard, including loyalty discounts, bundling, exclusive dealing, and resale price maintenance agreements under federal law. Courts applying the rule of reason must examine the likely anticompetitive effects of the vertical agreement at issue, along with its beneficial and legitimate business justifications.[6] The policy behind this higher standard of proof is that some agreements among vertically-involved companies may actually deliver efficiencies to the market, be pro-competitive, or are ancillary to a legitimate competitive agreement.

The third standard of review is the product of judicial rule-making, and is something of a hybrid between the other two standards. It involves a "quick look" version of the rule of reason and requires that the defendant advance an affirmative defense in the form

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2 15 U.S.C. § 1.

3 *See Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984); *Northern Pacific Railway Co. v. United States*, 356 U.S. 1, 5–6 (1958); *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc. ("BMI")*, 441 U.S. 1, 19–20, (1979). Because these actions are conclusively presumed to be unreasonable, no inquiry into the harm actually caused is required. *Copperweld*, 467 U.S. at 768; *Northern Pacific,* 356 U.S. at 5.

4 *State Oil Co. v. Khan*, 522 U.S. 3, 10.

5 See Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 74 Yale L.J. 776 (1965) and 75 Yale L.J. 373 (1966); Thomas J. Piraino, *Reconciling the Per Se and Rule of Reason Approaches to Antitrust Analysis*, 64 S. Cal. L. Rev. 685 (1991).

6 *See, e.g., National Collegiate Athletic Assn. v. Board of Regents of Univ. of Okla.*, 468 U. S. 85, 109–110, and n. 39 (1984); *National Soc. of Professional Engineers v. United States*, 435 U. S. 679, 688–691 (1978); *Board of Trade of Chicago v. United States*, 246 U. S. 231, 238 (1918).

of a legitimate justification for suspect conduct before the court can proceed to a fuller assessment of any competitive effects.

Notably, Section 1 of the Sherman Act is not limited to arrangements to fix sales prices. Agreements among competing buyers to fix the prices at which they *purchase* can also violate Section 1, and it is this formulation that brings no-poach agreements within the purview of the Sherman Act.[7] A no-poach agreement between competing employers is certainly not the traditional commodity sales price-fixing agreement. But it is an agreement among employers to lower the price paid for labor, and thus, it violates the antitrust laws. Antitrust laws can and have been applied to labor markets using the same analytical approach used in evaluating consumer product markets.[8] Whether this approach is in fact suitable when analyzing challenges to no-poach franchise agreements remains to be seen.

When competing in the same labor markets, no-poach agreements between any two or more employers are considered horizontal restraints, regardless of whether the employers are competitors in the downstream product markets for the sale of goods or services. Thus, naked no-poach agreements between totally separate horizontal labor market competitors are subject to the less-stringent *per se* standard of review.[9] Such agreements are condemned by the courts, the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"). In fact, both the DOJ and the FTC together announced their policy against no-poach agreements as *per se* violations of Section 1. In the Fall of 2016, the DOJ and the FTC jointly issued written guidance entitled, "Antitrust Guidance for Human Resource Professionals."[10] According to the Antitrust Division, "[n]o-poach agreements are naked if they are not reasonably necessary to any separate, legitimate business collaboration between the employers . . . [and] are *per se* unlawful because they eliminate competition in the same irredeemable way as agreements to fix product prices or allocate customers."[11] From that point forward, the DOJ "intended to proceed criminally against naked no-poach and wage-fixing agreements."[12]

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7 *See National Macaroni Mfrs. Ass'n v. FTC*, 345 F.2d 421, 426-27 (7th Cir. 1965) (finding that an agreement among buyers of a product, rather than sellers, to limit the amount of premium priced durum wheat products purchased *per se* illegal because the effect of the restriction was intended to, and did reduce the price of durum wheat that had risen as a result of a shortage); *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312, 317–18 (2007) (holding that the same test applied to both predatory-pricing and predatory-bidding claims under the Sherman Act).

8 *See* FTC Hearings on Competition and Consumer Protection in the 21st Century, Public Comments of 18 State Attorneys General on Labor Issues in Antitrust (July 15, 2019) [hereinafter, "AGs Public Comments"].

9 Federal Trade Commission, Department of Justice Antitrust Division, Antitrust Guidance for Human Resource Professionals, at 3 (Oct. 2016)).

10 Press Release, U.S. Dep't of Justice, *Justice Department and the Federal Trade Commission Release Guidance for Human Resources Professional on How Antitrust Law Applies to Employee Hiring and Compensations* (Oct. 20, 2016), *available at* www.justice.gov/atr/file/903511/download.

11 *Id.*

12 *Id. See also* Mark L. Krotoski, *DOJ Antitrust Division Announces Imminent Criminal Prosecution for "No Poaching" Agreements*, NAT'L L. REV. (Feb. 6, 2018), https://www.natlawreview.com/ article/doj-antitrust-division-announces-imminent-criminal-prosecution-no-poaching [https://perma. cc/ CFQ2-VE79].

III. FRANCHISE NO-POACH AGREEMENTS

In an unusual move, however, in March 2019 the DOJ modified its position with respect to no-poach agreements made within a single franchise, reasoning that because single-franchise no-poach agreements are part of a larger franchise agreement between the parties, they do not qualify as "naked" restraints.[13] The DOJ's 2019 position clashed with the position taken by several state attorneys general, led by the State of Washington, condemning no-poach agreements within franchises as *per se* antitrust violations. In fact, the Washington Attorney General ("AG") had been so successful in its enforcement actions that by August 2019 it had convinced dozens of companies to willingly withdraw their franchise no-poach agreements without filing a single complaint.[14] The AG's position that such no-poach agreements constitute *per se* violations no doubt influenced negotiations between the companies and the States. This placed the AGs and the DOJ at odds on the issue of franchise no-poach agreements.

The DOJ's Statement of Interest sparked significant opposition from the AG and the American Antitrust Institute ("AAI").[15] The AAI drafted a position letter to the DOJ characterizing the DOJ's position on the standard of proof in franchise no-poach agreements as "misguided" and expressed that it was "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."[16] Indeed, more than half of the major franchise companies in the U.S. include no-poach clauses in their franchise agreements, and these agreements

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13 Corrected Statement of Interest of the United States of America, *Stigar v. Dough Dough, Inc.*, No. 2:18-CV-00244-SAB (E.D. Wash. Mar. 8, 2019), ECF No. 34 [hereinafter "Statement of Interest"]. The Department of Justice filed their Statement of Interest in the consolidated cases against Carl's Jr., Auntie Anne's and Arby's in the Eastern District of Washington federal court *Stigar v. Dough Dough, Inc.*, No. 2:18-cv-00244-SAB (E.D. Wash. 2018), See *infra*, Note 55. In response, the Attorney General of Washington submitted an amicus brief to aid the court's assessment of the state antitrust law claims in *Stigar*, taking an opposite stance to that proposed by the DOJ and arguing for *per se* treatment, at least for those claims for which the State AG acts as the primary enforcer for the State. *Stigar v. Dough Dough, Inc., et al.*, No. 2:18-CV-00244-SAB (E.D. Wash. March 11, 2019), Amicus Curiae Brief by the Attorney General of Washington, ECF No. 36 [hereinafter, WA AG Amicus Curiae Brief]. The three cases in the Eastern District of Washington settled in just a matter of days after the Washington AG filed its *amicus* brief, on March 18, 2019 before the court weighed in on the applicable standard in these consolidated cases.

14 In fact, 66 companies willingly agreed to abandon the no-poach provisions in their franchise agreements as a result of the AG's effort. Washington State Off. of the Att'y Gen., Press Release, *AG Ferguson's Initiative Ends No-Poach Clauses At Four More Corporate Chains Nationwide* (Aug. 8, 2019), https://www.atg.wa.gov/news/news-releases/ag-ferguson-s-initiative-ends-no-poach-clauses-four-more-corporate-chains

15 *See generally* AAI Letter, WA AG Amicus Curiae Brief.

16 American Antitrust Institute Position Letter at 1 (May 2, 2019), available at https://www.antitrustinstitute.org/wp-content/uploads/2019/05/AAI-No-Poach-Letter-w-Abstract.pdf [hereinafter "AAI Position Letter"].

are more often adopted in low-wage, low-skilled industries.[17] In support of its position, the DOJ responded to the AAI, citing an AAI legal policy paper published in 2018 for the proposition that the rule of reason is the applicable standard, "unless the arrangement amounts to a hub-and-spoke conspiracy."[18] In its position letter, however, the AAI made perfectly clear that it was prepared to "clarify that [it] disagrees with the interpretations of the law offered in the Statement of Interest . . . and to explain the basis for [AAI's] belief that the Division's approach to franchise no-poaching cases is unsound."[19]

IV. WHAT STANDARD OF REVIEW SHOULD APPLY TO FRANCHISE NO-POACH AGREEMENTS?

The conflicting positions of the DOJ and the AGs on the standard that should apply when an anti-poaching provision within a franchise agreement is challenged have not been resolved uniformly by the courts. Indeed, it remains a relatively novel issue. In the few instances in which no-poach franchise agreements have come up the response from the bench has been mixed.

Even before the DOJ's March 2019 Statement of Interest, many defendants in private franchise no-poach actions brought motions to dismiss arguing that the rule of reason standard of review should apply, and that plaintiffs did not adequately plead the elements necessary for such a claim. But few have been successful. For example, in *Butler v. Jimmy John's*, defendants argued that plaintiff did not plead a plausible enough claim under the Sherman Act to survive a 12(b) motion.[20] The *Jimmy John's* Court found that plaintiffs plausibly alleged a "hub-and-spoke" conspiracy where the "hub" was comprised of a collection of vertical agreements with other firms—the "spokes"—who in turn entered into horizontal agreements to make up the "wheel."[21] Although the court declined to decide the applicable standard of review this early in the litigation, Judge Reagan explained that if the evidence shows that franchisees are independent, the agreements will likely be subject to the hybrid quick-look analysis.

Separately, in *Deslandes v. McDonald's* the court had no trouble concluding that the no-poach provision included in McDonald's franchise agreement was akin to an agreement

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17 Krueger A. B. and O. Ashenfelter (2018), *Theory and Evidence on Employer Collusion in the Franchise Sector*, NBER Working Paper Series No. 24831, at 4, http://www.nber.org/papers/w24831 [hereinafter Krueger & Ashenfelter, 2018] ("No-poaching agreements are comparatively less frequent in industries with higher average wages and education levels, contrary to models that view no-poach agreements as a mechanism to encourage training investment or to protect intellectual property.").

18 AAI Position Letter at 1 (quoting Randy M. Stutz, The Evolving Antitrust Treatment of Labor-Market Restraints: From Theory to Practice, Am. Antitrust Inst. (July 31, 2018) [hereinafter "AAI Paper"].

19 *Id.*

20 *Butler v. Jimmy John's Franchise, LLC,* 331 F. Supp. 3d 786, 795 (S.D. Ill. 2018).

21 *Id.* at 797. The lawsuit was first led by Sylas Butler in January 2018, and now is now captioned *Conrad v. Jimmy John's Franchise, LLC*, Case No. 3:18-cv-00133-NJR-RJD (S.D. Ill. May 21, 2019), ECF No. 189-1. Judge Reagan subsequently retired and defendants filed another "extremely similar" motion, including many of the same arguments that Judge Reagan's prior order already adjudicated. *Id.* at 2. Applying the law of the case doctrine, the newly presiding judge denied defendants' renewed motion to dismiss. *Id.* at 6.

to divide the market.[22] Walking through its reasoning, the court explained that McDonald's "[f]ranchisees are not granted exclusive rights or territories and are specifically warned that they may face competition from other franchisees, new franchisees, and restaurants owned by McOpCos [McDonald's Operating Companies]." Because McOpCos restaurants were in direct competition with its franchisees, the court held that the restrictive provision in its franchise agreements was a horizontal restraint.[23] Despite the horizontal nature of the restraints at issue, the court found the quick-look approach appropriate. In another case involving a no-poach franchise agreement, Judge Bryan of the Western District of Washington relied in part on *Deslandes v. McDonald's* and found that Cinnabon employee plaintiffs had plausibly alleged facts to show that the no-poach provisions in defendants' franchise agreements should be analyzed under the quick-look test.[24]

Of the recent litigation targeting no-poach provisions in franchise agreements, so far just one defendant has managed to escape suit. In *Ogden v. Little Caesars Enterprises*,[25] Judge David M. Lawson of the Eastern District of Michigan found that plaintiffs did not plead facts sufficient to show that their case fit "within the narrow set of cases to which the Supreme Court has applied the *per se* analysis, and even under the hybrid 'quick-look' approach the complaint fail[ed] to state a claim."[26] Strangely, the court cited to *Butler v. Jimmy John's* to support this reasoning. There, as Judge Lawson noted, the plaintiff "explicitly stated in his complaint" that the Jimmy John's store where he worked required him to sign an employee non-competition agreement, "which the franchisees force on their employees in order to enforce the no-hire provisions between stores." The no-poaching provision at issue in *Little Caesars* was instead included in the franchise agreements between the corporate parent and its franchisees. The court's flawed analysis appears to suggest that a restrictive employment covenant that affects an employee's mobility within the franchise brand—and to which the employee is a party apprised of the terms and limitations the agreement—qualifies as "far more onerous" so as to warrant a quick-look, whereas a restrictive covenant to which the employee is *not* a party, and therefore not apprised of the terms, limitations, let alone existence of the agreement, but which carries with it the same restrictions affecting the employee's mobility within the franchise brand deserves the stricter rule of reason. Practicality and reason contradict this logic. Although the *Little Caesars* court did not definitively dismiss the potential application of a quick-look analysis to no-poach agreements, it reasoned that the no-poach provisions in other cases where courts have found that a quick-look analysis might apply were "far more onerous and directly enforced employment restraints."[27]

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22 *See Deslandes v. McDonalds USA LLC,* Case No. 1:17-cv-04857, ECF No. 53, at 12 (N.D. Ill. June 25, 2016) ("[t]hus, because a no-hire agreement is, in essence, an agreement to divide a market, the Court had no trouble concluding that a naked horizontal no-hire agreement would be a per se violation of the antitrust laws.").

23 *Id*. at 11.

24 *Yi v. SK Bakeries, LLC et al.,* Case No. 18-cv-05627-RJB (W.D. Wash. filed Aug. 3, 2018).

25 *Ogden v. Little Caesar Enterprises, Inc., et al.*, No. 2:18-CV-12792 (E.D. Mich. filed Sept. 7, 2018).

26 *Ogden v. Little Caesar Enterprises, Inc., et al.*, No. 2:18-CV-12792, Op. & Order (July 29, 2019) ECF No. 56 at 1.

27 *Id*. at 16.

The challenge facing the courts is the sometimes-vertical nature of the markets in which franchise agreements operate. As noted above, many vertical agreements are analyzed under the rule of reason, such as resale price maintenance cases.[28] But it is important to understand that this standard applies to those agreements not simply because they are vertical in nature, but because certain types of vertical conduct can be "replete with procompetitive justifications."[29] As the Washington AG points out, because franchisors commonly own and operate their own corporate owned stores in addition to their network of franchise locations throughout the country, "it would be a mistake to view a franchise agreement as vertical in all instances."[30] When a franchise agreement includes a no-poaching provision that restricts solicitation and hiring among franchisees *and* a corporate-owned store—"indisputably a horizontal competitor of a franchisee for labor"—the agreement must be analyzed as a *per se* restraint.[31]

A common misperception is that all vertical agreements are analyzed under the rule of reason. They are not.[32] The question of when the higher rule of reason burden applies turns not on whether the agreement is simply vertical in nature, but rather on whether it is ancillary to a <u>legitimate</u> pro-competitive agreement. "A formalistically vertical restraint" with no known, cognizable efficiencies can have a close family resemblance to a *per se* illegal horizontal restraint in its effects, regardless of the different levels of distribution at which the parties operate.[33] Absent an ancillary legitimate pro-competitive agreement, vertical agreements bearing a close family resemblance to a horizontal restraint should

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28 *See Leegin Creative Leather Prod., Inc. v. PSKS, Inc.,* 551 U.S. 877, 127 S. Ct. 2705, 168 L. Ed. 2d 623 (2007).

29 *Id.* at 889.

30 WA AG Amicus Curiae Brief at 6.

31 *Id.* (citing *Am. Motor Inns, Inc. v. Holiday Inns, Inc.,* 521 F.2d 1230, 1235, 1253-54 (3d Cir. 1975) (holding that "otherwise unreasonable restraints of trade are not insulated from the antitrust laws" simply by the fact that the company functions as a franchisor in addition to operating motels on the same horizontal market level as its franchisees).

32 *See also MM Steel, L.P. v. JSW Steel (USA) Inc.,* 806 F.3d 835, 850 (2015) (declining to hold that the *Leegin* "silently overruled" the line of cases applying *per se* liability to each member of a group boycott despite vertical components of the conspiracy).

Vertical agreements can be used to facilitate coordination of a horizontal conspiracy without the other parties to those agreements even knowing about, or agreeing to the horizontal conspiracy's goals. *United States v. Apple, Inc.*, 791 F.3d 290, 325 (2d Cir. 2015). "Because it may be difficult to distinguish such facilitating practices from procompetitive vertical resale price agreements, *Leegin* notes that those 'vertical agreement[s] . . . would need to be held unlawful under the rule of reason.' But there is no such possibility for confusion in the hub-and-spoke context, where the vertical organizer has not only committed to vertical agreements but has also agreed to participate in the horizontal conspiracy. In that situation, the court need not consider whether the vertical agreements restrained trade because all participants agreed to the horizontal restraint, which is 'and ought to be, per se unlawful.'" *Id.* at 324-25 (internal quotations omitted).

33 *Polygram Holdings, Inc. v.* FTC, 416 F.3d 29, 36 (2005 (Ginsburg, J) (a "rebuttable presumption of illegality arises" when there exists a "close family resemblance between suspect practice and another practice that already stands convicted in the court of consumer welfare."); *Gen. Leaseways, Inc. v. Nat'l Truck Leasing Assoc.*, 744 F.2d 588, 595 (7th Cir. 1984) (taking a quick-look to conclude that the market division agreement amounted to a *per se* illegal, horizontal conspiracy because no reason was suggested why an otherwise procompetitive agreement to provide reciprocal truck-leasing services required participants not to compete with one another in the leasing of trucks).

be analyzed as *per se* illegal restraints, or, at the very least, should otherwise be analyzed under the quick-look test.[34]

Vertical agreements between a franchisor and franchisees are no exception. The DOJ, in its Statement of Interest in the *Stigar* case, acknowledged that "if a company plausibly pleads direct competition between a franchisor and its franchisees to hire employees with similar skills, a no-poach agreement between them is correctly characterized as horizontal and, if not ancillary to any legitimate and procompetitive joint venture, would be *per se* unlawful."[35] Thus, unless the no-poach agreements come under the ancillary restraints doctrine, it is still generally accepted that they would be *per se* unlawful anticompetitive agreements.

But, even under the ancillary restraints doctrine, merely attaching an anticompetitive agreement or provision to a legitimate one does not transform the analysis from *per se* or quick look to rule of reason. "Ancillary" is defined as "providing necessary support to the primary activities or operation of an organization, institution, industry, or system."[36] Unsurprisingly, the legal definition of an ancillary agreement is similar. "To be ancillary, and hence exempt from the per se rule, an agreement eliminating competition must be subordinate and collateral to a separate legitimate transaction and reasonably necessary to make the main transaction more effective in accomplishing its purpose."[37] Thus, mere attachment to a legitimate agreement is not sufficient. "[A] restraint is not saved from the 'naked' classification simply because it is included in some larger joint venture arrangement that is clearly efficient."[38] There must be a "plausible connection between the specific restriction and the essential character of the legitimate agreement."[39]A legitimate basis for the restraint must be identified and it must be necessary to the legitimate underlying agreement. In other words, it is not ancillary if it is not necessary to make the broader agreement effective. It is also not ancillary until a legitimate basis for the restraint is identified.

The rationale for adjudicating vertical restraints under the rule of reason is that they may produce efficiencies that promote competition with outside companies, notwithstanding the potential that they may reduce competition in the internal labor market.[40] For example, in *Leegin Creative Leather Products v. PSKS, Inc.,* the Supreme Court recognized that for that resale price maintenance ("RPM") policy at issue, cognizable procompetitive justifications were identified in the expansive economics

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34 *See Butler v. Jimmy John's Franchise, LLC,* 331 F. Supp. 3d 786, 793 (S.D. Ill. 2018) (acknowledging that the quick-look approach is appropriate when the restraint is a vertical agreement in which the anticompetitive effects of the agreement are so obvious that "an observer with even a rudimentary understanding of economics could conclude that the arrangement in question would have an anticompetitive effect on customers and markets")(quoting *California Dental Ass'n v. F.T.C.,* 526 U.S. 756, 770 (1999))).

35 Corrected Statement of Interest of the United States of America, *Stigar v. Dough, Inc.*, No. 2:18-CV-00244-SAB (E.D. Wash. Mar. 8, 2019), ECF No. 34, at 13.

36 *Id.*

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

38 XI Phillip E. Areeda & Herbert Hovenkamp, Antitrust Law, ¶ 1908b, 230 (2d. ed. 2000).

39 *Gen. Leaseways, Inc. v. Nat'l Truck Leasing Assoc.*, 744 F.2d 588, 595 (7th Cir. 1984).

40 AAI Position Letter at 7.

literature submitted, but it did not make any blanket pronouncement that intrabrand vertical restraints always produce efficiencies.[41] In fact, the Court cautioned that while vertical agreements setting minimum prices may have procompetitive justifications, "the potential anticompetitive consequences of vertical price restraints must not be ignored or underestimated."[42] Eliminating "free riding" is the primary economic theory on which a pro-competitive claim for a RPM policy is based, whereby discount retailers free ride on retailers who furnish services then capture some of the increased demand those services render.[43] In the context of franchise no-poach agreements, the ostensibly legitimately pro-competitive agreement is the franchise agreement itself.

In that context, a franchisor might argue that a vertical restraint is reasonable because it prevents intrabrand free-riding, whereby one franchisee is prevented from raiding another franchisee's employees after the employing franchisee invested time and money to train the employees, thereby promoting interbrand competition.[44] Notably, no-poach agreements are significantly less frequent in industries with higher average wages and education levels. This seemingly challenges models that view these employment covenants as a mechanism to encourage training investment, or protect intellectual or quasi-intellectual property.[45] In fact, the AAI acknowledged that the free-rider justification for a franchise no-poach provision is a "non-starter," because among other things, training for the entry level employees most often subject to these agreements, is "minimal and unavoidable."[46] Moreover, even if the free-rider theory had teeth, the only arguable efficiency is the cost savings to franchisees, which it may reinvest in its brand to sell more product, arguably promoting interbrand competition in the downstream product market. Even if cognizable

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41 551 U.S. 877, 890 (2007).

42 *Id.* at 894.

43 For example, a consumer might learn about a manufacturer's product from a retailer who offers product demonstrations, invests in inviting showrooms, or otherwise hires and trains knowledgeable employees to educate its customers on the products it carries. 551 U.S. at 890-91. If that consumer can turn around and purchase that same manufacturer's product at a discount from another retailer who does not offer any of these services, the retailer providing the service will eventually cease to do so. *Leegin* provides that the minimum resale price may alleviate this problem by preventing discounters from undercutting the service provider, and with price competition decreased, the manufacturer's retailers compete among themselves over services, thereby promoting interbrand competition. *Id.*

44 *See e.g. 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").

45 Alan B. Krueger & Orley Ashenfelter, Theory and Evidence on Employer Collusion in the Franchise Sector 18 (Princeton Univ., IZA Institute of Labor Economics, Working Paper No. 11672, at 4 Sept. 2017).

46 AAI Position Letter at 8, n. 40.

The complaints in the consolidated cased in the Eastern District of Washington allege no-poach agreements covering crewmembers who twist and bake soft pretzels at Auntie Annie's, *Stigar v. Dough, Inc.*, No. 2:18-cv-00244-SAB (E.D. Wash. filed Aug. 3, 2018), crewmembers working at Arby's fast food sandwich shops, *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, *Harris v. CJ Star, LLC*, No. 2:18-cv-00247-TOR (E.D. Wash filed Aug. 3, 2018).

product market benefits result, procompetitive effects in a product market cannot be used to justify a restraint restricting the solicitation and hiring of employees.[47]

By agreeing—against a franchisee's own self-interest—to refrain from hiring other franchisee's employees, all franchisees in a chain reduce competition in their labor market and decrease the likelihood of an employee leaving for another franchisee's potential job offer. "This is equivalent to a reduction in the elasticity of labor supply faced by individual franchisees and, in the usual models of monopsony."[48]

Perhaps the biggest problem with the DOJ and defendant franchisees' analyses under the ancillary restraints doctrine is the lack of any actual connection between the franchise agreement and the no-poach agreement. On this issue, the AAI stated that it could not imagine a legitimate basis for the no-poach agreement, notwithstanding the ways in which it is vertical in nature.[49] Notably absent from the DOJ's Statement of Interest was any justification for the restraint on the labor market. Instead, the DOJ seemed to classify all such vertical agreements as pro-competitive ancillary agreements, characterizing the franchisee-franchisor relationship as "in many respects vertical" because they "normally conduct business at different levels of the market structure."[50] The DOJ goes on in this somewhat circular fashion to say that, because agreements between the franchisor and franchisee are vertical, the franchise no-poach agreements should also be assessed under the rule of reason.

But recounting the vertical nature of the franchise agreements containing the no-poach agreements falls far short of identifying any legitimate basis for the no-poach agreements themselves. It also ignores the market reality that while a franchisor-franchisee agreement may be vertical in nature, the relationship between them in the labor market and the entire relationship between franchisees is not, and the "full-blown rule of reason is inappropriate for vertical restraints that have horizontal anticompetitive effects and no known, cognizable efficiencies."[51] Should a restriction between competing franchisees,

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47 AAI Position Letter at 3; *See also Deslandes v. McDonald's USA, LLC,* No. 1:17-CV-04857, Mem. Op. & Order (N.D. Ill. June 25, 2018) at 14-15.

> "[D]efendants nonetheless argue that their restraints have procompetitive benefits. Specifically, defendants argue that the no-hire restriction promotes interbrand competition, by which they mean between McDonald's and Burger King, rather than the intrabrand competition between McDonald's restaurant at, say, 111 W. Jackson and the McDonald's at, say 223 W. Jackson. It makes sense for McDonald's franchisees and the McOpCos to cooperate to promote intrabrand competition for hamburgers, because a customer who is satisfied with a hamburger she buys today at 111 W. Jackson might tomorrow prefer a hamburger from the McDonald's at 223 W. Jackson to a hamburger from Burger King. This case, though, is not about competition for the sale of hamburgers to customers. It is about competition for employees, and in the market for employees, the McDonald's franchisees and McOpCos within a locale are direct, horizontal competitors."

48 Alan B. Frueger & Orley Ashenfelter, Theory and Evidence on Employer Collusion in the Franchise Sector 18 (Princeton Univ., IZA Institute of Labor Economics, Working Paper No. 11672, at 4 Sept. 2017).

49 AAI Position Letter at 8.

50 Statement of Interest at 11.

51 AAI Position Letter at 1.

facilitated through an agreement with the franchisor, be subject to a higher standard of proof than other horizontal agreements? It becomes an even tougher task when one considers the fundamental fairness of no-poach agreements. Unlike the typical agreements within a franchise where the parties themselves explicitly agree to limit the geographic scope of a franchisee's territory, or restrict what products are sold, no-poach agreements between franchisors and franchisees or between franchisees of a single brand concern employees who generally do not know about the no-poach agreements and certainly do not negotiate them or agree to them. Employees are not parties to the no-poach agreements. Employees are simply the ones who suffer the consequences of the agreements without realizing any upside.

As the AAI pointed out, in response to the Washington AG's efforts, 66 companies willingly abandoned their no-poach provisions, agreeing not to use them anymore throughout the United States, without the AG even filing a complaint.[52] If the no-poach provisions were truly ancillary (that is, necessary) to the franchise agreements, then they would not have so easily and quickly been abandoned. It seems that, in fact, these no-poach agreements have no legitimate justification, and "the ancillary restraints doctrine is exceedingly unlikely to apply when a vertical restraint has no plausible justifications or cognizable efficiency benefits."[53]

For someone like Paloma, whether the no-poach agreement is evaluated under the *per se* rule, the rule of reason or a quick look, the effect is the same. Her wages were depressed, and her job mobility was dramatically restricted.

V. CLASS CERTIFICATION ISSUES MAY ARISE EARLY

Karen concluded Paloma likely had a case in terms of liability. Paloma's next question was whether it was a case that Karen would take. Because Paloma could not afford to pay Karen's hourly rate and Karen could not afford to work on a contingency basis for the relatively low damages Paloma may be entitled to individually, it would have to be a class action, Karen continued her research into class certification issues surrounding no-poach agreements.

In addition to uncertainties surrounding the appropriate standard of review in franchise no-poach class actions, such cases also face a unique set of hurdles at the class certification stage. Against a backdrop of heightened federal scrutiny of restrictive hiring and solicitation provisions in franchise agreements, private lawsuits challenging no-poaching agreements are on the rise.[54] Though these cases remain in the very early

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52 *Id.* at 12 (citing 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-foodchains-will-end-restrictions-low-wage-workers).

53 *Id.* at 12.

54 Employee-plaintiffs have filed various cases seeking damages and barring enforcement of no-poach agreements in many courts, including three consolidated cases in the United States District Court for the Eastern District of Washington, *Stigar v. Dough Inc.*, No. 2:18-cv-00244; *Harris v. CJ Star LLC*, No.2:18-cv-00247; and *Richmond v. Bergey Pullman Inc.*, No. 2:18-cv-00246. Plaintiffs claimed that the no-poach agreements are unlawful per se anti-trust violations because of clear anticompetitive effects of the agreements.

stages of litigation, they are well-positioned to influence the development of no-poach class action jurisprudence. To understand the particular challenges franchise-employee plaintiffs may face at the class-certification stage, an examination of the early no-poach cases that reached class certification is instructive.

A. The Importance of Economic Analysis on Predominance

Class certification in past no-poach cases, as with most antitrust cases, often turned on plaintiffs' ability to demonstrate through economic analysis that common issues with respect to antitrust injury and damages predominated over individualized issues under Rule 23(b)(3). The Third Circuit's opinion in *Weisfeld v. Sun Chemical Corp.*, is instructive on this point.[55] There, plaintiffs sought to certify a class consisting of all personnel who provided technical services and possessed specialized skills in the manufacture, distribution, and sale of printing inks, and who were employed by any of the defendants or their predecessors during the relevant time period. In *Weisfeld,* the court found that predominance was not satisfied at the class certification stage when, instead of the "multiple regression and yardstick analyses [that] have been widely accepted," plaintiffs' expert instead submitted a scant three-page declaration stating that he intended to use a multiple regression model.[56] In short, as with most antitrust cases, no-poach cases will typically require a detailed expert opinion grounded in established methods of economic analysis at the class certification stage to show that class-wide impact can be assessed through reliable methods.

B. Defining a No-Poach Class Presents Particular Issues as to Commonality

Almost a decade after the *Weisfeld* decision, the Ninth Circuit affirmed certification of a nationwide class of employees who were the subjects of employer no-poach agreements.[57] In *In re High-Tech Employees*, plaintiffs alleged that several leading high tech companies engaged in an "overarching conspiracy" to eliminate competition for skilled labor, with the intent and effect of suppressing the compensation and mobility of defendants' employees.[58] Again, defendants were quick to contest plaintiffs' satisfaction of Rule 23(b)(3)'s predominance requirement, arguing that neither antitrust impact nor damages were susceptible to class-wide proof.[59]

Plaintiffs originally sought certification of an "All Employees" class which included more than 100,000 employees of the high-tech companies, and only in the alternative, certification of a more limited class of salaried, technical, creative, and research development employees ("Technical Class").[60] The court found that the "adjudication of Defendants' alleged antitrust violation will turn on overwhelmingly common legal

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55 84 Fed. App'x. 257 (3d Cir. 2004).

56 *Id.* at 259-64

57 *In re High-Tech Employees Antitrust Litigation*, 5:11-cv-02509 (N.D. Cal. filed May 23, 2011).

58 *In re High-Tech Employees Antitrust Litigation*, 5:11-cv-02509, Order Granting Plaintiffs' Supplemental Motion for Class Certification, ECF No. 531, at pp. 4, 24.

59 *Id.* at 18.

60 *Id.* at 6-7.

and factual issues," and that plaintiffs satisfied their Rule 23(b)(3) burden on the issue of the predominance of common issues with respect to damages.[61] Based on the evidence available to plaintiffs at the time, however, the court was unable to conclude that plaintiffs adequately demonstrated that common issues regarding the impact of the alleged violation on members of the All Employee Class or Technical Class would predominate under Rule 23(b)(2).[62] Addressing the court's concerns, plaintiffs amended the proposed class definition and successfully sought to certify only a nationwide Technical Class of employees.[63] So why was the class certified in *High Tech* but not in *Weisfeld*?

First, rather than a simple three-page declaration lacking the substance of any proposed regression analysis submitted by plaintiffs in *Weisfeld*, plaintiffs in *High Tech* offered substantial evidence, including documentary evidence and expert reports using statistical modeling, economic theory, and data, to show that common questions predominated over individual questions in determining the impact of antitrust violations.[64] The *High Tech* court found that plaintiffs' evidence and expert reports "paint[ed] a picture of Defendants' business practices and the market in which Defendants operate that suggests that common proof could be used to demonstrate the impact of Defendants' actions on Technical Class members."[65] Importantly, the *High Tech* Plaintiffs' showed that Defendants maintained formal compensation structures and made significant efforts to maintain internal equity within those structures, supporting plaintiffs' theory that the anti-solicitation agreements' downward pressure on individual employees' salaries would have applied similar downward pressure across defendants' salary structures and on all Technical Class employees' salaries.[66] Next the court found that plaintiffs' documentary evidence supported its theory that wage suppression within an individual defendant firm would have affected Technical Class members employed by another defendant firm because the defendants viewed each other as competitors for the same labor.[67]

In a related follow-up action—*Nitsch v. Dreamworks Animation SKG Inc*—the Ninth Circuit affirmed certification of a similar class of employees who alleged that their employers entered into a series of bilateral agreements limiting employee mobility and compensation.[68] Once more, the Ninth Circuit rejected defendants' arguments that individual issues with respect to antitrust injury and damages predominated.[69] Importantly, in *Nitsch* the certified class consisted of animation and visual-effect employees, and specifically, those who held job titles delineated in plaintiffs' expert report.[70] "[I]n passing," the defendants argued that plaintiffs' claims were not typical of the class because some class members had arbitration or release agreements with some defendants, and the named

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61 *Id*. at 8.

62 Order Granting Plaintiffs' Supplemental Motion for Class Certification, ECF No. 531, at p. 8.

63 *Id*. at 10.

64 *Id*. at 31.

65 *Id*.

66 *Id*. at 40.

67 *Id*. at 47.

68 315 F.R.D. 270 (N.D. Cal. 2016).

69 *Id*. at 281.

70 *Id*.

plaintiffs were not parties to those same agreements.[71] The court explained that "defenses that may bar recovery for some class members of the putative class, but those that are not applicable to the class representative do not render a class representative atypical under Rule 23."[72]

Next, on the issue of predominance, the court emphasized that the "inquiry is not a mechanical inquiry of 'bean counting' to determine whether there are more individual questions than common questions," but rather, a "hard look at the soundness of statistical models."[73] Defendants challenged predominance arguing that as a result of the arbitration agreements and releases signed by some class members, "overwhelming individual inquiries" predominated.[74] Again, based on extensive documentary evidence and economic theory, the court disagreed and found that common questions predominated over individual questions with respect to antitrust impact.[75] Specifically, the court found that the "evidence suggest[ed] that Defendants maintained a formal wage structure and used internal equity as a factor in determining compensation."[76]

VI. *SEAMAN V. DUKE UNIVERSITY, ET AL.* ILLUSTRATES THE IMPORTANCE OF RIGOROUS ECONOMIC ANALYSIS IN SUPPORT OF CLASS CERTIFICATION

After reviewing *Weisfeld* and the *High Tech* line of cases, Karen was satisfied that if discovery unearthed evidence showing that RRU had formal compensation systems in place and/or maintained some sort of internal equity structure, this documentary evidence along with reliable economic analysis would suffice to show that common questions relating to antitrust impact would predominate for a class of RRU employees. In fact, Karen was confident of this because in Paloma's case, the no-poach agreements were between RRU and its franchisees, eliminating the need to engage in a cumbersome company-by-company analysis of proprietary compensation structures. Moreover, in light of RRUs long-standing history in the tax services industry and hundreds of locations throughout the country, Karen was optimistic that discovery would likely produce evidence to support a theory of antitrust impact based on an internal equity structure, similar to that in *High Tech Employees.*

As Karen continued her research to determine whether Paloma's case would be suitable for class action treatment, she could not help but notice similarities to the story of Dr. Seaman, a college professor who was foreclosed from seeking employment at a competing university as a result of a no-hire agreement to which she was not a party. Dr. Seaman's story unfolded in *Seaman v. Duke University, et al.*[77] There, Dr. Danielle

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71 *Id.* at 284.

72 *Id.* (quoting *Barnes v. AT&T Pension Benefit Plan—Nonbargained Program*, 270 F.R.D. 488, 494 (N.D. Cal. 2010)).

73 *Id.* at 288 (citing *Butler v. Sears, Roebuck & Co.*, 727 F.3d 796, 801 (7th Cir. 2013)).

74 *Id.*

75 *Id.* at 315.

76 *Id.*

77 *Seaman v. Duke University, et al.*, Case No. 1:15-cv-00462 (M.D.N.C. filed June 5, 2015).

Seaman, a radiologist and Assistant Professor of Radiology at Duke University, brought suit against defendants Duke University ("Duke"), the University of North Carolina at Chapel Hill ("UNC"), and their affiliates alleging defendants agreed they would not hire or attempt to hire faculty employed by each other, thereby resulting in "suppressed compensation [for plaintiff and members of the class] throughout defendants' medical schools and healthcare facilities."[78] "Faculty" was defined to include employees who had an academic appointment at either the Duke or UNC Schools of Medicine.[79]

Dr. Seaman sought to certify a class of all persons employed by defendants "as a faculty member, physician, nurse, or other skilled medical staff."[80] Defendants did not "seriously contend" that the requirements of Rule 23(a) were not satisfied. Instead the dispute centered on whether common issues with respect to antitrust impact and damages predominated over individual issues.[81]

In line with *High Tech* and *Nitsch*, Dr. Seaman asserted an "internal equity structure" impact theory under which defendants' conduct would have suppressed compensation on a faculty-wide basis.[82] Specifically, Dr. Seaman's theory contended that "individual harm of decreased lateral offers and corresponding lack of retention offers," suppressed compensation across all faculty as a result of defendants' internal equity structures, which she defined as policies and practices designed to ensure "relatively constant compensation relationships between employees."[83] To support her impact theory, Dr. Seaman presented documentary and testimonial evidence, as well as expert reports providing economic theory and statistical modeling, including "sharing" regression analyses that examined how an individual faculty member's compensation moved in relation to other faculty members' compensation. Finding the sharing regression analyses provided further support for Dr. Seaman's antitrust impact theory, the court was satisfied that this was a "class-wide theory supported with class-wide proof."[84] With respect to damages, using common data, including payroll and other employment records for all faculty across defendants, plaintiff's expert conducted regression analyses to develop an aggregate class-wide damages estimate for all faculty, which the court also found was consistent with plaintiff's antitrust impact theory.[85]

As for non-faculty included in the proposed class definition, Dr. Seaman's expert averred that by virtue of defendants' internal equity structures, the no-hire agreement as to faculty and the resulting suppression of faculty compensation had a trickle-down effect as to all non-faculty employees. Although the court agreed that the *Seaman* plaintiffs met the threshold requirements to pursue the same theory of antitrust impact with respect

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78 *Seaman v. Duke University, et al.*, Case No. 1:15-cv-00462 (M.D.N.C. filed June 5, 2015), Mem. Opn. & Order, (M.D.N.C. Feb. 1, 2018), Dkt. No. 189 at 2-3 (Feb. 1, 2018) [hereinafter Duke Order on Class Cert.].

79 *Id.* at 2, note 1.

80 *Id.* at 3-4.

81 *Id.* at 6.

82 *Id.* at 9-11.

83 *Id.* at 9.

84 *Id.* at 13.

85 *Id.* at 14.

to non-faculty employees as faculty employees, and also found that the damages analysis was consistent with the impact theory, the *Seaman* court declined to include non-faculty in the certified class. The court cited concerns regarding manageability, particularly in light of the different documentary and testimonial evidence of internal equity required for non-faculty, which the court notes, is specific to non-faculty.[86] Moreover, though similar to the faculty sharing regression model, the non-faculty sharing regression model analyzed different compensation metrics, requiring an "additional evidentiary step" to connect the non-faculty evidence to the no-hire agreement's alleged impact on faculty compensation.[87] Importantly, the court expressly noted that non-faculty class members could pursue a separate action, thereby leaving open the possibility that non-faculty employees could seek class certification based on the same antitrust impact theory offered for faculty members, with respect to defendants' internal equity structures.[88]

For Karen, *Seaman* confirmed that while she and her team may *someday* be tasked with showing whether RRU employed an internal equity structure to support an antitrust impact theory, at this early stage it might be acceptable to table such complex inquiries until she obtained discovery that experts could rely upon in supporting the class certification stage of the litigation.

Now satisfied that Paloma could and should pursue her claim as a class action and equipped with an understanding of what a satisfactory antitrust impact theory at class certification might look like, Karen refocused her efforts on developing Paloma's case and began to draft her complaint. For Karen, an understanding of these earlier cases indeed shed light at the end of what she once perceived to be a dark no-poach class certification tunnel. However, as another saying goes, sometimes the light at the end of the tunnel is a train. Karen soon learned that the predominance related inquiries she had tabled for a later time may in fact be ripe for determination at the pleading stage of the litigation. In deciding whether these considerations could wait, she had to consider a recent decision out of the Western District of Pennsylvania Court: *In re Railway Employee No-Poach Antitrust Litigation*.[89]

VII. *IN RE RAILWAY EMPLOYEE NO-POACH ANTITRUST LITIGATION* SUGGESTS ADVANCING A *PRIMA FACIE* SHOWING THAT REQUIREMENTS OF RULE 23 ARE SATISFIED AT THE PLEADING STAGE

In *Railway*, the plaintiffs alleged that their employers, who were "among the world's dominant rail equipment suppliers," entered into unlawful no-poach agreements pursuant to which each agreed not to hire or solicit the other's employees.[90] Defendants quickly moved to dismiss the consolidated class action complaint and to strike the class action

86 *Id*. at 15.

87 *Id*.

88 *Id*. at 20.

89 *In re Railway Industry Employee No-Poach Antitrust Litigation*, No. 18-0798 (M.D. Pa. June 20, 2019) Opinion.

90 *Id*. at 4-5.

allegations.[91] As for the applicable standard of review, the court agreed with plaintiffs that the no-poach agreements, pled as market allocation agreements that were not ancillary to any other agreements with proper business purposes, may be considered *per se* violations.[92] With respect to defendants' motion to strike class action allegations, however, the court focused its analysis on whether the *Railway* plaintiffs satisfied the predominance requirement under Rule 23(b)(3), at the pleading stage.

The court explained that plaintiffs bear the burden of "advancing a *prima facie* showing that the class action requirements of Fed. R. Civ. P. 23 are satisfied or that discovery is likely to produce substantiation of the class allegations."[93] The proposed class was defined to include all persons employed by, or hired through staffing agencies or vendors to work for, defendants or their affiliates, at any time from the start of the conspiracy to the present.[94] In their motion to strike, defendants challenged plaintiffs' class definition as overbroad and argued that the consolidated class action complaint shows plaintiffs would not be able to satisfy typicality under Rule 23(a) and predominance under Rule 23(b).

The *Railway* Plaintiffs alleged that defendants' antitrust violation was the same for all members of the proposed class and likewise resulted in suppressed compensation for all class members.[95] As for typicality, while the defendants conceded that the "underlying legal theory of Plaintiffs' claims may apply class-wide," they argued that the factual underpinnings of the claims, including for example, terms of employment, would differ in that an employee who has special skills in the industry would individually negotiate terms, as opposed to one without skills specific to the industry.[96] The court explained that despite possible factual differences among the various kinds of employees in the putative class, the court could not at that early stage of the litigation conclude that those differences created a conflict of interest between the named plaintiffs and members of the putative class, so as to render the named plaintiffs' claims atypical of the class.[97]

On the issue of predominance, defendants argued that plaintiffs would not be able to satisfy the requirements under Rule 23(b)(3) because plaintiffs' "expansive class definition will require the Court to consider each employee's contract, salary history, professional qualifications, geographic location and willingness to relocate, and fungibility within the labor markets, when determining proof of both antitrust injury and damages."[98]

The *Railway* Plaintiffs alleged that defendants' agreements applied to all employees regardless of their title, position, or status, and that each agreement harmed each plaintiff regardless of his or her employer because every agreement "disrupted the normal bargaining and price-setting mechanisms that apply in the labor market, causing

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91 *Id.*

92 *Id.* at 19-20.

93 *Id.* at 48 (citing *Trunzo v. Citi Mortgage*, Civ. Action No. 11-1124, 2018 WL 741422, at * 4 (W.D. Pa. Feb. 7, 2018)).

94 *Id.* at 12.

95 *Id.*

96 *Id.* at 53.

97 *Id.* at 59-60.

98 *Id.* (citing Defendants' Motion to Dismiss, Dkt No. 124-1, at 26).

suppressed compensation levels generally."[99] In a rare turn, Judge Conti concluded that the plaintiffs had not "set forth factual allegations sufficient to make a prima facie showing that defendants' agreements caused **all** employees of defendants harm (antitrust impact)" that can be proven on a class-wide basis or that discovery will likely substantiate plaintiffs' allegations that the common issues will predominate over the individual questions raised by plaintiffs' proposed class of all employees."[100]

Notably, all of the various decisions the court discussed at length in its order and which provide the framework for its own antitrust impact analysis—including *Weisfeld*, *High Tech*, *Nitsch*, and *Seaman*—were decided following extensive discovery, briefings on class certification, and the submission of multiple, detailed expert reports that included economic theory, statistical modeling, and data. Citing *Weisfeld*, the court acknowledged that the Third Circuit Court of Appeals recognized that evidence showing class members' compensation was correlated over time may be evidence to show that antitrust injury in a wage suppression case can be proven on a class-wide basis.[101] Then citing *High Tech*, *Nitsch*, and *Seaman*, the court further acknowledged "other courts in wage suppression or no-hire cases have certified classes and found antitrust impact could be proven on a class-wide basis when there is evidence that the class members' wages were correlated and the defendant-employers emphasized internal or external equity, which ensured individuals performing similar jobs are compensated on a similar level."[102]

The *Railway* court concluded that in the no-poach context, in order to satisfy the requirement of predominance with respect to antitrust impact, there must be evidence to show that defendants' compensation structures in the relevant industry "were so rigid that the compensation of all class members were tethered together."[103] In other words, the *Railway* decision proposes that at the earliest stage of litigation and well in advance of any meaningful discovery, class action plaintiffs like Paloma are required to set forth sufficient factual allegations concerning the internal compensation structures employed by each of the named defendants to demonstrate the unyielding nature of these compensation systems such that the compensation for all employees strictly adheres to and/or is bound by these fixed systems.

While the *Railway* decision may provide important guidance for class plaintiffs and employees like Paloma who are in the initial stages of considering whether and how to pursue class claims challenging no-poach provisions in franchise agreements, it remains to be seen whether other courts will follow this heightened standard at the pleading stage. That said, the predominance and related compensation structure inquiries Karen recently tabled are now at the forefront of her analysis and consideration in drafting Paloma's class action complaint.

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99 *Id*.

100 *Id*. at 3, 63.

101 *Id*. at 63 (citing *Weisfeld v. Sun Chem. Corp.*, 84 F. App'x 257 (3d Cir. 2004).

102 *Id*. at 63-64 (citing *Nitsch v. Dreamworks Animation SKG, Inc.*, 315 F.R.D. 270, 293 (N.D. Cal. 2016); *Seaman v. Duke Univ.*, No. 1:15-CV-462, 2018 WL 671239, at *8 (M.D.N.C. Feb. 1, 2018); *In re: High-Tech Employee Antitrust Litigation*, 985 F.Supp.2d 1167 (N.D. Cal. 2013)).

103 *Id*. at 76.

VIII. CONCLUSION

Karen concluded there are many complexities for a plaintiff to navigate when considering whether to bring a no-poach antitrust action. Thoughtful analysis at the outset, coupled with a clear understanding of the antitrust analysis courts have applied in this context, is critical to securing a meaningful recovery for Paloma and other clients subject to no-poach employment restraints.

LET ME RIDE: NO SHORT-CUTS IN THE ANTITRUST ANALYSIS OF RIDE HAILING

By Daniel Bitton, David Pearl and Patrick Shaw[1]

The ride-hailing industry, and gig economy more generally, is under pressure. On the one hand, there has been a push in the California legislative and judiciary branches to treat drivers and other gig economy participants as employees of gig economy companies. On the other hand, ride-hailing companies like Uber have faced antitrust lawsuits, including claims that their centralized pricing algorithms amount to Section 1 Sherman Act price fixing among drivers.

Some have suggested that ride-hailing companies like Uber and Lyft face a catch-22: if their drivers are classified as employees they would have to comply with costly labor regulations, but if their drivers are deemed to be independent contractors Uber and Lyft could be considered to be illegally fixing prices because the companies determine how much drivers charge riders on their platforms.[2] In the authors' view, this is a false analytical choice. It is certainly true that if drivers are employees of a ride-hailing company, the company could not be liable for fixing prices with them under Section 1. But, it does not logically follow that ride-hailing companies incur Section 1 liability for setting prices of rides purchased through their app if drivers are, instead, viewed as independent contractors. To the contrary, there is a legitimate question whether ride hailing pricing amounts to unilateral conduct, a vertical restraint or a horizontal restraint—all of which differ analytically for purposes of determining potential antitrust liability under Section 1.

Moreover, ride-hailing apps and pricing algorithms do not fit the types of historical practices that always or nearly always restrict competition or decrease output—conduct for which courts have deemed per se antitrust analysis appropriate. Given their relatively recent advent, it is the view of these authors that the rule of reason should be applied to analyze whether pricing algorithms like the ones Uber and Lyft and other gig economy companies use provide procompetitive market benefits.

Ride-hailing apps and pricing algorithms have injected new competition and innovation into what were historically monopolistic markets insulated from competition and innovation by government licensing rules. Additionally, there are usually multiple ride-hailing options in each city, in addition to cab service, and output and efficiency of transportation has increased, in part because ride hailing pricing algorithms efficiently match supply and demand for rides. Ride-hailing companies thus have brought about greater competition and innovation in transportation services, as well as new, flexible, freelance work opportunities for gig-economy workers.

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2 Aaron Gordon, *The Legal Argument That Could Destroy Uber*, Jalopnik (May 20, 2019), available at https://jalopnik.com/the-legal-argument-that-could-destroy-uber-1834790506 ("Gordon").

The rule of reason offers a more searching[3] and far more appropriate analysis in the ride hailing context because it takes into account the beneficial effects of the pricing algorithms that Uber, Lyft and other gig economy companies use. A recent court decision concluding the opposite on a motion to dismiss seems to miss the mark and ignores Supreme Court precedent.

I. EMPLOYEES OR INDEPENDENT CONTRACTORS?

This past April, the National Labor Relations Board ("NLRB") published an advisory memorandum providing support for Uber and Lyft's position that their drivers are independent contractors, and thus not subject to the protections offered by the National Labor Relations Act.[4] However, in 2018, the California Supreme Court in the case *Dynamex Operations West, Inc. v. Superior Court*[5] adopted the "ABC" test for determining whether delivery drivers were independent contractors or employees. The test strongly favors a determination that a driver is an employee. On the heels of the *Dynamex* decision, the California State Legislature passed Assembly Bill 5, a bill that codified the "ABC" test in determining whether workers are employees or contractors.[6]

In an Op-Ed in the San Francisco Chronicle, Uber's CEO and Lyft's founders have explained that "a change to the employment classification of ride-share drivers would pose a risk to [their] business."[7] Moreover, as they also explain in their Op-Ed, reclassification would ultimately be harmful to drivers too because many prefer the freedom and flexibility that the current system allows rather than the more rigid schedules associated with traditional employment. Additionally, the Op-Ed mentions that many drivers are often driving as a means to supplement income, on top of another job or venture. Whether drivers would actually qualify as employees of ride-hailing companies like Uber or Lyft under the new California state legislation is still an open question.

Some have suggested that gig economy companies like Uber and Lyft face an even greater risk if they do not classify their drivers as employees: Section 1 antitrust liability.[8]

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3 *See, e.g.,* Rebecca Haw Allensworth, *The Commensurability Myth in Antitrust*, 69 Vand. L. Rev. 1, 5 n.7 (2016) ("The Rule of Reason . . . [is] a standard that balances pro- with anticompetitive effects. . . .")

4 U.S. National Labor Relations Board, Office of General Counsel, Advice Memorandum, Cases 13-CA-163062, 14-CA0158833, 29-CA-177483 (Apr. 16, 2019) available at https://www.laborrelationsupdate.com/files/2019/05/NLRB-Uber-memo.pdf.

5 4 Cal.5th 903 (2018).

6 Cal. Assem. Bill 5 (2019-2020, Reg. Sess.); *see* Kate Conger & Noam Scheiber, *California Bill Makes App-Based Companies Treat Workers as Employees*, The New York Times (Sept. 11, 2019), available at https://www.nytimes.com/2019/09/11/technology/california-gig-economy-bill.html?smid=nytcore-ios-share .

7 Dara Khosrowshahi, Logan Green, & John Zimmer, *Open Forum: Uber, Lyft ready to do our part for drivers*, San Francisco Chronicle (June 12, 2019), available at https://www.sfchronicle.com/opinion/openforum/article/Open-Forum-Uber-Lyft-ready-to-do-our-part-for-13969843.php?psid=k9i1h.

8 *See*, Hal Singer, *Uber Under The Antitrust Microscope: Is There A "Firm Exemption" To Antitrust?*, Forbes (Feb. 25, 2019), available at https://www.forbes.com/sites/washingtonbytes/2019/02/25/uber-under-the-antitrust-microscope-is-there-a-firm-exemption-to-antitrust/#145b3e092a47; Gordon, *supra*, note 2.

For example, in *Meyer v. Kalanick*[9], plaintiff Spencer Meyer filed a class action against the co-founder and then-CEO of Uber, Travis Kalanick, alleging that Kalanick had facilitated an illegal price-fixing conspiracy among Uber and its drivers by requiring drivers to use Uber's pricing algorithm to set the prices that the drivers would charge riders, in violation of Section 1 of the Sherman Act.[10] The plaintiff's complaint relied, in part, on Uber's statement that it "is not a transportation company and does not employ drivers."[11] Although the case was ultimately settled through binding arbitration,[12] the plaintiff's claims did survive Kalanick's motion to dismiss.[13]

It is certainly the case that Uber or Lyft cannot be illegally fixing prices if their drivers are employees: the antitrust laws recognize an exemption for intra-firm agreements. This exemption is based on the idea that firms are a single entity, and you cannot have an illegal agreement when there is only one entity involved. As the United States Supreme Court wrote in the case *Copperweld Corp. v. Independence Tube Corp.*,[14] "officers or employees of the same firm do not provide the plurality of actors imperative for a Section 1 conspiracy."

However, that does not mean that the centralized pricing algorithms that Uber and Lyft deploy to set ride fares for drivers amount to unlawful price fixing if drivers are independent contractors. Ride-hailing pricing does not easily fall into a traditional antitrust paradigm. We therefore consider whether pricing algorithms like the ones Uber and Lyft deploy for their ride-hailing services should be classified as unilateral single firm pricing, or as a horizontal or vertical restraint, as that can have a significant impact on the mode of antitrust scrutiny: rule of reason or per se. Ultimately, even if one classifies ride hailing pricing as horizontal price restraints, in these authors' view the Supreme Court's decision in *Broadcast Music Inc. v. Columbia Broadcasting System, Inc.*[15] ("*BMI*") suggests that the rule of reason antitrust analysis should apply. And, as discussed below, there are a number of reasons to believe that a rule of reason analysis would lead to a finding that the pricing algorithms of ride hailing apps have had net procompetitive effects.

II. SHOULD CENTRALIZED RIDE-HAILING PRICING BE TREATED AS UNILATERAL PRICING?

Ride-hailing companies like Uber and Lyft offer riders an app through which they can hail rides when and where they need it, based on a fare the ride-hailing company

9 174 F.Supp.3d 817 (S.D.N.Y. 2016).

10 *Id.* at 820.

11 *Id.*

12 *See Meyer v. Kalanick*, 291 F. Supp. 3d 526 (S.D.N.Y. 2018).

13 174 F. Supp. 3d at 829.

14 467 U.S. 752, 769 (1984).

15 441 U.S. 1 (1979).

determines. Uber's algorithms set the fare when a user hails a ride on Uber's platform,[16] and Lyft's algorithm sets the fare when a user hails a ride on Lyft's platform. The algorithm sets the fare based on a number of different factors such as the length and distance of the trip, as well as rider demand at the time the user hails the ride.[17] Uber charges a user the fare for the ride, retains a percentage of the fare, and then remits the remainder to the driver.[18] Lyft's approach and pricing works largely the same way.[19]

In a market or antitrust analysis, drivers could be viewed as input suppliers to Uber's and Lyft's transportation platform services to consumers. Alternatively, Uber and Lyft could be viewed as two-sided platforms,[20] if one considers Uber and Lyft as providing both a service to riders and a service to drivers (i.e. to find riders, drive them, and receive payment).

When viewed that way, the pricing algorithms Uber and Lyft use could be treated as plain unilateral pricing of their transportation platform services to their customers: (a) the ride-hailing fare for consumers, (b) a fee for the rider access service for the drivers (the percentage of the fare that Uber and Lyft take vs. pass onto the drivers), or (c) both. In an analogous context, limousine-for-hire companies set the fare for their limo services centrally, even though in many cases their drivers are independent contractors.[21] We are not aware of allegations that these arrangements are hub and spoke conspiracies between limousine-for-hire companies and their drivers.

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16 According to former Uber CEO Travis Kalanick's brief in *Meyer v. Kalanick*, Uber's terms of service with its drivers at that time allowed for downward departure in the price charged from the recommended price. Memorandum of Law In Support of Defendant Travis Kalanick's Motion to Dismiss, *Meyer v. Kalanick*, 174 F.Supp.3d 817, at *10 (S.D.N.Y. 2016). We are not aware of the details of the current driver arrangement, but such a provision would make it even more unlikely that Uber's pricing would be considered price-fixing because there would have to be additional evidence that Uber and its drivers had an agreement not to depart from the recommended fare despite being able to do so.

17 How Much Can Drivers Make With Uber, https://www.uber.com/us/en/drive/how-much-drivers-make/ (last visited Sept. 11, 2019).

18 Uber Service Fee: How Can Pricing Serve Drivers and Riders?, https://marketplace.uber.com/pricing/service-fee (last visited Sept. 11, 2019).

19 How and When Driver Pay is Calculated, https://help.lyft.com/hc/en-us/articles/115013080008-How-and-when-driver-pay-is-calculated#calculations (last visited Sept. 11, 2019); The Service Fee, https://help.lyft.com/hc/en-us/articles/115013081048 (last visited Sept. 11, 2019).

20 Two–sided platforms enable two distinct types of participants to interact more readily and realize gains from trade or other interaction. They provide each customer group with access to the other customer group.

21 *See, e.g.,* Groundlink.com, FAQs, Rates & Fees, https://www.groundlink.com/faq/ and Groundlink.com, Independent Contractors Agreement Terms and Conditions, https://driver.groundlink.com/terms-and-conditions. Note that, similar to surge pricing from ride-hailing services, Groundlink features "demand-based pricing," which raises prices during times of high demand in order to ensure there is sufficient driver supply.

III. SHOULD RIDE-HAILING PRICING BE TREATED AS A SERIES OF VERTICAL RESTRAINTS?

Uber and Lyft's ride-hailing service and pricing arrangement have also been characterized as a series of vertical agreements between Uber or Lyft and drivers.[22] Under a vertical agreement framework, drivers provide services to riders, and Uber and Lyft supply an input service to the drivers. When people sign up to drive for Uber or Lyft, they do so to connect to riders using Uber's platform or Lyft's platform. Drivers pay Uber and Lyft a portion of the fare for each ride they provide using the ride-hailing platform. In return, Uber and Lyft connect drivers to riders and provide drivers an easy way to bill for the rides.

Under the federal antitrust laws, such vertical pricing arrangements between a supplier and customer of services, even if they impose minimum resale prices, typically receive rule of reason analysis, not a per se analysis. In contrast, some states, including California, still treat minimum resale price maintenance arrangements as per se unlawful.[23]

However, as even the court in *Kalanick* recognized, the pricing algorithms of ride-hailing companies like Uber and Lyft arguably do not really qualify as "resale" pricing, since no resale occurs in the transaction.[24] In the vertical framework outlined above, drivers consume the platform services offered to them by ride-hailing apps like Uber and Lyft as an input into the service the drivers provide to riders. The drivers do not resell the platform service to riders. So even under the laws of states that have per se prohibitions against minimum resale price maintenance, such as California, one question would be whether ride hailing app pricing can really be characterized as such.

IV. SHOULD RIDE-HAILING PRICING BE TREATED AS A "HUB-AND-SPOKE" CONSPIRACY?

In *Meyer v. Kalanick*, the court declined to accept as a matter of law that Uber's many agreements with drivers were purely vertical, holding that the plaintiff had sufficiently pled a "hub-and-spoke" conspiracy.[25] A "hub and spoke" conspiracy can be thought of as a hybrid vertical and horizontal agreement. Ultimately, though, the construct is meant to infer a horizontal agreement among competitors. As the court explained in *Meyer v. Kalanick*:

> [C]ourts have long recognized the existence of "hub-and-spoke" conspiracies in which an entity at one level of the market, the "hub," coordinates an agreement among competitors at a different level, the "spokes." These arrangements consist of *both* vertical agreements between the hub and each spoke and a horizontal agreement among the spokes

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22 *See* 174 F. Supp. 3d at 823.

23 For example, minimum resale price maintenance is still per se illegal under California's Cartwright Act. *See, e.g., Alan Darush MD APC v. Revision LP*, No. CV 12-10296 GAF (AGRx), 2013 WL 1749539 (C.D. Cal. Apr. 10, 2013).

24 *See* 174 F. Supp. 3d at 826 ("Here, unlike in Leegin, Uber is not selling anything to drivers that is then resold to riders.").

25 174 F. Supp. 3d at 823-24.

> to adhere to the [hub's] terms, often because the spokes would not have gone along with the vertical agreements except on the understanding that the other spokes were agreeing to the same thing.[26]

The court concluded that the plaintiff plausibly alleged that drivers agreed to Uber's pricing terms with "the clear understanding that all other Uber drivers are agreeing to charge the same fares."[27] The court found that the plaintiff's allegations were bolstered by the occasional events Uber holds for its drivers, such as picnics, which would theoretically give drivers an opportunity to organize, as well as an instance in which drivers in New York City once collectively negotiated higher fares from Uber.[28] Defendant Kalanick argued that a conspiracy among drivers is "wildly implausible" because it would involve an agreement "among hundreds of thousands of independent transportation providers all across the United States."[29] The court gave short shrift to that argument reasoning that it was Uber's own "genius" in utilizing the "magic of smartphone technology" that could enable Uber to orchestrate such a large conspiracy.[30]

This reasoning is troubling. First, the allegation that the countless Uber drivers had reached a horizontal agreement was not plausible, nor supported with substantial factual allegations.[31] Illustrative is the precedent upon which the *Kalanick* court relied. That precedent involved far fewer spokes to the conspiracy than in the case of Uber or Lyft, which have thousands of drivers, and it was shown that those spokes extensively communicated with each other. For example, in *Interstate Circuit Inc. v. United States*, there were only eight film distributors making up the rim of the hub-and-spoke agreement,[32] while in *United States v. Apple Inc., et al.*, there were only five publishing companies making up the rim.[33] This is a far cry from the hundreds of thousands of Uber drivers all over the world.

Moreover, *Interstate Circuit* involved express communications, in the form of letters between the hub (a film exhibitor) and the spokes (film distributors).[34] In *Apple*, the court found that the spokes (book publishers) expressly colluded with each other and that the hub (Apple) consciously played a role in organizing their collusion.[35] Specifically, the district court in *Apple* found that the collusion among the publishers was accomplished through regular meetings, writing, "[o]n a fairly regular basis, roughly once a quarter, the CEOs of the Publishers held dinners in the private dining rooms of New York restaurants, without counsel or assistants present, in order to discuss the common challenges they

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26 *Id.* at 824 (internal alterations and emphasis in original) (quoting *United States v. Apple, Inc.*, 791 F.3d 290, 314 (2d Cir. 2015)).

27 *Id.*

28 *Id.* at 821, 825.

29 *Id.* at 825.

30 *Id.*

31 *Id.* at 824 (internal alteration omitted).

32 306 U.S. 208, 214 (1939).

33 791 F.3d at 296.

34 306 U.S. at 216-17.

35 791 F.3d at 316.

faced, including most prominently, Amazon's pricing policies."[36] Additionally, Apple also participated in these direct conversations and meetings.[37] While the court in *Kalanick* correctly recognized that technology may be able to facilitate hub-and-spoke conspiracies, Uber and Lyft drivers do not have nearly the same level of direct conversation around pricing with each other or with Uber and Lyft, either through the app or otherwise, as was present in the *Apple* case.

Second, the allegations that the drivers (the alleged spokes) agreed with Uber (the alleged hub) on the condition or assurance by the hub that other spokes agreed to those same terms were not well-supported in the complaint. It is true that ride-hailing companies offer a platform service that applies the same pricing algorithm to each ride, no matter who drives or who rides. Drivers for the most part probably know this when they sign up. But that does not mean they agreed to sign up to the Lyft or Uber platform *on the condition or assurance* that other drivers would agree to or be subject to the same Uber or Lyft pricing algorithm.

Inference of a horizontal (hub-and-spoke) conspiracy requires more than allegations of mere knowledge. Other hub-and-spoke cases illustrate this point. For example, in *Toys "R" Us, Inc. v. FTC*,[38] the court found that the spoke toy manufacturers accepted restrictions on their ability to sell toys to certain Toys "R" Us competitors on the express condition that the other largest toy manufacturers agreed to do the same.[39] The court found these assurances important because the manufacturers were worried that other manufacturers would cheat by breaking the terms of the agreement.[40] The FTC explained, "[t]hese manufacturers were in effect being asked by TRU to reduce their output . . . and as is classically true in such cartels, they were willing to do so only if TRU could protect them against cheaters."[41]

Furthermore, the anticompetitive agreement in *Toys "R" Us* was directly targeted at harming low-cost competitors, with the FTC writing, "TRU sought to eliminate the competitive threat the [low-cost competitor toy] clubs posed by denying them merchandise, forcing clubs' customers to buy products they did not want, and frustrating customers' ability to make direct price comparisons of club prices and TRU prices."[42] There is no factual support for the idea that all Uber drivers, or even a significant portion of them, entered into the Uber driver agreement with an explicit assurance that other drivers would be using the same pricing algorithm. Many of the other factors present in *Toys R Us*—including efforts to drive out low-cost competitors, forcing consumers to buy rides they do not want, or frustrating consumers' ability to price other ride-for-hire services—are not alleged to exist in the hail-riding context either.

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36 *United States v. Apple*, 952 F. Supp. 2d 638, 651 (S.D.N.Y. 2013).

37 *Id*. at 657-58.

38 221 F.3d 928 (7th Cir. 2000).

39 *Id*. at 932.

40 *Id*. at 936.

41 *Id*.

42 *Id*. at 932.

Uber's and Lyft's pricing algorithms do not exist to provide drivers assurances that competition on price will be eliminated between them or to prevent competition from a lower priced competitor. Rather, this pricing mechanism attempts to ensure the greatest degree of supply and demand efficiency as discussed below. Furthermore, the allegations in *Kalanick* were devoid of a suggestion that drivers could not sign up for multiple ride-hailing apps. Those ride-hailing platforms compete with each other on price and what pay they offer drivers, which in turn leads to additional competition among drivers. One would expect a true anticompetitive pricing agreement to prohibit drivers from breaking ranks with the conspiracy by driving for another ride-hailing company.

Empirical evidence of an actual price-fixing conspiracy among Uber drivers in Washington, D.C. suggests that ride-hailing apps, on their own, would be insufficient vehicles for facilitating such a conspiracy. In May of this year, reports emerged that Uber drivers at Reagan National Airport near Washington, D.C. were conspiring to game the Uber algorithm and artificially inflate prices.[43] Groups of fifty or so drivers apparently met near the airport and all agreed to turn off their apps right before multiple flights were scheduled to land. Because lack of supply tends to influence the Uber algorithm to increase prices, prices for rides from Reagan National would begin to creep up. Two drivers who kept their apps on would monitor the pricing and signal to the others to turn their apps back on once prices reached a certain threshold. Fixing prices among 50 drivers in a very limited vicinity near Reagan National Airport required real-time and in-person communications. If Uber or Lyft already provided a mechanism for drivers to conspire to charge supracompetitive fares, then surely this elaborate scheme would not have been necessary.

V. NO MATTER HOW YOU CLASSIFY RIDE-HAILING PRICING, THE RULE OF REASON SHOULD APPLY: *BMI*

In *Broadcast Music Inc. v. Columbia Broadcasting System, Inc.*[44] ("*BMI")* the Supreme Court held that while the pricing restraint at issue was horizontal price fixing "in the literal sense,"[45] it nonetheless had to be analyzed under the "rule of reason" not the per se rule.[46] The defendants in *BMI*, ASCAP and BMI, were licensing agencies whose members were music composers.[47] ASCAP and BMI were given the authority by their composer-members to provide a non-exclusive blanket license to use the members' copyrighted music to organizations such as radio stations or television networks. Under the blanket license, a single fee gave the licensee access to any of the songs in the ASCAP or BMI repertoires, respectively.[48] The blanket license did not preclude each member from negotiating individual licenses to their music. CBS sued ASCAP and BMI, claiming that

43 Minda Zetlin, *Here's Why Uber and Lyft Drivers Are Artificially Creating Surge Prices*, Inc.com (May 23, 2019), available at https://www.inc.com/minda-zetlin/uber-lyft-drivers-artificial-surge-pricing-reagan-national-washington-arlington-drive-united.html.

44 441 U.S. 1.

45 441 U.S. at 8.

46 *Id.* at 24-25.

47 *Id.* at 5.

48 *Id.* at 5-6.

the single-fee blanket license amounted to per se illegal price fixing in violation of Section 1 of the Sherman Act.[49]

The Supreme Court disagreed, holding that although facially "price fixing," ASCAP and BMI's blanket licenses should be analyzed under the rule of reason framework.[50] The Court did so for three main reasons, each of which applies equally to ride-hailing pricing. We discuss them below.[51]

A. Lack of Experience with Ride-Hailing Platforms and Pricing

Under antitrust law, practices are deemed per se illegal when "the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output."[52] The *BMI* Court pointed out that courts only classify a business practice as per se illegal when they have considerable experience with it, noting that it had never examined a practice like the blanket licenses before.[53]

That reasoning applies in ride-hailing pricing as well. Courts do not have "considerable experience" with Uber and Lyft's pricing policies: these companies and others with similar pricing models have only existed for about a decade,[54] and there has been minimal antitrust inquiry into whether their centralized pricing algorithms constitute price fixing.[55]

B. Pricing Algorithm Ancillary to Ride-Hailing

The *BMI* Court pointed out that horizontal restraints are not properly classified as per se illegal when they are not "naked restraints of trade," but ancillary to other procompetitive agreements.[56] The Court suggested that the blanket license program at issue in *BMI* had procompetitive effects because it was necessary to enable thousands of

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49 *Id.* at 6.

50 *Id.* at 16-24.

51 Note that *BMI* arguably involved a much clearer example of a horizontal restraint than does ride-hailing, since BMI and ASCAP are licensing agencies representing competing performing artists, who were their members, while it is at a minimum debatable whether Uber and Lyft represent drivers who sign up for their service.

52 441 U.S. at 19-20.

53 *See also United States v. Topco Associates, Inc.*, 405 U.S. 596, 608 (1972) ("It is only after considerable experience with certain business relationships that courts classify them as per se violations of the Sherman Act."); *Northrop Corp. v. McDonnell Douglas Corp.*, 705 F.2d 1030, 1051-52 (9th Cir. 1983) (finding agreements under which Northrop would limit its marketing of aircraft to those suitable for land-based operation and McDonnell Douglas limited its marketing to aircraft suitable for aircraft-carrier operation governed by rule of reason analysis where, among other factors, the courts lacked significant experience with either the business practice or industry involved).

54 Uber was founded in 2009 and the current incarnation of Lyft began in 2012. The History of Uber, https://www.uber.com/newsroom/history/ (last visited Aug. 31, 2019); Andrew Graeiner, Matt McFarland, Ivory Sherman, & Jen Tse, *A History of Lyft, From Fuzzy Pink Mustaches to Global Ride Share Giant*, CNN (Apr. 2, 2019) available at https://www.cnn.com/interactive/2019/03/business/lyft-history/index.html.

55 In addition to *Meyer v. Kalanick*, Uber's pricing system has been analyzed under a theory of price-fixing under the Maryland Antitrust Law. *See The Yellow Cab Co. v. Uber Technologies, Inc.*, Case No. 14-CV-2764-RDB, 2015 WL 4987653 (D. Md. Aug. 19, 2015).

56 441 U.S. at 19-20.

different entities to negotiate licenses for the many different copyrighted pieces of music, as well as to enforce the copyrights on these works; a nearly impossible task without blanket licensing. The setting of a fixed price was therefore a "necessary consequence" of offering a blanket license,[57] such that a rule of reason analysis applied.

Here, the pricing algorithms at issue are similarly integral to the ride-hailing service. There are intuitive reasons to believe that a centralized pricing algorithm is key to the functioning and output enhancing virtues of ride-hailing. Historically, taxi prices are regulated, and the rationale for these regulations was, in part, to ensure predictability and avoid price gouging.[58] Regulated prices, however, are not actually based on supply and demand, and thus highly inefficient.[59] The Uber and Lyft pricing algorithms, however, adjust for supply and demand in a particular locale, optimizing market efficiency, while preserving the benefits of centralized pricing that customers have come to expect. Thus, as discussed below, this increases the probability that there will be rides available when and where people need them. Further, a centralized pricing algorithm contributes to greater transparency and thus a reduction of transaction costs. Because of the consumer benefit of these centralized pricing algorithms, the algorithms are integral to the product just as a blanket license in *BMI* was necessary to effectuate the copyright protections of the license.

C. Ride-Hailing Apps and Price Algorithms Are a New Product

The *BMI* Court explained that the blanket license also required rule of reason analysis rather than *per se* treatment because it actually created a new product:[60] an aggregating, one-stop shop service that allowed users of the compositions to have a lot of flexibility in selecting which songs they would like to use. Since the blanket license was a new product, and each composer member remained free to license and price its own work, the uniform price of the blanket license was not a price restraint that limited competition; the

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57 *Id.* at 21.

58 Transportation Research Board, *Between Public and Private Mobility: Examining the Rise of Technology-Enabled Transportation Services*, Committee for Review of Innovative Urban Mobility Services Special Report 319, p. 40 (2016) available at https://www.nap.edu/read/21875/chapter/5 ("[Taxicab] fare regulation is designed to ensure predictability in the amount customers will be charged, to eliminate price gouging, and to ensure a reasonable return for owners and drivers.").

59 *See* Mark W. Frankena & Paul A. Pautler, *An Economic Analysis of Taxicab Regulation*, Fed. Trade Comm'n, Bureau of Econ. Staff Report, 6-7 (1984) available at https://www.ftc.gov/ sites/default/files/documents/reports/economic-analysis-taxicab-regulation/233832.pdf ("It appears that taxi regulations have often been designed to protect public transit systems and existing taxi firms from competition. . . . Some of the more obvious ways in which the allocation of resources under existing regulations is inefficient include: (a) the number of taxi rides taken is inefficiently low, because of regulation that raise fares, restrict the amount of service, and increase waiting times; (b) the cost of producing taxi trips is unnecessarily high, because of regulations that prevent ride sharing and increase deadheading and waiting in taxi lines; and (c) there are shortages of certain types of services because of the incentives provided by the structure of fares.").

60 441 U.S. at 22.

individual composers did not participate in the market for the blanket license product.[61] When they were first launched, ride-hailing apps were a completely new product, as were their pricing algorithms, which for the first time presented a mechanism for customers to find a truly on-demand ride. Because of the pricing algorithm, cars efficiently met this demand in a way that taxi cabs and other ride services had not. Just as the individual composers in *BMI* could not offer a blanket license for a single fee covering the repertoires of multiple composers, individual drivers could not, pre-Uber and Lyft, offer a service that showed all (or multiple) drivers available in an area, much less determine the most efficient ride fares based on the availability of drivers. Meanwhile, as in *BMI*, neither Uber nor Lyft precludes drivers from individually selling rides or signing up with other ride-hailing services. Indeed, many drivers multi-home Uber, Lyft, and other ride-hailing apps.[62]

The emergence of ride-hailing apps and centralized pricing algorithms thus does not appear to have eliminated competition; to the contrary, as discussed below, all signs points to it having created a lot of new competition in transportation services. As a consequence, driver agreements on pricing attendant to ride-hailing services should be analyzed under the rule of reason.[63]

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61 A number of cases since *BMI* have developed the exception further. In *Arizona v. Maricopa Cnty Med. Soc.*, 457 U.S. 332, 340-41 (1982), the Supreme Court, among other things, emphasized that the price restraints had to be necessary to achieve any claimed efficiencies, and that it is important that participants in a restraint don't compete much outside of the restraint anyways. *Id.* at 353-57. In *Nat. Collegiate Athletic Assoc. v. Board of Regents of the Univ. of Oklahoma,* 468 U.S. 85 (1984), the Supreme Court analyzed restrictions that the National Collegiate Athletic Association ("NCAA") placed on its member schools. The court determined that this practice was to be analyzed under a rule of reason framework because the horizontal restraints are essential if the "college football product" is to be available at all. *Id.* at 101-02. *See also O'Bannon v. Nat. Collegiate Athletic Ass'n*, 802 F.3d 1049 (9th Cir. 2015). Ultimately, however, the Court concluded the rules were unlawful under a rule of reason analysis because they resulted in increased prices and decreased output. 468 U.S. at 113, 120.

62 It is well known that some agents may multi-home in two-sided markets (e.g., a consumer may carry and a merchant may accept multiple credit cards). In the case of ride-hailing, a driver may drive for both Uber and Lyft, and a rider may use both companies' apps and request a ride from the company that has a driver closer by.

63 These market realities suggest that even under California law, the rule of reason should apply. California courts have been more reticent to move away from the per se rule than federal courts. For example, courts have recognized that even vertical pricing restraints still receive per se treatment in California. *See, e.g., Alan Darush MD APC v. Revision LP*, Case No. 12-CV-10296-GAF (AGRx), 2013 WL 1749539, *6 (C.D. Cal. Apr. 10, 2013). Nonetheless, there is still some precedent that can be found suggesting California's Supreme Court would, at least, consider applying rule of reason. The *Fisher v. City of Berkeley* Court has recognized the *BMI* decision and noted that the "price-fixing illegal per se rule . . . has . . . suffered steady and growing criticism as an often arbitrary, mechanical, and inconsistently applied rule that ignores the realities of market power and net economic effects." 37 Cal. 3d 644, 666-67 & n.14 (1984). It went on to consider whether applying the per se rule to municipal defendants concerning rent control ordinances would be "economically reliable" or "overinclusive[]." *Id.* at 668-671. That court concluded it would be, and declined to apply the per se rule. *Id.* at 671.

VI. RULE OF REASON ANALYSIS SUGGESTS RIDE-HAILING PRICING IS PROCOMPETITIVE

Under a rule of reason analysis, a court likely would find ride hailing app pricing procompetitive. The Ninth Circuit in *Tanaka v. University of Southern California*,[64] laid out the rule of reason test as follows, and many courts have followed a similar approach:

> The plaintiff bears the initial burden of showing that the restraint produces 'significant anticompetitive effects' within a 'relevant market'. If the plaintiff meets this burden, the defendant must come forward with evidence of the restraint's procompetitive effects. The plaintiff must then show that 'any legitimate objectives can be achieved in a substantially less restrictive manner.[65]

While we have not seen evidence that Uber's or Lyft's centralized pricing algorithms have resulted in "significant anticompetitive effects," there is ample evidence that these algorithms have had significant procompetitive effects.

First, output has grown significantly since ride-hailing apps emerged. An analysis conducted by Statista shows that in 2009, before the introduction of ride-hailing apps, there were 170.9 million pickups in New York City.[66] In 2017 ride-hailing apps were responsible for 159.9 million pickups in New York City, while taxis were still responsible for 125.5 million, for a total of 285.4 million pickups. This suggests the introduction of ride-hailing services is correlated with an increase of 114.5 million pickups in New York City.

Second, the quality and efficiency of hailing rides has also improved substantially since ride-hailing apps emerged. Many taxi cab services were forced to adopt apps for ride-hailing and payment in direct response to this innovation by ride-hailing platforms like Uber. [67] Studies suggest that since Uber's introduction, taxis have also responded by improving the quality of their service, as reflected by a decreased number of passenger complaints to taxi regulators about things such as broken heating and air conditioning or rude driver behavior. [68]

Finally, initial data suggests that the centralized pricing algorithms of apps like Uber and Lyft have created a highly efficient mechanism to optimize supply and demand and

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64 252 F.3d 1059 (9th Cir. 2001).

65 *Id.* at 1063. Other circuits have established similar burden shifting frameworks. *See e.g., FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2001).

66 Patrick Wagner, *Ride-Hailing Apps Surpass Regular Taxis in NYC*, Statista (Apr. 10, 2018), available at https://www.statista.com/chart/13480/ride-hailing-apps-surpass-regular-taxis-in-nyc/.

67 *See*, e.*g*., Luz Lazo, *The D.C. Taxi App Has Arrived*, The Washington Post, (Feb. 11, 2016), available at https://www.washingtonpost.com/news/dr-gridlock/wp/2016/02/11/the-d-c-taxi-app-has-arrived/.

68 Scott Wallsten, *The Competitive Effects of the Sharing Economy: How is Uber Changing Taxis?* (June 1, 2015), available at https://www.ftc.gov/system/files/documents/public_comments/2015/06/01912-96334.pdf.

maximize the availability of nearby drivers when there is local rider demand.[69] When there is high demand, Uber's and Lyft's pricing algorithms increase the fares to encourage drivers who would not otherwise plan to be working to come out and drive. This has been confirmed empirically in at least one study.[70] In *The Effects of Uber's Surge Pricing: A Case Study*, the authors analyzed a natural experiment, comparing two nights in which there was present an unusually high demand for Uber rides in New York City: the night of a sold-out Ariana Grande concert in Madison Square Garden and New Year's Eve. On the latter night, an error in Uber's system meant that surge pricing was not in effect for 26 minutes. The first night saw the amount of drivers in the area near the venue double and wait times remained constant at 2.6 minutes. During the latter night, average wait times spiked during the outage periods to 8 minutes. Additionally, the number of ride requests that were fulfilled dropped precipitously, meaning that many would-be riders could not get a ride.

Thus, there is significant evidence of pro-competitive benefits arising from ride-hailing apps, and the pricing algorithms themselves.

There also are other indicia suggesting that these ride-hailing apps are not stifling competition. Uber, as the first mover, and Lyft, as second mover, presumably both have substantial positions in ride-hailing or transportation services. One third party report contains estimates that Uber accounts for 71 percent and Lyft for 27 percent of app-based ride-hailing sales in the US, respectively.[71]

Of course, it is not clear how meaningful these numbers are for antitrust purposes, since one would first have to determine in what relevant market ride-hailing companies operate. A discussion of the relevant antitrust market is beyond the scope of this article, but obvious questions are whether to include taxi cabs and other limousine-for-hire services, among others. Public transit may also be a substitute, depending on where someone is and needs to go. In any event, at a minimum, Uber and Lyft face competition not only from each other, but also from other ride-hailing apps, such as Juno, Via, or Flywheel, as well as taxi cabs, most of which now also offer their services on hailing and payment apps, such as Curb. Riders and drivers both can and regularly do multi-home ride-hailing platforms.[72] There thus is little cost in switching between providers. Meanwhile, Uber and Lyft reportedly make little profit on their ride-hailing services. This all suggests that barriers to entry, expansion, and switching in ride-hailing are low, and competition

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69 How Surge Pricing Works, https://www.uber.com/us/en/drive/partner-app/how-surge-works/ (last visited Sept. 9, 2019).

70 Jonathan Hall, Cory Kendrick & Chris Nosko, *The Effects of Uber's Surge Pricing: A Case Study*, working paper (2016) available at http://economicsforlife.ca/wp-content/uploads/2015/10/effects_of_ubers_surge_pricing.pdf.

71 Kathryn Gessner, *Uber vs. Lyft: Who's Tops in The Battle of U.S. Rideshare Companies*, Second Measure (Aug. 21, 2019) available at https://secondmeasure.com/datapoints/rideshare-industry-overview/.

72 Melissa Berry, *How Many Uber Drivers Are There?,* The Ride Share Guy (June 1, 2019), available at https://therideshareguy.com/how-many-uber-drivers-are-there/; Eric. A. Morris et al., *Assessing the Experience of Providers and Users of Transportation Network Company Ridesharing Services*, Center for Connected Multimodal Mobility Final Report, 58 (May, 2019) available at https://cecas.clemson.edu/C2M2/assessing-the-experience-of-providers-and-users-of-transportation-network-company-ridesharing-services/.

is vigorous. Such robust competition leaves little room for accumulation or exercise of market power.

VII. CONCLUSION

Ride-hailing apps like Uber and Lyft have revolutionized the transportation market. They have unseated taxi monopolies, hastened the rise of the gig economy, and provided a new, convenient way to get around. Centralized pricing algorithms play a key part in facilitating these benefits. Courts and regulators should be careful to consider these benefits, and appropriately apply rule of reason analysis to allegations of anticompetitive conduct in the ride-hailing industry. Anyone who remembers what it was like trying to find a cab in San Francisco or Los Angeles before 2009 surely will agree.

MONOPSONY AND ITS IMPACT ON WAGES AND EMPLOYMENT: PAST AND FUTURE MERGER REVIEW

By Caroline C. Corbitt[1]

I. INTRODUCTION

Should impact on workers' wages be part of merger review? The question has been debated by recent scholarship that is grounded in a wider discussion about how—and if—antitrust law can address rising inequality and falling wages in the United States.

Past merger review conducted pursuant to Section 7 of the Clayton Act has focused on evaluating potential monopoly power and anticompetitive harms. But there is a growing call for merger review to consider *monopsony*[2] and its potential harm to workers. Monopsony refers to a situation in which a buyer of products or services has dominant market power. It differs from (and is theoretically the opposite of) a monopoly, in which a seller of products or services has dominant market power.

Companies buy many products or services in the course of running a business. One of their primary purchases is the purchase of labor from workers. A labor market is monopsonistic when one or a small number of firms dominate hiring in the market. A firm with monopsony power can wield this power to lessen competition in the labor market, including by imposing wages below the competitive rate. Large market power—such as the power displayed by tech giants like Apple and Amazon—may also give a firm the ability to impose onerous working conditions on workers such as noncompete clauses, or enable a firm to make stringent pricing demands of its suppliers.

Regulators have recently signaled their intent to evaluate potential labor market monopsony in merger review going forward. But it is unclear how existing antitrust law and guidelines, particularly the Horizontal Merger Guidelines, will be applied to merger review actions.

II. MONOPSONY IN LABOR MARKETS

In a perfectly competitive labor market, employers would face an elastic supply of workers who are highly responsive to changes in wage—and each firm would hire up to the point at which the revenue brought in by workers' labor is equal to the market wage. But in a labor market dominated by monopsony, employers have disproportionate power, allowing them to lower wages below the competitive level. Monopsony causes workers to exit the market and the number of available jobs to decrease: economic modeling demonstrates that is more profitable for a monopsonist to offer fewer jobs at a lower salary

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1 Caroline Corbitt is an associate attorney at Pritzker Levine LLP. The views expressed herein are her own.

2 The term *monopsony* was first used in print by economist Joan Robinson in her book, *The Economics of Imperfect Competition* (1933), from a combination of the Greek roots *mónos*, "single," and *opsōnía*, "purchase."

than to hire additional workers at a competitive rate.[3] Monopsony power also allows a firm to pay below-competitive wages without worrying that employees will leave.[4]

Monopsony and its effect on wages have been the subject of growing discussion in the antitrust field. Some have argued that monopsony in labor markets occurs more frequently than monopoly in product markets because perfectly competitive labor markets are more illusory than perfectly competitive product markets—there will always be inherent frictions in bargaining between firms and workers.[5]

Others have noted that because antitrust enforcement has largely concerned product competition, not labor competition, firms are more likely to exploit their labor market power than their product market power.[6] For example, firms may pursue mergers that reduce labor competition, expecting that such mergers will escape government scrutiny because the merging companies are not competitors in a product market.[7] To date, government regulators have never blocked a merger because of concerns of monopsony power in a labor market.[8]

A. Labor Market Concentration

Monopsony power in labor markets may stem from factors such as increased market concentration, job search frictions, and job specialization.[9] Firms may also gain market power through forcing employees to enter into non-compete agreements, utilizing independent contractors, and colluding with other firms (*e.g.*, through no-poach agreements).[10]

A labor market is "concentrated" if hiring in that market is dominated by a single or small number of firms.[11] The effect of labor market concentration has been the subject of numerous studies. Many labor markets are highly concentrated, particularly in rural

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3 Ioana Marinescu & Herbert J. Hovenkamp, *Anticompetitive Mergers in Labor Markets,* Faculty Scholarship at Penn Law (April 2019), at 7-8, available at https://scholarship.law.upenn.edu/faculty_scholarship/1965/; Jee-Yeon K. Lehmann, *et al.*, *Antitrust in Labor Markets: Insights from the FTC Hearings on Competition and Consumer Protection in the 21*st *Century*, Analysis Group (Feb. 15, 2019), at 3, https://www.analysisgroup.com/globalassets/uploadedfiles/content/news_and_events/news/2019-antitrust-in-labor-markets-insights-ftc-hearings-competition-consumer-protection.pdf.

4 Ioana Marinescu & Eric A. Posner, *Why Has Antitrust Law Failed Workers?*, SSRN (Feb. 14, 2019), at 2-3, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3335174.

5 Directorate for Financial and Enterprise Affairs Competition Committee, *Competition Concerns in Labor Markets*, DAF/COMP(2019)2, 4 (2019).

6 Eric A. Posner, *Why the FTC Should Focus on Labor Monopsony*, ProMarket Blog (November 5, 2018), https://promarket.org/ftc-should-focus-labor-monopsony.

7 Suresh Naidu, Eric A. Posner, & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 Harv. L. Rev. 536, 572 (2018); Directorate, *supra* note 5, at 23.

8 Naidu, *supra* note 7, at 571.

9 Marinescu & Posner, *supra* note 4, at 9.

10 Naidu, *supra* note 7, at 554; Debbie Feinstein & Albert Teng, *Buyer Power: Is Monopsony the New Monopoly?*, 33(2) Antitrust 12, 13 (Spring 2019).

11 Jose Azar, Ioana Marinescu, & Marshall Steinbaum, *Labor Market Concentration*, SSRN (Dec. 10, 2018), at 1, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3088767.

or semi-rural areas, and scholars argue that labor market concentration is growing.[12] According to one study, as many as 60 percent of labor markets are highly concentrated.[13] At the same time, wages have stagnated, meaning that the share of the United States' GDP held by labor has been rapidly declining—and suggesting that rising labor market concentration may be a cause.[14] Research based on online job-search data has indicated that posted wages tend to be 0.4 to 1.5% lower when market concentration increases by 10 percent.[15]

Leading experts in the field debated the topic of labor market concentration during the Federal Trade Commission's October 16, 2018 Hearings on Competition and Consumer Protection in the 21st Century.[16] Economist Matthias Kehrig argued that the evidence that concentration in labor market is increasing is ambiguous.[17] Others criticized the methodology of labor market concentration studies to date.[18] Also contested was whether highly concentrated labor markets are linked to lower wages.[19] In the view of one panelist, the late Alan Krueger, growing employer concentration has caused the wage stagnation of recent decades, and increased employer concentration has likely facilitated collusion between employers.[20] But according to economist Robert Topel, even if labor markets are concentrated, the correlation between employer concentration and lower wages may not be significant enough to "be worth the attention of the antitrust authorities."[21]

If labor market concentration is increasing and is a cause of wage stagnation, the economic harm could be extensive. In the view of University of Chicago law professor Eric Posner, labor market concentration leads to more pronounced economic harm than product market concentration because "wage suppression is much more significant than price inflation."[22]

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12 Jose Azar, *et al.*, *Concentration in U.S. Labor Markets: Evidence from Online Vacancy Data*, NBER Working Paper No. 24307 (March 2018, rev. Feb. 2019), https://www.nber.org/papers/w24395.pdf; Marinescu & Posner, *supra* note 4, at 2, 10.

13 Lehmann, *supra* note 3, at 4-5.

14 Marinescu & Posner, *supra* note 4, at 13-16; Marshall Steinbaum, *Antitrust in the Labor Market: Protectionist, or Pro-Competitive?*, ProMarket Blog (Sept. 20, 2017), https://promarket.org/antitrust-labor-market-protectionist-pro-competitive/.

15 The study specifically correlated posted wages with a 10 percent increase in the Herfindahl-Hirschman Index (with labor markets defined by commuting zone and occupation.) Lehmann, *supra* note 3, at 4-5. Azar, *supra* note 12, at 39.

16 FTC Hearing #3: Multi-Sided Platforms, Labor Markets, and Potential Competition (October 16, 2018), transcript available at https://www.ftc.gov/policy/hearings-competition-consumer-protection; Lehmann, *supra* note 3, at 1-2.

17 Lehmann, *supra* note 3, at 4.

18 *Id.* at 5.

19 *Id.* at 4-5.

20 *Id.* at 4. Mr. Kreuger was an esteemed labor economist who advised Bill Clinton and Barack Obama during their presidencies. He died on March 16, 2019. At the time of his death, he was the James Madison Professor of Political Economy at Princeton University. *See* https://www.princeton.edu/news/2019/03/19/alan-b-krueger-prominent-labor-economist-and-dedicated-public-servant-dies.

21 Lehmann, *supra* note 3, at 5.

22 Posner (ProMarket), *supra* note 6.

One way to address problematic labor market concentration is through merger law—blocking "wage-suppressing mergers before they occur."[23]

B. Existing Merger Law and Guidelines

The Federal Trade Commission and the Department of Justice have traditionally focused their merger enforcement efforts on preventing monopolies and harm to product markets. Why enforcement has not targeted monopsonistic labor markets or other forms of labor-market restraints is unclear. Randy M. Stutz of the American Antitrust Institute has suggested possible reasons for this policy decision, including the belief that antitrust and labor policy should be kept separate, a prioritizing of consumer welfare over labor welfare, and perceived difficulty in ascertaining the harmful effects of anticompetitive practices by buyers on labor.[24]

Perhaps because of lagging wage growth in recent decades, federal agencies have begun to increase their scrutiny of anticompetitive labor markets. In 2010, the Antitrust Division of the Department of Justice investigated "no-poaching" agreements not to hire each other's employees made between major technology companies, including Apple and Google.[25] The Federal Trade Commission has followed suit in investigating "naked" wage-fixing and no-poaching agreements.[26] In 2016, the agencies also released a new publication "to alert human resource (HR) professionals and others involved in hiring and compensation decisions to potential violations of the antitrust laws": Antitrust Guidance for Human Resource Professionals.[27]

In keeping with the trend of increased oversight of labor markets, the Department of Justice and the Federal Trade Commission have recently signaled their intention to consider labor market monopsony in merger review going forward.[28] Eighteen State Attorneys General have echoed federal regulators.[29]

Due to the lack of prior merger enforcement efforts on the labor side, there are few examples of how government enforcers and courts may actually act to evaluate monopsony in labor markets. The Department of Justice, together with eleven state Attorneys General and the District of Columbia, have challenged a merger partially on monopsony grounds at least once. In 2016, they challenged a proposed merger between Anthem and Cigna, alleging in part that the merger would create a monopsony in the

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23 Marinescu & Hovenkamp, *supra* note 3, at 2.

24 Randy M. Stutz, *The Evolving Antitrust Treatment of Labor-Market Restraints: From Theory to Practice*, American Antitrust Institute White Paper (July 31, 2018), at 2-6, https://www.antitrustinstitute.org/wp-content/uploads/2018/09/AAI-Labor-Antitrust-White-Paper_0-1.pdf.

25 *United States v. Adobe Systems, Inc., et al.*, Case No. 1:10-cv-01629 (D.D.C.).

26 Lehmann, *supra* note 3, at 1.

27 Department of Justice/Federal Trade Commission, *Antitrust Guidance for Human Resources Professionals* (October 2016), available at https://www.justice.gov/atr/file/903511/download.

28 Feinstein, *supra* note 10, at 15.

29 Public Comments of 18 State Attorneys General on Labor Issues in Antitrust (July 15, 2019); Federal Trade Commission Hearings on Competition and Consumer Protection in the 21st Century, available at https://oag.dc.gov/sites/default/files/201907/State_AGs_Comments_to_FTC_on_Labor_Issues_in_Antitrust.pdf.

health care services market, leading to a reduction in payments to doctors and other providers (as well as worsening the quality of health care services in the market).[30] But the monopsony claim was not actually considered by the district court or the D.C. Circuit.[31] (In dissent, Brett Kavanaugh, then a judge on the D.C. Circuit, wrote that the case should be remanded to the district court to consider the monopsony claim and its potential effect on provider rates.[32])

C. The Horizontal Merger Guidelines

The Horizontal Merger Guidelines, promulgated by the Federal Trade Commission and the Department of Justice to outline the principles and policies by which the two agencies review proposed mergers, provide limited guidance on the agencies' monopsony enforcement policies.

The Guidelines recognize the problem of monopsony stemming from mergers, noting that "Mergers of competing buyers can enhance market power on the buying side of the market, just as mergers of competing sellers can enhance market power on the selling side of the market."[33] The Guidelines further state that the agencies may weigh monopsony power heavily in evaluating mergers between buyers: agencies will not "evaluate the competitive effects of mergers between competing buyers strictly, or even primarily, on the basis of effects in the downstream markets in which the merger firms sell."[34]

While the Horizontal Merger Guidelines clearly indicate that monopsony should be evaluated under merger review, the Guidelines do not discuss monopsony in the specific context of the labor market.[35] Analysis of monopsony power, according to the Guidelines, should "employ essentially the [same] framework described [for product markets] for evaluating whether a merger is likely to enhance market power on the selling side of the market."[36] But what, in the absence of further instruction, does this mean?

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30 *United States v. Anthem, Inc.*, Case No. 1:16-cv-01493, Plaintiffs' Supplemental Memorandum on the Buy-Side Case (ECF No. 410) at 9-10 (D.D.C. Dec. 19, 2016); Feinstein, *supra* note 10, at 14.

31 *See generally United States v. Anthem, Inc.*, Case No. 1:16-cv-01493; *United States v. Anthem, Inc.*, 855 F.3d 345 (D.C. Cir. 2017).

32 *Anthem*, 855 F.3d at 377-78 (Kavanaugh, J., dissenting).

33 Department of Justice/Federal Trade Commission, *Horizontal Merger Guidelines* (Aug. 19, 2010), available at https://www.justice.gov/atr/horizontal-merger-guidelines-08192010.

34 *Id.*

35 *See id.*

36 *Id.*

III. APPLYING EXISTING MERGER LAW TO LABOR MARKET MONOPSONY

Section 7 of the Clayton Act grants the courts the authority to review and block mergers that involve an "activity affecting commerce" that may "substantially . . . lessen competition" or tend to "create a monopoly." [37] In merger review, courts must identify a "line of commerce" and "section of the country" in which a potential merger would be anticompetitive.[38]

Many have argued that existing merger review law and guidelines can be effectively applied or adapted to the problem of labor market monopsony. Any such consideration of labor market monopsony must involve two major avenues of merger inquiry: market definition and market power.

A. Market Definition

Defining the affected market is a key step in merger analysis. This allows enforcers to "identify market participants and measure market shares and market concentration"—which are suggestive of a "merger's likely competitive effects."[39] The Guidelines state that market definition depends "solely on demand substitution factors, *i.e.*, on customers' ability and willingness to substitute away from one product to another in response to a price increase or a corresponding non-price change such as a reduction in product quality or service."[40]

There have been different proposals to modify the Horizontal Merger Guidelines' market definition standard to encompass labor. The market could be defined using a "hypothetical monopsonist test"—adapted from the "hypothetical monopolist test" in the Guidelines. Under the hypothetical monopolist test, agencies assess whether a hypothetical monopolist could, if not subject to regulation or product competition, impose a "small but significant and non-transitory increase in price" (SSNIP) without consumers reducing their purchases of a product.[41] Comparably, a hypothetical monopsonist test would gauge an employer's ability to impose a "small but significant and non-transitory decrease in wages" (SSNDW) without losing workers.[42]

Job characteristics are important in labor market definition: markets for highly specialized workers are likely narrower than markets for more generalized ones.[43] Another proposal is to initially define a given labor market through job characteristics, using commuting zone and occupational data (such as the classifications encompassed

37 15 U.S. Code § 18.

38 *Id. See* Marinescu & Hovenkamp, *supra* note 3, at 2.

39 Merger Guidelines, *supra* note 33.

40 *Id.*

41 *Id.*

42 Naidu, *supra* note 7, at 575-576; Directorate, *supra* note 5, at 24-25.

43 Directorate, *supra* note 5, at 24.

in the Standard Occupational Classification System).[44] Some argue that this approach is imprecise, but acknowledge that it might be useful for an agency quick-look.[45]

Any labor market definition must ultimately encompass not just job and skill type, but also geographic area and time period.[46] A market is constrained by the ability or willingness of workers to relocate or commute.[47] Most workers can only be unemployed for a short period of time, leading to proposals to define the labor market for time periods ranging from three months to one year.[48]

B. Market Power

Market power is also a key aspect of merger analysis, as a merger "should not be permitted to create, enhance, or entrench market power or to facilitate its exercise."[49] As part of determining market power, the Horizontal Merger Guidelines prescribe conducting a Herfindahl-Hirschman Index (HHI) analysis of market concentration.[50] Mergers in already-concentrated markets that result in an HHI increase of more than 200 points are presumed to increase market power.[51] Merging entities must offer "convincing evidence" to rebut the presumption that the merger will enhance market power.[52] The HHI test could also be used to analyze labor market concentration—either through inputting employers' share of the labor market workforce or the employers' share of workforce vacancies.[53]

Market power can also be demonstrated through direct evidence of a proposed merger's effect on a market.[54] Labor market power could be shown through evidence that the merging companies have previously entered into no-poaching agreements.[55] Randy M. Stutz has suggested that agencies might begin their efforts to police monopsony power by reviewing mergers between firms that have previously agreed not to "poach" each other's employees.[56]

IV. LIMITATIONS OF MONOPSONY REVIEW IN MERGER CASES

Economists Ioana Marinescu and Eric Posner argue that "from an economic standpoint, monopolization of product markets and monopsonization of labor markets

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44 *Id.* at 25; Marinescu & Posner, *supra* note 4, at 7-9.

45 Directorate, *supra* note 5, at 25.

46 Marinescu & Posner, *supra* note 4, at 7.

47 *Id.*

48 Directorate, *supra* note 5, at 25.

49 Merger Guidelines, *supra* note 33.

50 *Id.*

51 *Id.*

52 *Id.*

53 Directorate, *supra* note 5, at 25.

54 Stutz, *supra* note 24, at 16.

55 *Id.*

56 *Id.*

pose exactly the same challenge to the economy—mispricing of resources (material or human), resulting in their underemployment, which both harms the economy and results in inequitable outcomes."[57] But the belief that monopsony and monopoly concerns pose the same economic challenges and should be equally weighed is controversial, and necessarily involves considering the merits of a longstanding antitrust doctrine: the consumer welfare standard.

A. Reevaluating the Consumer Welfare Standard

The consumer welfare standard is inextricably intertwined with merger review. At a minimum, the consumer welfare standard weighs purported "efficiencies" from a merger such as lower production costs against predicted impact on consumer welfare (*i.e.*, consumer pricing). To some, the consumer welfare standard only protects downstream purchasers of goods.[58] Others contend that consumer welfare refers to the welfare of all consumers in society and thus relates to monopoly and monopsony. [59]

The Horizontal Merger Guidelines as well as Supreme Court case law are clear that harm to consumers in one market cannot be outweighed by efficiency gains in another.[60] But adding labor markets complicates this picture. The consumer welfare standard can pose a conflict between consumer and worker welfare: in some instances, lower consumer prices could stem from a firm's monopsony power and corresponding ability to extract more money from suppliers or lower workers' wages.[61] Take, for example, Amazon and Uber—two companies who have wielded their enormous market power to drastically lower prices on goods and taxi services. The consumer pays less, but is this benefit outweighed by the lower prices paid to Amazon's suppliers and the lower wages paid to Uber's drivers?

In prioritizing consumers over workers, the consumer welfare standard may contribute "to the creation and maintenance of buyer power in labor and other markets."[62] But others argue monopsony should not be considered by antitrust law unless a monopsony will cause a demonstrable detrimental effect on consumers.[63]

The role of the consumer welfare standard in monopsony merger review was heavily debated at the Federal Trade Commission's October 2018 Hearings. Panelist Renata Hesse acknowledged that the consumer welfare standard would treat lower labor costs as an "efficiency" but argued that a merger's effects on the labor market can be considered separately from the consumer welfare test.[64] Economist and health policy expert Martin Gaynor noted that it is important to distinguish between competitive and anticompetitive

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57 Marinescu & Posner, *supra* note 4, at 3.

58 Feinstein, *supra* note 10, at 13.

59 *Id.*

60 *United States v. Philadelphia Natl'l Bank*, 374 U.S. 321, 370-71 (1963); Marinescu & Hovenkamp, *supra* note 3, at 30-31.

61 *Id.*

62 Feinstein, *supra* note 10, at 13.

63 *Id.*

64 Lehmann, *supra* note 3, at 6.

efficiencies in the labor market—technological advancements may bring about lower wages through competitive means, while market power may bring about lower wages through anticompetitive means.[65] Attorney Jon Jacobson argued that labor markets should be considered in merger review but that existing product market merger review already addresses most potential labor market issues.[66] Economist Nancy Rose predicted that the benefits of heightened review of labor market issues in merger reviews would be low and would ultimately result in fewer overall challenges to mergers.[67]

Review of past mergers may shed light on whether monopsony effects have been ignored in favor of consumer benefits.[68] It may demonstrate that the tension between consumer welfare and labor welfare is sometimes irreconcilable under the consumer welfare standard. During the panel, Mr. Jacobson proposed an alternative standard for assessing a merger's effect—assessing a merger's impact on output rather than impact on consumer prices.[69] Such a standard could be applied equally to labor and product markets.[70]

Economists Adil Abdela and Marshall Steinbaum have proposed another alternative to the consumer welfare standard: an "effective competition standard."[71] Their proposed effective competition standard "(1) shifts the burden of proof in any merger review to the merging parties, to prove their transaction would not harm competition; (2) mandates that antitrust enforcers look more often upstream for anti-competitive effects, including in labor markets; (3) establishes right of market access for upstream suppliers, which, in this case, would include content creators who use wireless technology to reach customers."[72]

B. Expanding Antitrust Laws to Address Labor Market Monopsony

Many have urged the Federal Trade Commission and the Department of Justice to revise the Horizontal Merger Guidelines to encompass monopsony.[73] Others, including antitrust scholars and presidential candidates, have gone further, advocating for a revision of our existing antitrust laws. Senator and presidential contender Amy Klobuchar has proposed inserting "or a monopsony" after every instance of the term "monopoly" in Section 7 of the Clayton Act.[74] Economists Ioana Marinescu and Eric A. Posner have

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65 *Id.*

66 *Id.* at 9.

67 *Id.*

68 *See id.* at 8.

69 *Id.* at 6.

70 *Id.*

71 Adil Abdela & Marshall Steinbaum, *Labor market impact of the proposed Sprint—T-Mobile merger*, Economist Policy Institute/Roosevelt Institute (Dec. 17, 2018), at 21, available at https://www.epi.org/files/pdf/159194.pdf.

72 *Id.*

73 *E.g.*, Lehmann, *supra* note 3, at 9.

74 Feinstein, *supra* note 10, at 12.

drafted new legislation to address labor market monopsony with labor-specific definitions of markets and anticompetitive behaviors.[75]

Presidential candidate and Senator Elizabeth Warren has called for new regulations of America's largest companies. Her new regulatory scheme would target the ways in which tech giants such as Facebook, Amazon, and Google have, in her view, used mergers to eliminate potential competitors.[76] Senator Warren's proposal would unwind Facebook's acquisitions of Instagram and WhatsApp; Google's acquisitions of Waze, Nest, and DoubleClick; and Amazon's acquisitions of Whole Foods and Zappos.[77] She also proposes to split apart enormous companies that act as both marketplaces and vendors, such as Amazon Marketplace and AmazonBasics.[78]

Senator Warren's plan does not explicitly address monopsony beyond referring to the market power that Amazon exerts over its suppliers.[79] However, commentators have observed that companies such as Amazon, Airbnb, Uber, and Facebook have enormous monopsony power as buyers (over products, services, and content), and that Senator Warren's plan might help remedy these marketplace imbalances.[80]

V. CONCLUSION

Labor's declining share of the American economy may have many causes. For example, labor unions have decreased, reducing workers' bargaining power—and likely strengthening employers' market power.[81] To some economists, blaming rising labor market concentration and employer market power is misplaced—they believe that diminished worker bargaining power is the more significant cause of the rising gap between median workers' pay and their productivity.[82]

While multiple factors may contribute to our "contemporary inequality in wealth, income, and social status," Marshall Steinbaum observes that diminished worker bargaining power and rising labor inequality must be attributed in part to "the erosion of antitrust laws restricting dominant firms [...] and the concurrent use of antitrust against any attempt by those workers or independent businessmen or contractors to bargain collectively against

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75 Ioana Marinescu & Eric. A. Posner, *A Proposal to Enhance Antitrust Protection Against Labor Market Monopsony*, Roosevelt Institute Working Paper (Dec. 21, 2018), available at https://rooseveltinstitute.org/proposal-enhance-antitrust-protection-against-labor-market-monopsony/.

76 Elizabeth Warren, *Here's how we can break up Big Tech*, Medium (March 9, 2019), https://medium.com/@teamwarren/heres-how-we-can-break-up-big-tech-9ad9e0da324c; Astead W. Herndon, *Elizabeth Warren Proposes Breaking up Tech Giants Like Amazon and Facebook*, The New York Times, March 8, 2019, available at https://www.nytimes.com/2019/03/08/us/politics/elizabeth-warren-amazon.html.

77 *Id.*

78 *Id.*

79 *See* Warren, *supra* note 76.

80 Antonio Garcia Martinez, *Facebook Is Not a Monopoly, but It Should Be Broken Up*, Wired, https://www.wired.com/story/facebook-not-monopoly-but-should-broken-up/.

81 Directorate, *supra* note 5, at 5.

82 Josh Bivens, Lawrence Mishel, & John Schmitt, *It's not just monopoly and monopsony,* Economic Policy Institute, April 25, 2018, at 2-3, http://epi.org/145564.

such concentrations of power."[83] As Eric Posner argues, setting aside the debate over the origin of "stagnating economic growth rates, rising inequality, and political conflict," we must acknowledge that "labor monopsony, wherever it occurs, is a problem."[84]

As discussed above, merger review and other forms of government enforcement against monopsony—particularly labor market monopsony—have been limited. Private antitrust litigation against monopsony is also rare.[85] The Clayton Act does not apply to mergers if any merging firm operates entirely within a state, meaning that only national mergers can be challenged.[86] Employers often operate within a single state, putting them outside the reach of the Clayton Act.

Labor-side class actions pose particular challenges: it is generally more difficult to demonstrate commonality on a classwide basis in a labor market than in a product market.[87] Additionally, labor market classes are often smaller than product market classes, meaning that damages will be smaller as well—and it may not be financially viable for plaintiffs' attorneys who work on contingency to take these cases.[88] Moreover, workers may not be able to bring class action lawsuits against their employers because their employment agreements include arbitration provisions.[89]

While monopsony may be only a partial cause of income inequality and wage stagnation in America, increased antitrust scrutiny of monopsony through merger review and other avenues is nonetheless merited. There must be stronger enforcement of existing laws and guidelines—as well as new laws and guidelines that give government agencies a clear mandate to address all forms of monopsony, including in the labor market.

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83 Marshall Steinbaum, *Antitrust, The Gig Economy, and Labor Market Power*, 82 Law and Contemporary Problems 45-64, 61 (2019), available at https://scholarship.law.duke.edu/lcp/vol82/iss3/3.

84 Posner (ProMarket), *supra* note 6.

85 Posner (ProMarket), *supra* note 6; Marinescu & Posner, *supra* note 4, at 29.

86 Marinescu & Posner, *supra* note 4, at 24 (discussing *United States v. Am. Bldg. Maint. Indus.*, 422 U.S. 271 (1975)).

87 *Id.* at 29.

88 Posner (ProMarket), *supra* note 6.

89 Marinescu & Posner, *supra* note 4, at 39 (discussing *Am. Express Co. v. Italian Colors Rest.,* 570 U.S. 228 (2013) and *Epic Sys. Corp. v. Lewis*, 584 U.S. ___ (2018)).

WHISTLEBLOWING AND CRIMINAL ANTITRUST CARTELS: A PRIMER AND CALL FOR REFORM

By Robert E. Connolly and Kimberly A. Justice[1]

> "In the two decades I was deeply involved in the Crazy Eddie fraud, the only threat that made us lose sleep at night was the possibility of a whistleblower blowing the lid on our crimes. Consistent studies by the Association of Certified Fraud Examiners have shown that most frauds are exposed by whistleblowers, far ahead of frauds exposed by any other source."
>
> Sam E. Antar, Former Crazy Eddie CFO, former CPA, and a convicted felon[2]

I. INTRODUCTION

We are currently in the heyday of government prosecuting agencies using whistleblowers as a means of exposing frauds that are difficult to detect without the aid of an "insider." News outlets routinely report on record breaking awards made by the Securities and Exchange Commission ("SEC") to whistleblowers who blow the whistle on financial fraud. SEC whistleblowers can be eligible for an award when they voluntarily provide the agency with "original, timely, and credible information" that leads to a successful enforcement action.[3] Awards can range from 10 percent to 30 percent of the money collected when penalties are more than $1 million.[4] The SEC has awarded more than $300 million to whistleblowers since the inception of the agency's whistleblower program[5] including a recent award of $500,000 to an overseas whistleblower.[6] More than $2 billion in monetary sanctions have been ordered against wrongdoers based on actionable

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2 Henry Cutter, *SEC Seeks Right to Cut Whistleblower Bounties*, Wall Street Journal, June 29, 2019, https://www.wsj.com/articles/sec-proposes-whistleblower-awards-for-smaller-cases-1530212390 (last visited Sept. 16, 2019), (comment by Sam E. Antar, Former Crazy Eddie CFO, former CPA, and a convicted felon).

3 The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 includes whistleblower incentives and protections and directs the SEC to issue monetary awards to individuals who voluntarily provide original information leading to successful enforcement of monetary sanctions of over $1 million. The awards are between 10 and 30 percent of collected monetary sanctions. *See* 15 U.S.C.A. ¶ 78u-6.

4 *Id*. For more detailed information, see *SEC Office of the Whistleblower, Frequently Asked Questions*, https://www.sec.gov/whistleblower/frequently-asked-questions#faq-1 (last visited Sept. 16, 2019).

5 *SEC Whistleblower Awards over $300 Million*, https://www.sec.gov/page/whistleblower-100million (last visited Sept. 16, 2019).

6 SEC Press Release, *SEC Awards Half-Million Dollars to Overseas Whistleblower,* July 23, 2019, https://www.sec.gov/news/press-release/2019-138 (last visited September 16, 2019).

information provided by whistleblowers since the program's inception.[7] The Commodity Futures Trading Commission ("CFTC")[8] and Internal Revenue Service[9] have also made large awards to whistleblowers whose cooperation has resulted in large settlements.

The SEC and other agencies have legislation providing for whistleblower awards. There is no such legislation for reporting a price fixing scheme or bid rigging antitrust crime. As discussed below, however, *if the government, not a private party, is the victim of illegal price collusion*, the False Claims Act provides a vehicle for a whistleblower to file a qui tam case and receive an award. To remedy this unacceptable anomaly and to strengthen cartel enforcement overall, we advocate passage of an SEC-style "cartel" whistleblower statute.[10] It is our contention that there are scores of lower level employees—sales managers, estimators—who may come forward, risk losing their job and incur significant legal fees—***if*** there is a mechanism by which they may be compensated—i.e. receive a reward for this difficult and life changing act. Public policy and vigorous cartel enforcement favors rewarding lower level cartel players to expose cartel ringleaders.

In this article we discuss the current options for being a whistleblower for criminal antitrust cartels; anti-retaliation protections for whistleblowers; and a proposal for antitrust whistleblower reform by creating criminal cartel whistleblowing opportunities similar to those offered by the SEC.[11]

II. WHISTLEBLOWING UNDER THE FALSE CLAIMS ACT ("FCA") [12]

Currently, a person can blow the whistle on financial crimes fraud if the *government* is the victim of the fraud, such as bid rigging on federally funded contracts.[13]

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7 *Id.*

8 Commodity Futures Trading Press Release, *Commodity Futures Trading Commission Announces Approximately $2.5 million Whistleblower Award,* June 24, 2019, https://www.cftc.gov/PressRoom/PressReleases/7943-19 (last visited Sept. 16, 2019).

9 During fiscal year 2018, the IRS awarded $312 million to tax fraud whistleblowers and whistleblowers enabled the IRS to recover $1,441,255,859. See *IRS Whistleblower Program, Fiscal Year 2018 Annual Report to Congress*, https://www.irs.gov/pub/whistleblower/fy18_wo_annual_report_final.pdf (last visited Sept. 16, 2019).

10 The authors have previously written shorter articles on this topic. *See It's a Crime There Isn't a Criminal Antitrust Whistleblower Statute,* Antitrust Law Daily, April 5, 2019, http://business.cch.com/ald/ALD_Criminal-Antitrust-Whistleblower-Statute_04-05-2018_final_locked.pdf (last visited Sept. 16, 2019); *The Political Stars Align for a Criminal Antitrust Whistleblower Statute,* Antitrust Law Daily, February 2019, http://business.cch.com/ald/ALD_Criminal-Antitrust-Whistleblower-Statute_20190208.pdf (last visited Sept. 16, 2019).

11 This article is only a primer on what a lawyer should consider before advising a client about becoming a whistleblower and taking on a case. Becoming a whistleblower can be a life changing experience for the individual involved in both negative and positive ways.

12 False Claims Act, 31 U.S.C. §§ 3729-3733.

13 This article discusses claims under the FCA. Almost every state has statutory provisions similar to the FCA to allow for recovery for false claims when that state is a victim of financial losses. The California False Claims Act provisions can be found at https://leginfo.legislature.ca.gov/faces/codes_displaySection. xhtml?lawCode=GOV§ionNum=12650.&article=9.&highlight=true&keyword=False%20Claims%20At (last visited Sept. 16, 2019). The State of California Department of Justice has a False Claim Unit website with additional information, https://oag.ca.gov/cfs/falseclaims.

A. The FCA

A whistleblower can file a claim under the FCA. The FCA's qui tam provision, § 3730(b), allows a private person, known as a "relator," to bring an action on behalf of the United States if the government has suffered monetary damages due to fraud.[14] The whistleblower can receive a percentage of the government's recovery if the litigation results in a damage award for the government. Successful relators may receive a reward of up to 25 percent of a settlement if the government intervenes and prosecutes the case and 30 percent if the government does not but the relator prevails after moving ahead on her own. The FCA also provides reimbursement for attorney's fees, costs, and expenses.[15]

Qui tam actions are initially filed under seal for an initial 60 day period.[16] At the time of filing the suit, the relator serves upon the DOJ a "relator statement" explaining the allegations in the suit and the evidence the relator has to support the suit. The defendant is not served during the time the government investigates to determine if it will intervene. During this time the identity of the relator remains confidential.[17] As discussed below, however, the complaint will eventually be unsealed and become public.

B. Anti-Retaliation Protection Under the FCA

Whistleblowers understandably worry about potential retaliation for coming forward. The FCA contains an anti-retaliation provision to address this legitimate concern. Employers are prohibited from discriminating against employees, contractors, and agents "because of lawful acts done by the employee, contractor, agent or associated others in furtherance of an action under this section or other efforts to stop one or more violations" of the FCA.[18] Prohibited retaliation includes: termination, suspension, demotion, harassment, or any other discrimination in the terms and conditions of employment. To state a claim for retaliation, a plaintiff must demonstrate that: (1) he engaged in activity protected under the statute; (2) the employer knew the plaintiff engaged in a protected activity; and (3) the employer discriminated against the plaintiff "because he . . . engaged in protected activity."[19]

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14 *Id.*

15 31 U.S.C. 3730(b). For a recent Ninth Circuit FCA case, *see United States ex. rel. Campie v. Gilead Scis., Inc.*, 2015 WL 3659765 (N.D. Cal. June 12, 2015), *rev'd and remanded sub nom. United States ex rel. Campie v. Gilead Scis., Inc.,* 830 F. 3d. 890 (9th Cir. 2017). This case has taken an unusual turn in that the United States is seeking to dismiss the case on the grounds that it has and will continue to require a large and unwarranted investment of government resources. *See also* Valerie Bauman, *Gilead Suit Tests Government's Authority to Dismiss Fraud Cases*, Bloomberg Law, August 22, 2019, https://news.bloomberglaw.com/health-law-and-business/gilead-suit-tests-governments-authority-to-dismiss-fraud-cases (last visited Sept. 16, 2019).

16 31 U.S.C. § 3730(b)(2).

17 This decision is rarely made within 60 days. The government routinely seeks extensions of the seal of up to six months. The government's investigation while the case remains under seal can sometimes take several years.

18 31 U.S.C. § 3730(h).

19 *Mendiondo v. Centinela Hosp. Med. Ctr.*, 521 F.3d 1097, 1103 (9th Cir. 2008) (holding that the heightened pleading requirements of Rule 9(b) do not apply to a retaliation claim). *See also United States ex rel. Campie,* 862 F. 3d 890, for a fuller discussion of the elements of a retaliation suit under the FCA.

C. No Whistleblower Anonymity Under the FCA

The strong presumption that court proceedings are open to the public means that a whistleblower complaint, and the whistleblower's identity, will eventually become public. The significant public interest in open judicial records will almost always outweigh the relator's desire to limit access to her identity. In essence the laws say that if you come forward as a whistleblower, you have the potential for a large monetary reward and you have anti-retaliation protection under the FCA (even if you think it is inadequate), but if you file a lawsuit it will become matter of public record. Nonetheless, relators have tried (almost always unsuccessfully) other means to file a suit while keeping their identity concealed even after the case is unsealed.

1. John Doe Plaintiffs

Federal Rule of Civil Procedure 10(a) requires that "[t]he title of the complaint must name all the parties." [20] This apparent prohibition of anonymous filings stems from the strong presumption in favor of transparency in judicial proceedings. A plaintiff's use of a pseudonym "runs afoul of the public's common law right of access to judicial proceedings."[21] Anonymous filings are permitted in very limited circumstances, such as sexual assault, national security issues, or other compelling reasons. That a plaintiff may suffer embarrassment or economic harm is not enough.[22] Instead, a plaintiff must show "both (1) a fear of severe harm, and (2) that the fear of severe harm is reasonable."[23] Fear of retaliation from a drug cartel for being a government informant is one example of the showing of the severity of the harm that will justify keeping a party's name anonymous.[24]

2. Sealing the Case Docket

Relators have also failed to permanently seal the record of dismissed FCA claims. In *US v. Apothetech Rx Specialty Pharmacy Corp.,*[25] relators claimed they would face potential retaliatory actions if the case was not permanently sealed. The court held, however, that such "generalized apprehensions of future retaliation" were not enough to overcome the strong public right of access to judicial proceedings.[26] The court denied the relators' motion for a permanent seal. Noting that such closed proceedings "must be rare and only for cause shown that outweighs the value of openness," the court held that the relators' concerns alone, even if well-founded, "are insufficient to overcome the public

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20 Fed. R. Civ. P. 10 (a); *Caption; Name of Parties.*

21 *Does I Thru XXIII v. Advanced Textile Corp.*, 214 F.3d 1058, 1067 (9th Cir.2000).

22 *Id.*

23 *Doe v. Kamehameha Sch./Bernice Pauahi Bishop Estate*, 596 F.3d 1036, 1043 (9th Cir.2010). *See also Doe v. Megless*, 654 F.3d 404, 409 (3d Cir. 2011) (district court should determine whether a litigant has a reasonable fear of severe harm that outweighs the public's interest in open litigation.).

24 In *United States v. Doe*, 870 F.3d 991, 998-1000 (9th Cir. 2017), the Ninth Circuit reversed the district court's denial of a defendant's motion to seal all sentencing documents that would reveal his identity and that he informed on a drug cartel. The appellate court found that Doe had provided useful information against a large drug cartel and that he and his family would be endangered should his cooperation become known.

25 2017 WL 1100818, Civ. No. 3:15-CV-588 (S.D. Miss. Mar. 20, 2017).

26 *Id. at *2.*

right to access judicial records." The court also noted that the FCA provided a remedy for retaliation[27] and relators had other remedies like tortious interference with business relations and defamation. [28]

3. Corporate Relators

Courts have ruled that various types of legal entities are also a "person" for purposes of the FCA's qui tam provision.[29] A corporation, therefore can be the whistleblower plaintiff but the organization must have been in existence at the time of the alleged fraud[30] in order to have the "direct and independent" knowledge needed to file a case.[31] There will be limited opportunities to use a corporate relator and even then, the identity of the individual whistleblowers will likely come to light at some point in the litigation. Keeping individuals' names out of the case captions, however, provides some anonymity from online search engines.[32]

D. The FCA and Government Purchasers

As mentioned, a whistleblower may be able to collect a reward *if* the government is the victim of a criminal antitrust violation. For example, a whistleblower recently exposed a cartel that fixed prices and rigged bids on U.S. Department of Defense fuel oil contracts in South Korea. Bid rigging is a criminal per se violation of the Sherman Act. Submitting a rigged bid to the United States also violates the FCA because the companies must certify that the bids were independently arrived at, when in fact they were the product of collusion. Three South Korea-based oil companies pled guilty in November 2018 to the misconduct alleged by the whistleblower. The defendants agreed to pay a total of approximately $82 million in criminal fines and approximately $154 million to the United States for civil antitrust and FCA violations related to the bid-rigging conspiracy.[33]

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27 *Id.* (citing 31 U.S.C. § 3730(h) (relator has recourse to FCA for retaliation)).

28 For the same reasons, the court also denied relators' motion to redact all identifying information from the complaint. For a discussion of the case written by a member of the law firm involved, see Chelsea M. Rutherford, *Relators Denied Permanent Seal on FCA Case Record after Voluntary Dismissal*, April 21, 2017, https://www.fcaupdate.com/2017/04/relators-denied-permanent-seal-on-fca-case-record-after-voluntary-dismissal/ (last visited Sept. 16, 2019).

29 *See, e.g., Minnesota Ass'n of Nurse Anesthetists v. Allina Health Sys. Corp.*, 276 F.3d 1032, 1048 (8th Cir. 2002) ("There is no hint in the history of the 1986 Amendments Act that Congress intended to disqualify organizational relators.").

30 *See U.S. ex rel. Precision Co. v. Koch Indus. Inc.*, 971 F.2d 548, 553- 54 (10th Cir. 1992) ("Precision did not come into existence as a corporate entity until June 1988. . . . Therefore, Precision cannot seriously argue it qualifies as an original source of the . . . information upon which its FCA allegations are based.").

31 *See, e.g., U.S. ex rel. Springfield Terminal Ry. Co. v. Quinn*, 14 F.3d 645, 656-57 (D.C. Cir. 1994).

32 R. Scott Oswald and David Fullerborn, *Shielding Relator's Identity in Qui Tam Actions: The Landscape After ACA Changes to the False Claims Act*, December 2016, at The Federal Lawyer, http://www.fedbar.org/Resources_1/Federal-Lawyer-Magazine/2016/December/Features/Shielding-Relators-Identity-in-Qui-Tam-Actions-The-Landscape-After-ACA-Changes-to-the-False-Claims.aspx?FT=.pdf (last visited Sept. 16, 2019).

33 *See* DOJ Press Release, *Three South Korean Companies Agree to Plead Guilty and to Enter into Civil Settlements for Rigging Bids on United States Department of Defense Fuel Supply Contracts,* November 14, 2018, https://www.justice.gov/opa/pr/three-south-korean-companies-agree-plead-guilty-and-enter-civil-settlements-rigging-bids (last visited Sept. 16, 2019).

Moreover, the companies that have pled guilty are cooperating, resulting in two additional companies agreeing to plead guilty and pay over $75 million in criminal fines and over $50 million in civil settlements.[34] The whistleblower will collect between 15 and 25% of these recoveries. This has been a tremendously positive demonstration of the power of potential awards under the FAC to incentivize whistleblowers to come forward and disclose corporate fraud and misconduct.

If the same whistleblower had information about price fixing/bid rigging on fuel supply contracts sold to businesses and/or homeowners, however, there would be no government damages and no vehicle to file a false claims whistleblower suit. Why should there be an incentive for a whistleblower to come forward and expose bid rigging on government contracts, but not bid rigging against consumers at large? There shouldn't be; businesses and consumers deserve the same protection as the government.

III. A PROPOSAL FOR REFORM

Our proposal is simple: legislation should be passed that mirrors the current SEC whistleblowing regime to allow an individual who has original, timely and credible information about a price fixing or bid rigging cartel, whether the victims are public or private entities, to report that information. If a successful enforcement action results from that information, the whistleblower should receive a financial award.

Now is a great time to consider this proposal because there is already some Congressional action on antitrust whistleblower reform. On July 24, 2019 Senators Charles Grassley (R-Iowa) and Patrick Leahy (D-Vt.), reintroduced legislation to extend whistleblower protection for employees who provide information to the DOJ related to criminal antitrust violations. The Criminal Antitrust Anti-Retaliation Act[35] seeks to protect whistleblowers in criminal antitrust cases by prohibiting employers from retaliating against an employee who provides information to the Department of Justice regarding conduct that violates the criminal antitrust laws. Senator Grassley noted: "Just as whistleblower protections for government employees help root out waste, fraud and abuse, they can also help prevent misconduct in the private sector."[36] The Senate unanimously passed a similar version of the legislation in 2013, 2015 and 2017[37], but the bill was never even taken up by the House of Representatives. With the House now in Democratic hands, and a renewed interest in the benefits of whistleblower to expose fraud, the bill

34 *See* DOJ Press Release, March 20, 2019, *More Charges Announced in Ongoing Investigation into Bid Rigging and Fraud Targeting Defense Department Fuel Supply Contracts for U.S. Military Bases in South Korea*, https://www.justice.gov/opa/pr/more-charges-announced-ongoing-investigation-bid-rigging-and-fraud-targeting-defense (last visited Sept. 16, 2019).

35 The text of the proposed Criminal Antitrust Anti-Retaliation Act is available at https://www.grassley.senate.gov/sites/default/files/116.S19075%2C%20the%20Criminal%20Antitrust%20Anti-Retaliation%20Act.pdf (last visited Sept. 16, 2019).

36 United States Senator Charles Grassley Press Release, *Grassley Leahy Reintroduce Criminal Antitrust Retaliation Act*, July 24, 2019, https://www.grassley.senate.gov/news/news-releases/grassley-leahy-reintroduce-criminal-antitrust-anti-retaliation-act (last visited Sept. 16, 2019).

37 *Id.*

has a much improved chance of becoming law.[38] Makan Delrahim, head of the Antitrust Division of the DOJ, just recently expressed support for the bill while testifying before a United States Senate antitrust oversight hearing.[39]

The Grassley-Leahy bill is a good bill, but it's only a start. The prospect of some anti-retaliation protection is unlikely to draw out many people to take the enormous risk of becoming an industry whistleblower. A financial incentive is needed to compensate for the risks involved of coming forward and just as importantly, the ability to hire a lawyer who can help navigate the often lengthy process of becoming an antitrust whistleblower.

A. Are There Potential Criminal Antitrust Whistleblowers?

There are many potential whistleblowers in virtually every price-fixing/bid rigging conspiracy.[40] Price fixing/bid rigging cartels by definition involve at least two companies and most have numerous individual cartel participants. As one example, in the Antitrust Division's international cartel prosecution against AU Optronics in the thin-film transistor liquid crystal display panels ("TFT-LCD") industry, besides the two corporate defendants AU Optronics Corporation and AU Optronics Corporation of America, the indictment charged 6 individual defendants from the companies.[41] Numerous other employees in those companies had some participation in the cartel as well. There were also seven other corporate defendants who pled guilty.[42] All told, there were dozens of individuals who could have been whistleblowers in this case—and of varying culpability. Cartels often even have nomenclature designating the culpability level of the conspirators i.e., Masters (top-level) to sherpas (working group level).[43] Even in a local bid rigging case, the estimators

38 *See* Robert Connolly and Kimberly Justice, *The Political Stars Align for a Criminal Antitrust Whistleblower Statute,* Antitrust Law Daily, February 2019, http://business.cch.com/ald/ALD_Criminal-Antitrust-Whistleblower-Statute_20190208.pdf (last visited Sept. 16, 2019).

39 Testimony of Makan Delrahim, Assistant Attorney General Antitrust Division, DOJ, at the Senate Judiciary Subcommittee on Antitrust, *Antitrust Enforcement Oversight Hearing*, September 18, 2019, available at C-Span, https://www.c-span.org/video/?464378-1/antitrust-enforcement-oversight-hearing (47:05-47:50) (last visited Sept. 18, 2019).

40 Government employees cannot be whistleblowers on bid rigging matters because their job requires them to report fraud, waste and abuse. *See United States ex rel. Fine v. Chevron, U.S.A.,* 72 F.3d 740, 744 (9th Cir. 1995) (en banc) (Agreeing with the district court that the fact that a relator "was employed specifically to disclose fraud is sufficient to render his disclosures nonvoluntary."); *see also Wercinski v. IBM Corp.,* 982 F. Supp. 449, 461-62 (S.D. Tex. 1997) (same); *United States ex rel. Foust v. Grp. Hospitalization & Med. Servs., Inc.*, 26 F. Supp. 2d 60, 73 (D.D.C. 1998) (same); Webster's 2564 ("voluntary implies freedom from any compulsion that could constrain one's choice" and defining it as "produced in or by an act of choice").

41 A copy of the indictment of AU Optronics and six of its executives, *US .v AU Optronics Corporation, et al.* No CR-09-0110 (N.D. Cal. 2010.)(SI), is available at https://www.justice.gov/atr/case-document/superseding-indictment-1 (last visited Sept. 16, 2019).

42 Don Clark and Brent Kendall, *AU Optronics Fined $500 Million in Price-Fixing Case*, Wall Street Journal, September 20, 2012, https://www.wsj.com/articles/SB10000872396390444032404578008420937555176 ("The Justice Department previously has secured negotiated guilty pleas against seven other Asian companies accused of LCD price-fixing in the case, including LG, obtaining combined fines of $890 million.") (last visited Sept. 16, 2019).

43 *See* Kurt Eichenwald, *US Wins A Round Against Cartel*, New York Times, January 30, 1997, available at, https://www.nytimes.com/1997/01/30/business/us-wins-a-round-against-cartel.html (last visited Sept. 16, 2019).

at the conspirator companies and salespeople usually know about any collusion. Dangling a potential whistleblower award into cartel waters will typically have many "little fish" contemplating the bait.

Without a potential whistleblower award, however, it will be rare for an individual to come forward. Even the lowest level employee who knows his company is fixing prices and takes any act to carry out the price fixing agreement (like the salesman who is told to check prices with a competitor) is subject to a maximum 10-year jail sentence.[44] In order for a low-level cartel participant to come forward, he needs to engage a qualified attorney and negotiate a non-prosecution agreement with the Antitrust Division. This is an expensive, potentially life changing decision. Long-term unemployment may well follow. Hefty attorney fees surely will. Even the most desirable whistleblower—one with no culpability at all, such as a secretary, or customer—will not ensnare herself in a cartel investigation without some means to cover significant attorney costs and reap some compensation for doing "the right [but very costly] thing."[45] A potential whistleblower award allows engagement of an attorney on a contingency fee and provides the possibility that the whistleblower will have the financial means to withstand potential retaliation by the industry.

The FCA, the Dodd-Frank Act, and other whistleblower statutes are successful, in part, because individuals with actionable information can engage an attorney to guide them through the process in exchange for a possible award of attorney fees and a contingency fee. The whistleblower's attorney can develop the potential whistleblower's claim, negotiate with the government, and represent the potential whistleblower throughout the process, all without an upfront cost to the potential whistleblower. A former employee, for example, maybe one who has been fired or downsized—would have a way to report illegal conduct without assuming a tremendous legal bill—and even have a financial incentive to do so.

B. The SEC Whistleblowing Legislation Should Be Imitated

The SEC's successful whistleblower program has returned hundreds of millions of dollars to investors as a result of actionable whistleblower information over the past six years. In 2018, the SEC announced a "record-breaking year" for its whistleblower program, after receiving more than 5,200 whistleblower tips and distributing more than $168 million in awards to 13 individuals.[46] The success story told in the CFTC's latest annual report is similar, including reporting the largest-ever CFTC whistleblower award

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44 Under conspiracy law, if an estimator, or a salesperson knows his company is involved in a price-fixing agreement, he is liable as a "coconspirator" if he takes any act in furtherance of the conspiracy (prepares a bid; quotes a fixed price). Consequently, virtually 100% of witnesses who cooperate with the Antitrust Division demand immunity. But, these "culpable" individuals would make ideal whistleblowers. A financial reward to low-level cartel participants—given the considerable expenses such a witness will incur in providing cooperation—seems like a reasonable exchange.

45 Cartel Capers, *A Whistleblower Story—Hypothetical*, September 25, 2018, http://cartelcapers.com/blog/a-whistleblower-story-hypothetical/ (last visited Sept. 16, 2019).

46 *See SEC, 2018 Annual Report to Congress, Whistleblower Program,* p. 9, available at https://www.sec.gov/sec-2018-annual-report-whistleblower-program.pdf.

of approximately $30 million.[47] The IRS paid one whistleblower more than $100 million for information that helped the government uncover a massive tax evasion scheme and led to a $780 million settlement.[48]

Andrew Ceresney, the former SEC Director, Division of Enforcement has stated:

> "The bottom line is that in its short history, our whistleblower program has had tremendous impact. And, as imitation is the sincerest form of flattery, other domestic and foreign regulators have sought to replicate the successes of our program."[49] It is time for SEC style cartel whistleblower legislation to allow the Antitrust Division to enjoy similar success.[50]

C. The Basic Elements of A Cartel Whistleblower Statute

1. Payment of Award

The SEC whistleblower program allows for a reward, in "any covered judicial or administrative action, or related action."[51] The Antitrust Division does not have administrative actions but an antitrust whistleblower would be eligible for an award based on the level of fines imposed after criminal convictions.

2. Amount of Award

The SEC provides for a whistleblower award of between 10 and 30 percent, but only where the penalties exceed $1 million.[52] In our view, this may not be an appropriate award schedule for an antitrust whistleblower. The $1 million threshold should be eliminated. A rigged electrical contract at a local hospital that would have been $750,000 with competitive bidding but has a low fixed bid of $1 million is as worthy of a whistleblower award as an international cartel where each consumer suffers a relatively small loss, but cumulatively the loss will easily exceed $1 million. Also, the 10 to 30 percent award range

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47 *See CFTC, 2018 Annual Report on the Whistleblower Program and Customer Education Initiative*, p. 2, https://whistleblower.gov/sites/whistleblower/files/2018-10/FY18%20Annual%20Report%20to%20Congress%20Final.pdf (last visited Sept. 16, 2019).

48 *See* David Kocieniewski, *Whistleblower Awarded 104 Million by I.R.S.,* New York Times, September 11, 2012, https://www.nytimes.com/2012/09/12/business/whistle-blower-awarded-104-million-by-irs.html (last visited Sept. 16, 2019).

49 Andrew Ceresney, SEC Director, Division of Enforcement, *"The SEC's Whistleblower Program: The Successful Early Years,* September 16, 2016, https://www.sec.gov/news/speech/ceresney-sec-whistleblower-program.html (last visited Sept. 16, 2019).

50 William Kovacic, a leading commentator in the antitrust world, has publicly endorsed the whistleblower idea: '"I think it would be a good idea to do this," he said. Although he did not expect the U.S. to adopt it soon, Kovacic predicted that with around 100 competition agencies around the world "sooner or later someone is going to try this."' David Lawsky, *Big Payoffs Eyed for Whistleblowers*, Reuters, November 20, 2007, https://www.reuters.com/article/us-antitrust-whistleblowers/big-payoffs-eyed-for-antitrust-whistleblowers-idUSL2045531920071120 (last visited Sept. 16, 2019).

51 15 U.S.C.A. ¶ 78u-6.

52 *Id*.

may be excessive in a large cartel case. These are details to be negotiated in any potential cartel whistleblowing legislation.

3. No Recovery for One Convicted of the Violation

No SEC whistleblower award can be made to "to any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award under this section."[53] An antitrust whistleblower statute should certainly retain this provision. This will give the Antitrust Division significant control over who can become a whistleblower. If the potential whistleblower has a level of culpability such that the Antitrust Division is not comfortable accepting that person as a whistleblower, the simple answer is to not grant non-prosecution protection. Another possible scenario is that the Antitrust Division grants non-prosecution protection to a highly culpable individual (making them eligible for an award because there would be no conviction) but include in the cooperation agreement that the cooperator waive the right to a potential "bounty." Culpability lessens SEC whistleblower awards.[54] In practice, potential criminal prosecution will make the Antitrust Division the gatekeeper of whistleblower awards.

4. Anonymous Reporting

Under SEC procedures, a whistleblower must have an attorney and the complaint can be filed anonymously through the attorney.[55] Anonymity may affect whether the SEC acts on the tip and can also diminish the credit a whistleblower might get for cooperation. But a whistleblower might stay anonymous through the entire proceeding. Anonymity cannot be guaranteed, however, as a whistleblower's identity may be disclosed if required in connection with a federal court or administrative action. A similar procedure for anonymity should be part of cartel whistleblower legislation, also understanding that a whistleblower's identity may become public as a result of the prosecutor's duty to turn over evidence at trial or other legal requirements.

Potential long-term anonymity in filing a whistleblower complaint, as opposed to certain public disclosure in a full blown FCA lawsuit, is one of the most attractive features of the SEC whistleblower program. It allows an individual to report wrongdoing with at least a reasonable possibility that his identity will not be revealed. Requiring that the information be reported through an attorney helps weed out frivolous claims. SEC-style cartel whistleblower legislation should be made available to whistleblowers on government contracts as an alternative to an FCA qui tam suit.

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53 *Id.* at ¶ 78u-6 (c)(2)(B) (no award to any whistleblower who is convicted of a criminal violation related to the action for which the whistleblower otherwise could have received an award).

54 *See SEC to Whistleblowers: Report Promptly and Expect a Minimal Award if You are Culpable*, National Law Review, September 17, 2018, https://www.natlawreview.com/article/sec-to-whistleblowers-report-promptly-and-expect-minimal-award-if-you-are-culpable (last visited Sept. 16, 2019).

55 *See* SEC Whistleblower, Frequently Asked Questions, https://www.sec.gov/whistleblower/frequently-asked-questions#faq-10 (last visited Sept. 16, 2019; *see also* 17 C.F.R. ¶ 240.21F-9 (setting forth procedures for submitting original information to the SEC).

D. The Objections Raised Against a Potential Cartel Whistleblower Statute Are Weak

In July 2011, the General Accounting Office issued a report on *Criminal Cartel Enforcement* [56] and found support for legislation protecting a whistleblower who comes forward, but little support for the idea that the whistleblower should be financially rewarded.[57] Nine of 21 key stakeholders stated that adding a whistleblower reward in the form of a bounty could result in greater cartel detection and deterrence, but 11 of 21 noted that such rewards could hinder the DOJ's enforcement program. In 2011, Antitrust Division officials did not take a position on anti-retaliation legislation but were opposed to providing a whistleblower bounty. The position of the current administration is not known.

The concerns about how a whistleblower reward could harm cartel enforcement can be grouped into these categories:

1. Credibility

There is concern that a whistleblower witness will lose credibility if he is eligible for a financial reward. But, a whistleblower would generally just "get the ball rolling" and allow subpoenas and search warrants to go out to subject companies. The whistleblower's usefulness may end or greatly diminish after the investigation begins. Moreover, in which scenario are consumers better off: When the government has no knowledge of a secret cartel? Or when a cartel is exposed by a whistleblower who will be eligible for a financial reward? It is better to have a witness who may have a credibility issue because of a possible reward than no witness at all.

2. Onslaught of Frivolous Claims

Another concern is that a potential whistleblower reward will lead to frivolous claims. There may be many leads, but Antitrust Division attorneys are skilled enough to know the difference between a report of simultaneous price increases and an insider who has knowledge of a cartel. Private antitrust attorneys will help play a screening role because they are not likely to take on a case on a contingency fee that is frivolous. Finally, the extra resources needed to review whistleblower complaints will be more than offset by the resources saved when a credible "insider" whistleblower lays out the facts exposing a cartel. The Antitrust Division already adheres to this principle with the successful Corporate Leniency Policy where a company and its cooperating executives can escape any criminal liability in return for whistleblowing on the cartel.[58]

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56 U.S. Government Accountability Office, *CRIMINAL CARTEL ENFORCEMENT: Stakeholder Views on Impact of 2004 Antitrust Reform Are Mixed, but Support Whistleblower Protection*, July 25, 2011, https://www. gao.gov/products/A98263 (last visited Sept. 16, 2019).

57 *Id.*

58 The Antitrust Division also sometimes uses "affirmative leniency," making a reverse proffer to a potential corporate leniency applicant that the Division staff feels would be a good candidate for corporate leniency.

3. Undermining Compliance Programs

Business groups complain that with a whistleblower reward, an employee who learns about cartel behavior may decide to go directly to the DOJ rather than report the information internally, thus potentially undermining corporate compliance programs. That may happen. An employee may reasonably conclude that the "compliance program" is not really working if senior executives are involved in a cartel, and it may be dangerous to report the information internally. But even if the employee does go directly to the government, all is not lost in terms of a company with a legitimate compliance program. A single whistleblower is highly unlikely to be able to prove a cartel beyond a reasonable doubt. The Antitrust Division may elect to approach the company where the whistleblower worked and offer an early favorable plea agreement or even leniency.

4. Rewarding the Culpable?

There should be no concern that a senior member of a cartel, a "master," could obtain a whistleblower reward. As discussed, the Antitrust Division would simply either not grant non-prosecution protection to an individual who played a central role in the cartel, or it could negotiate an agreement that precludes a very culpable executive from seeking a whistleblower reward or limits the award to the reimbursement of attorney fees.

E. Create an Antitrust Division Office of the Whistleblower

Our cartel whistleblower proposal requires that legislation be passed. Anyone proposing legislation should have a "Plan B." The Antitrust Division could immediately create an Office of the Whistleblower. A key aspect behind the success of the SEC whistleblower provision is that the SEC actively promotes the program through its Office of the Whistleblower.[59] The Antitrust Division has had successful whistleblower prosecutions besides the Korean fuel supply matter discussed above. But, the Antitrust Division does little to publicize the role of the whistleblower and encourage others to step forward.[60]

A Criminal Cartel Office of the Whistleblower would be particularly helpful during times of intense government financed reconstruction after natural disasters. The Antitrust Division and Federal Trade Commission have expressed concern that collusion can emerge following a natural disaster. In a joint statement, the agencies said, "While natural

59 *See generally SEC Office of the Whistleblower*, https://www.sec.gov/whistleblower (last visited Sept. 16, 2019).

60 A publicly documented example of this was in 2012 when the Antitrust Division settled a civil bid rigging complaint for a total of $550,000 for antitrust and FCA violations where two companies were charged with rigging contracts for Bureau of Land Management gas leases. *See* DOJ Press Release, *Justice Department Settlement Requires Gunnison Energy and SG Interests to Pay the United States a Total of $550,000 for Antitrust and False Claims Act Violations*, Feb. 15, 2012, https://www.justice.gov/opa/pr/justice-department-settlement-requires-gunnison-energy-and-sg-interests-pay-united-states (last visited Sept. 16, 2019). Similarly, there was a FCA case filed in the Antitrust Division's successful prosecution of the Puerto Rican ocean shipping cartel. That investigation resulted in the longest jail sentence ever received by an individual convicted of a Sherman Act violation–5 years. While there was a whistleblower in that case, the only reference to that fact is in a government post trial brief. *See US v. Frank Peake,* Case No: 16-2356 (filed Feb. 2, 2017), https://www.justice.gov/atr/case-document/file/936611/download (last visited Sept. 16, 2019).

disasters often bring out the best in human compassion and spirit, they can also lead to unscrupulous individuals and organizations taking advantage of those in need."[61] A visible Cartel Office of the Whistleblower would encourage whistleblowers to come forward to combat any collusion.

IV. CONCLUSION

Whistleblower awards work in helping to expose financial crimes where insider cooperation is necessary. Whistleblower awards have helped the SEC achieve remarkable results. Whistleblower awards help the Antitrust Division prosecute bid rigging and price fixing—when the government is the victim. The passage of criminal cartel whistleblower legislation will help expose cartels in both the public and private sector. It is an idea whose time has come.

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61 FTC Antitrust Division Joint Statement, *Antitrust Guidance Hurricanes Hartery and Irma*, September 12, 2017, https://www.ftc.gov/system/files/documents/public_statements/1253313/hurricanes_harvey_and_irma_ftc_doj_statement.pdf (last visited Sept. 16, 2019).

COMPETITIVE BALANCE IN SPORTS: "PECULIAR ECONOMICS" OVER THE LAST THIRTY YEARS[1]

By Daniel A. Rascher, Ph.D. and Andrew D. Schwarz[2]

In 1984, with its ruling in *Nat'l Collegiate Athletic Ass'n ("NCAA") v. Board of Regents of University of Oklahoma*,[3] the Supreme Court recognized that benefits can accrue to society when potential competitors limit their competition in the interest of competitive balance. In the thirty years that have followed, a period in which professional sports have increasingly become partnerships between owners on the one hand and strong players associations on the other (notwithstanding the recent cultural clashes between owners and players), courts and collective bargaining have mapped out boundaries of acceptable collective action geared around creating competitive balance, all in the name of increasing consumer demand for each sport's product. Similarly, college sports (though not in a bargaining-based partnership with its players) have relied on the same competitive-balance justification for its collective refusal to pay athletes at market-based rates (in addition to claims that the existence of college sports requires that "athletes must not be paid"[4]).

However, while the last thirty years have seen competitive balance put forth as a pro-competitive justification, the economic basis for this claim is not quite so clear. In fact, in many cases rules that have been adopted with the express aim of achieving competitive balance have been shown not to do so, while others that do achieve balance may only do so at the expense of consumer preferences. Figuring out which rules truly grow consumer demand is an empirical exercise—there is no one-size-fits-all theoretical answer.

At the professional level, the logic of competitive balance has received a fairly non-critical view, with players associations generally accepting that salary caps, revenue-sharing, and individual player maximums grow the total value of the sport via improved competitive balance, even though many of the mechanisms in question are not based on firm economic theory. In contrast, on the collegiate side, where in the absence of collective bargaining such rules have been challenged in antitrust litigation, courts have been more inclined to look for evidence that the team and individual-player pay caps implicit in "amateurism" actually help competitive balance before simply accepting this economic nostrum as fact. Put to that test, the argument that caps on compensation improve competitive balance has tended to fall flat.

For example, in *O'Bannon v. NCAA*, a group of men's college basketball and football players brought an antitrust class action to challenge the NCAA's restrictions on their ability to earn money from the use of their name, image, and likeness (NIL).[5] The district

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1 An earlier version of this article appeared in: 24 Entertainment, Arts and Sports Law Journal (Spring 2013), published by the New York State Bar Association, One Elk Street, Albany, NY 12207.

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3 468 U.S. 85, 102 (1984).

4 *Id.* at 102.

5 *O'Bannon v. Nat'l Collegiate Athletic Ass'n*, 802 F.3d 1049 (9th Cir. 2015).

court rejected competitive balance as a procompetitive justification for the naked collusion on athlete remuneration, finding that "the NCAA's current restrictions on student-athlete compensation do not promote competitive balance."[6] The Ninth Circuit concurred.[7] In *NCAA Athletic Grant-in-Aid-Cap Antitrust Litigation (a.k.a., "Alston")*, a class of major college football and men's and women's basketball players challenged the NCAA's collusive pay restrictions preventing schools from offering more compensation to these athletes for their athletic services.[8] In that case, the notion of competitive balance as a procompetitive justification took a back seat, with the defendants (NCAA and the FBS[9] conferences) proffering no evidence and thus having this defense ruled out at summary judgment.[10]

The analysis below explores whether and when efforts by sports leagues to promote on-the-field competitive balance are in the interests of consumers. First, we show that competitive balance can be an important and pro-competitive objective and outcome of sports leagues, but that the evidence is mixed as to whether consumer demand hinges on balance.[11] Second, we discuss the history of league efforts to promote competitive balance. Finally, we analyze the efficacy of two of the rules purporting to affect competitive balance, revenue sharing and salary caps. Along the way we also explore a case study: how would a class of elite athletes demonstrate class-wide harm from an anticompetitive restraint on the commercialization of their NIL and athletic reputation.

I. IMPORTANCE OF COMPETITIVE BALANCE: THE HISTORICAL ANTECEDENTS

The on-field dominance by the New York Yankees baseball teams of the 1920s led to attendance problems for the Yankees and for many of the other Major League Baseball (MLB) teams. Fans grew tired of lopsided, predetermined affairs, instead preferring uncertain outcomes and balance.

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6 *O'Bannon v. Nat'l Collegiate Athletic Ass'n*, 7 F. Supp. 3d 955, 978-79 (N.D. Cal. 2014) (noting that testimony by plaintiffs' expert witnesses cited several academic publications that showed the lack of a relationship between the pay restrictions and competitive balance), *aff'd in part, vacated in part*, 802 F.3d 1049 (9th Cir. 2015).

7 *O'Bannon*, 802 F.3d at 1072 ("We therefore accept the district court's factual findings that the compensation rules do not promote competitive balance. . . .").

8 *In re Nat'l Collegiate Athletic Ass'n Athletic Grant-in-Aid Cap Antitrust Litig.*, 375 F. Supp. 3d 1058 (N.D. Cal. 2019) (also known as *Alston v. NCAA*).

9 FBS stands for Football Bowl Subdivision, the set of approximately 130 schools that play football at the highest collegiate level. FBS was formerly known as Division 1A. At the time the *Alston* litigation was filed, there were 11 such conferences. In the interim, the Western Athletic Conference (WAC) stopped sponsoring football, so there are now 10 such conferences.

10 *In re Nat'l Collegiate Athletic Ass'n Athletic Grant-in-Aid Cap Antitrust Litig.,* No. 14-CV-02758-CW, 2018 WL 1524005, at *10, n.7 (N.D. Cal. Mar. 28, 2018).

11 *See*, *e.g.,* Daniel A. Rascher, Joel Maxcy & Andrew D. Schwarz, *The Unique Economic Aspects of Sports*, at 8 (Jan. 5, 2019) (". . . despite the existence of so many team-sport league policies, such as restrictions on competitive markets for players' services and revenue sharing between clubs, that are publicly justified by an appeal to the need for outcome uncertainty and competitive balance, empirical tests by sports economists have repeatedly found (a) little effect of outcome uncertainty on consumers demand for sports, and (b) little effect of most policy changes on competitive balance. In lay terms, the rules do not seem to help competitive balance, and competitive balance doesn't seem to sell that many tickets anyway.").

In 1964, economist Walter Neale recognized the uniqueness of competitive balance to sports in noting the "peculiar economics of professional sports."[12] Neale's work pointed out that while Coca-Cola may wish that Pepsi would disappear, the Yankees benefit financially when the Oakland A's[13] are of high quality. Thus, the nature of competition was infused with a need for cooperation, which has itself been the core of the argument that sports leagues and their franchises constitute a joint venture or perhaps even a single economic entity.[14] In fact, the courts upheld the Commissioner of Major League Baseball's decision to nullify certain trades in 1976, explicitly based on the notion that athletic competition would be reduced if allowed to be consummated.[15]

Does competitive balance increase demand? The economic research offers nothing more than an "it depends." Optimal levels of competitive balance can increase demand, but there is a growing body of recent research drawing on behavioral economics showing that competitive balance may often be outweighed by fans' preference that the home team win or for there being an upset, whether expectations are met and how, or changes in league standings.[16] Notwithstanding the many measures of competitive balance (e.g., within-game, game-to-game, within-season, season-to-season[17]), increased expected closeness of a contest has been shown to increase live gate attendance and television viewership.[18] The closeness of winning percentages and total team quality (measured as the sum of winning percentages) has been shown to improve TV viewership while the score at halftime affects the second-half television audience.[19] The closer games are expected to be (using both winning percentages and betting odds) and the higher the total quality of the two teams are, live gate attendance is improved as well (when controlling

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12 Walter Neale, *The Peculiar Economics of Professional Sports: A Contribution to the Theory of the Firm in Sporting Competition and Market Competition*, 78 Q. J. OF ECON. 1, 1-14 (1964).

13 When Neale wrote his paper, the A's were still located in Kansas City and were notoriously bad. During their thirteen years (1955-1967) in Kansas City, the A's lost almost 60% of their games.

14 *See* Michael A. Flynn & Richard J. Gilbert, *The Analysis of Professional Sports Leagues as Joint Ventures*, 111 The Econ. J. F27, F44-45 (2001).

15 *Finley & Co., Inc. v. Kuhn*, 569 F.2d 527, 538 (7th Cir. 1978), *cert. denied,* 439 U.S. 876 (1978).

16 Coates, D., Humphreys, B. R., & Zhou, L., *Outcome Uncertainty, Reference-Dependent Preferences and Live Game Attendance*, Economic Inquiry, 52, 959–973 (2014). Humphreys, B. R., & Zhou, L., *The Louis-Schmeling Paradox and the League Standing Effect Reconsidered*, Journal of Sports Economics, 16, 835–852 (2015).

17 Within-game balance essentially means that the outcome of the game is typically decided near the end of the game. This has been shown to have an impact on television ratings during the game, as viewers stop watching a game that has essentially been decided. Game-to-game balance means teams have an equal chance of winning every game, so that last game's winner is no more likely to win than last game's loser. Season-to-season balance means every team has an equal chance to win each year, regardless of how they did the prior season.

18 Rodney Fort describes the various measures of competitive balance. He also notes that the NFL has had the most balance over the years and attributes at least some of that to salary caps. Rodney Fort, *Competitive Balance in North American Professional Sports,* Handbook of Sports Economic Research 190, 190-206 (John Fizel ed., 2006).

19 Rodney J. Paul & Andrew B. Weinbach, *The Uncertainty of Outcome and Scoring Effects of Nielsen Ratings for Monday Night Football*, 59 J. of Econ. & Bus. 199, 210 (2012).

for other factors).[20] Analysis of MLB from 1901-1998 shows that attendance is improved with closer standings throughout the season.[21]

Twenty years after Walter Neale's revelation, the Supreme Court in *Board of Regents* recognized the special economic forces at work in sports leagues, holding that specific NCAA rules (namely the joint sale of television rights), which would otherwise be illegal *per se* in other industries, needed to be evaluated using the rule of reason weighing the net anti- or pro-competitive effect of the rules in question.[22] Fast forward twenty-five years to the more recent *American Needle* case, where the Supreme Court noted that the legitimate interest in maintaining competitive balance among teams is still subject to the rule of reason.[23] Ironically, in both of these cases, though the Supreme Court has enshrined competitive balance as a laudable aim, nevertheless both leagues/sanctioning bodies in question (the NCAA and the National Football League) lost, with the restraint in question found not to be justified because of competitive balance, and in the two more recent cases when the NCAA tried to take advantage of the legal support for competitive balance, it found it could not prove its "amateurism" rules contribute to competitive balance.[24]

To be clear, the concept of (athletic) competitive balance is pro-competitive (in an economic sense) only when it generates a desired product attribute that enhances the product and increases revenues, although in a rule-of-reason setting, it may have to be weighed against possible anticompetitive effects. As one of this paper's authors explained in *Alston*,

> "Procompetitive effects" is an economic term of art with specific economic meaning. In that economic context, the term is not a malleable, catch-all phrase, synonymous with socially desirable aims, however laudable those goals may be. To be procompetitive, a restraint must cause increases in overall economic welfare or the reduction in economic exploitation, as economists define those terms. . . . If a restraint causes net improvement to economic welfare according to economic theory and consistent with the results of studying the effects in the market place, a restraint can be characterized as causing "procompetitive effects."[25]

With many current leagues sharing specific revenue streams with players, it is clear that to the extent there is an optimal level of competitive balance in a given league/sport, it will benefit fans, owners, and players. Where room for debate exists is whether a specific rule actually enhances consumer demand (or even promotes competitive balance at all).

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20 Daniel A. Rascher, *A Test of the Optimal Positive Production Network Externality in Major League Baseball*, Sports Economics: Current Research, 37 (John Fizel, *et al.* eds., Praeger Press 1999).

21 Martin B. Schmidt & David J. Berri, *The Impact of Labor Strikes on Consumer Demand: An Application to Professional Sports,* 94 Am. Econ. Review, 344, n.1 (2004).

22 *Board of Regents*, 468 U.S. at 102.

23 *American Needle, Inc. v. National Football League*, 130 U.S. 2201 (2010).

24 *See* discussions of *O'Bannon* and *Alston* and accompanying notes 5-11, *supra*.

25 Rascher Direct Testimony, ¶4, *In re Nat'l Collegiate Athletic Ass'n Athletic Grant-in-Aid Cap Antitrust Litig.*, No. 14-md-02541 CW (N.D. Cal.).

II. THE EXOGENOUS STRUCTURE OF SPORTS LEAGUES

The notion that competitive balance is a key part of the product that customers of sports demand, and that it is really unique to sports, is essentially what Neale called the "peculiar economics of sports."[26] Three critical exogenous[27] facets of sports leagues help explain why rules aimed at enhancing competitive balance *can* be pro-competitive.

A. Competitive Balance Is Exogenous

As noted above, a unique aspect of sports leagues is that the primary product is typically an event (or season culminating in a championship) between two competitors, often two different companies. Yet, cooperation is needed and (some level of) parity is desired by fans. This cooperation and goal of competitive balance causes the members of leagues to create many rules that purportedly affect such balance. These rules are endogenous (e.g., a salary cap), in that they are created internally by league members. Of course, this is also the case with individual athlete sports like golf, tennis, auto racing, or mixed martial arts. Rules are established to create a competitive environment. However, some aspects of sports leagues are essentially exogenous and occur because of market forces.

Demand for competitive balance itself is exogenous to a league. Customers demand some level of balance (or not) to make the product exciting. Leagues have to figure out how to maintain an optimal level of competitive balance, but that is because the market demands it rather than because balance is inherently superior to imbalance. The nature of needing two teams to play each other, or six or more teams to form a minimally suitable league, or eighty golfers to play a tournament, automatically causes consolidation compared with other industries where competition across different firms occurs without any need to coordination. For example, Nike and adidas do not need each other for success, nor do they want each other to be formidable competitors. Yet, the Yankees need the A's to be decent enough to create competitive games and seasons.

B. The Market Demands That the Best Play Against the Best

In many aspects, demand for a single league or circuit may be an exogenous factor driven by fans' desire to see the best athletes and teams competing with and against each other in the same game, event, or season. Imagine if Chris Evert and Martina Navratilova had never played against each other because they were on different tennis circuits, or Jack Nicklaus did not compete against Arnold Palmer, or Jerry Rice did not catch touchdowns from Joe Montana, or Magic Johnson did not compete against Larry Bird. The market seems to demand that the best play against/with the best. This drives the long-run equilibrium toward single-sport leagues,[28] so that the single-sport provider is often a natural outcome of the nature of sports.

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26 *See* Neale, *supra* note 10.

27 Exogenous means "from the outside" and refers to forces outside of the control of the parties to the transaction, in contrast to "endogenous" forces within their control. A college soccer team's budget is set endogenously by the college, but a change in demand for soccer in the US, driven by the popularity of the FIFA video game, would result in an exogenous change in demand for that college's soccer team's tickets.

28 For a discussion of single sport leagues, see Paul C. Weiler, et al., Sports and the Law: Text, Cases, and Problems, 743 (4th ed. 2011).

However, there are more competitive means to meet this demand rather than simply merging competitive leagues into a monopoly, such as when otherwise competing leagues agree to face off in a common championship. Such an arrangement allows the major European soccer leagues to crown separate champions who then face off against each other (and other major teams) in the UEFA Champions league. In some sense, both the World Series and the Super Bowl began as similar two-league championships, but in both cases the leagues soon merged (in the case of the National Football League (NFL) and American Football League (AFL)) or at least stopped competing for talent (in the case of the National League and American League, which only formally merged in the 1990s[29]) even if they remained legally distinct.

In other sports, though, multiple parallel leagues can exist and thrive. For example, in mixed martial arts (MMA), while the Ultimate Fighting Championship (UFC) has been a consistent leader in the sport, Bellator and the Professional Fighters League (formerly the World Series of Fighting (WSOF)) compete with UFC. Recently, an Asia-based competitor, One Championship, announced its intent to enter the market as well, signing a broadcast deal with Turner Network Television (TNT).[30] Whether this sport needs a single league or other ways to ensure the best can compete against the best remains to be worked out.

Additionally, having many leagues (or many teams within a league) "reduces the absolute quality of play. From the perspective of the fans, some restrictions on the number of leagues in a sport and teams within a league may be socially desirable."[31] Research shows that too many leagues in baseball led to a decrease in the quality of play overall and a decline in demand.[32] Specifically, "adequate control of external effects associated with quality will be achieved only if there is but one league in a sport."[33] In other words, not only do fans desire to see the best play with/against the best, but multiple leagues also tend to dilute the existing talent base. Thus, sports can differ from most other industries, where having many providers generally leads to higher quality, more innovative products, and lower prices, all of which benefit customers. Similar to sports, there are joint ventures in other industries (e.g., biotech) that can lead to better products and distribution. Yet in sports, while customers would like lower prices (which may not be forthcoming when there are single providers of a sport instead of multiple competitors), they do not want diluted talent and do want the best to play against/with each other.

In college sports, there has been a historical evolution (within the NCAA) from schools within leagues playing each other without regard for a specific or defined level of play (i.e., MLB compared to minor league baseball). After decades of undivided

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29 In 1903, the American and National Leagues which agreed on rules about player employment did not merge. The two leagues also had separate offices and presidents until 1999. Pooled sales of broadcasting rights only occurred in 1962, and interleague play only started in 1997.

30 https://www.foxbusiness.com/features/ufc-one-championship-tnt-deal-north-america

31 Gerald Scully, The Market Structure of Sports, 23 (University of Chicago Press 1995).

32 Michael E. Canes, *The Social Benefits of Restrictions on Team Quality, in* GOVERNMENT AND THE SPORTS BUSINESS 81, 95 (Roger G. Noll ed., 1974). In the same book, Roger Noll noted that average quality of play was likely higher when there are fewer teams, but also it was unknown how important that was to fans (as opposed to close competitions). *Id.* at 412.

33 *Id.* at 95.

competition, the NCAA organized leagues as either at the university or college level, followed by a disaggregation of schools into Division I, II, or III. Even within Division I, there remained vast differences in commitments to major spectator-driven college sports. It therefore further separated into Division IA (schools offering major college football, now called FBS), Division IAA (schools offering a level just below IA in terms of football, now called FCS, but still playing at the same level in other sports), and Division IAAA (schools playing Division I sports, but not offering football). And finally, Division IA has further separated into the Power Five conferences and the Group of Five conferences, with the former now governed by a special set of somewhat more permissive five-conference rules, inaccurately referred to as "autonomy." The talent base has tended to follow this pattern with the most coveted athletes choosing FBS schools. Consequently, despite the (increasingly disproven) claim that capping college athlete pay improves competitive balance, we see college sports recruiting—especially in football and men's and women's basketball—dominated by an elite subset of teams. Rather than spreading out talent, the college caps seem to cement existing imbalance.[34]

One of this paper's authors is in the process of launching a professional college basketball league—the Historical Basketball League (HBL)[35]—with the goal of hiring a large portion of the top 150 athletes in each class entering college. The aim would be to provide fans with the ability to see the best playing with and against each other every night of the season, rather than waiting for an end-of-season tournament in March. If HBL is a success, it will be the NCAA's pay caps that led to, rather than prevented, this new league's dominance.

C. Sports Leagues and Teams Compete with Other Forms of Entertainment

The NFL is the single provider of major professional football in the U.S. (notwithstanding the recently failed Alliance of American Football (AAF) and the second attempt at the XFL, launching in summer 2020). Is it a monopolist, whether or not a "natural" one? That question hinges on whether the NFL competes in a larger product (or geographic) market that contains other entities. The jury in *USFL v. NFL* found that the "NFL had willfully acquired or maintained monopoly power in a market consisting of major-league professional football in the United States," but "the NFL had neither monopolized a relevant television submarket nor attempted to do so."[36] While some point to this as a confused verdict, it may in fact reflect the view that while the NFL is the dominant (or only) provider of professional football, by itself that does not mean there is a specific *television* market in which only the NFL (and erstwhile rivals such as the USFL or XFL) compete.[37] This is because sports are really multi-product bundles. The Los Angeles

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34 Katie Baird, *Dominance in College Football and the Role of Scholarship Restrictions*, J. of Sport Mgmt, 18, 233 (2004).

35 *See* www.HBLeague.com.

36 *United States Football League, et al. v. Nat'l Football League, et al.*, 842 F.2d 1335, 1341 (2d Cir. 1988).

37 Or as was noted that much more economic research is needed to determine the degree and type of competition that exist across sports franchises (whether in the same sport or different sports). *See* Kenneth Lehn & Michael Sykuta, *Antitrust and Franchise Relocation in Professional Sports: An Economic Analysis of the Raiders Case*, 42 Antitrust Bull. 541, 563 (1997).

Dodgers (baseball) and Los Angeles Rams (football) might compete for ticket sales (at least when their seasons overlap in September), but the Dodgers and Chicago Cubs (baseball) almost surely do not. In contrast, the Dodgers and Cubs do compete for free agents and as on that dimension are much closer competitors to each other than either is to the Rams. At the same time, though it would need to be shown empirically, all three might compete in a national market for jersey sales, though it is doubtful sports jersey compete with unbranded sweatshirts in some broader apparel market.

Importantly, in the context of antitrust, economic competition is a term of art, based on the economic concept of cross-price elasticity of demand. What matters is not whether a family's choice to attend an SF Giants game means there is no room in the household budget, or time in a particular week, to also attend a San Jose Sharks game, but rather whether in aggregate, the quantity of tickets bought for Sharks games varies appreciably with changes in Giants' ticket prices.[38] This means that intuition about overlapping seasons, etc., can only go so far in answering the economic question in a rigorous way. As such, many courts have found that there do exist distinct relevant markets in single sports.[39]

With that said, there is burgeoning academic research, and existing industry anecdotal research, showing that sports leagues compete with other forms of sports entertainment at least with respect to key outputs such as merchandise, licensing, and television

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38 Economically, this concept is referred to as cross-price elasticity of demand.

39 For example, in *USFL v. NFL* (*supra* note 37), it was determined there was a relevant market consisting of major-league professional football in the United States. In *Chicago Professional Sports Limited Partnership and WGN Continental Broadcasting Company, v. NBA* (known as the *Bulls* case), 808 F.Supp. 646 (N.D. Ill.) the court decided the case in the context of a market in which production was measured as the number of basketball games on TV.

broadcasts.[40] For example, when the National Hockey League (NHL) cancelled an entire season, NBA and minor league hockey both experienced boosts in attendance.[41] An older study estimated that average NHL per game live attendance was nearly 20% lower in the 'average' city with three other professional sports teams and that inter-sport competition

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40 This is in contrast with key inputs, such as players or coaches where a given professional league is rarely a substitute for another as a potential employer for a highly skilled athlete. For the idea of each league/sanctioning body as a monopolist or single buyer in a labor market, see *Brady v. Nat'l Football League*, 640 F.3d 785 (8th Cir. 2011), *O'Bannon v. Nat'l Collegiate Athletic Ass'n,* 802 F.3d 1049 (9th Cir. 2015), *In re Nat'l Collegiate Athletic Ass'n Athletic Grant-in-Aid Cap Antitrust Litig.*, 375 F. Supp. 3d 1058 (N.D. Cal. 2019), *Le v. Zuffa, LLC,* 216 F. Supp. 3d 1154 (D. Nev. 2016), and *McNeil v. Nat'l Football League,* 790 F. Supp. 871 (D. Minn. 1992). With respect to venues and other elements of professional sports marketing, it is often hard to see who is buying and who is selling. The discussion about who is a buyer and who is a seller is similar (but distinguishable) to the relatively new research on two-sided markets that was spawned by the credit card lawsuits. *See, e.g.,* Jean-Charles Rochet & Jean Tirole, *Cooperation Among Competitors: Some Economics of Payment Card Associations,* 33 Rand J. of Econ., 549 (2002). Under this hypothesis, the NFL would be seen as a two-sided market that brings together fans and apparel makers, charging both of them (and adding some valuable intellectual property to up the ante). Similarly, the NFL is a two-sided market bringing together fans, sponsors, and facilities and charging each of them access to the other. However, the recent Supreme Court ruling has made it clear that while many entertainment markets, including sports, have elements of two-sided (or multi-sided) markets, they do not fit into the classic "platform" type of two-side market, where what the platform sells the connection. *See Ohio v. American Express Co.,* 138 S. Ct. 2274 (2018).

Specifically, while NFL teams may provide sponsors with access to fans, they are not really selling sponsors to fans. Thus, just as the Court distinguished newspapers which sell access to customers and advertisers but do not sell advertisers to customers from credit cards which do provide direct (and reciprocal) matchmaking between merchants and customers, so too should most sports markets be distinguished as well. For college sports to be akin to a credit card, fans would need to be paying directly for athletes' services, with schools simply providing matchmaking services for a commission. Even in a cynical view of under-the-table payments, this is not how schools generate revenue from college sports, unless one believes colleges get a cut of "bag money" alleged to be paid by boosters to athletes.

Hence, in *Alston*, the Court rejected the idea that because fans want to watch athletes and athletes want to be watched by fans, college sports is a two-sided market. The court pointed to *American Express* for the simple distinction, that is, to be a true two-sided platform, there must be a "simultaneous interaction or proportional consumption through a platform by different market participants of what essentially constitutes 'only one product.'" The court thus concluded that "The multi-sided relevant market proposed by Dr. Elzinga is not analogous to the relevant market that the Supreme Court recognized as two-sided in American Express. In this litigation, the market participants and their interactions are nothing like what the Supreme Court observed in the context of credit-card transactions in American Express." *In re Nat'l Collegiate Athletic Ass'n Athletic Grant-In-Aid Cap Antitrust Litig.*, No. 14-MD-02541 CW, 2018 WL 4241981, at *4 (N.D. Cal. Sept. 3, 2018)

With that said, in entertainment markets, even if it's clear the market is a standard one-sided one where supply moves downstream to the ultimate customer, the question of who is buying and who is selling (or if both parties are doing both) can be a difficult one to answer.

41 Daniel A. Rascher, Matthew T. Brown, Mark S. Nagel & Chad D. McEvoy, *Where Did National Hockey League Fans Go During the 2004-2005 Lockout? An Analysis of Economic Competition Between Leagues*, 5 Int'l J. Sport Mgmt. & Marketing, 183, 192 (2009). Using the natural experiment of the NHL lockout in 2004, the research analyzed what happened to NBA franchises and minor hockey league franchises in terms of attendance. The NBA saw an increase in attendance of approximately 3.2%, while the minor hockey leagues saw increases ranging from 0% to 6%. The analysis controlled for other factors and looked at the years prior to and post-lockout.

reduces MLB season live attendance by 250,000 (21%) in the 'average' baseball city.[42] Other research suggests that the closer two teams are geographically, the lower attendance is at each team relative to two teams that are farther apart.[43] What has yet to be shown in a definitive way is whether moderate changes in the ticket prices of one sport's team has quantifiable impact on the quantity of tickets sold for other sports.[44]

There is overlapping fan support across sports; e.g., some Cincinnati Bengals season ticketholders likely also attend Cincinnati Reds games. Accordingly, adding a team to a market does have an impact on teams in other sports in that same market. For example, after the Nationals came to Washington D.C. in 2005, the Washington Wizards of the NBA saw a decline in attendance by 5% (for the two years prior and post-relocation), even though the Wizards improved its record by 40%.[45] The Washington Capitals also saw a 9% decline in attendance for the two years before and after the Nationals moved to Washington D.C., but this may be related to decreased on-the-ice scoring or the 2004 NHL work stoppage.[46] But now that the Nationals are established in the marketplace, it remains an open question how much their ticket prices influence changes in consumption of Wizards or Capitals games.

While general tickets findings are mixed, luxury suites clearly show a form of cross-sport competition, and the effect can be seen not just in attendance but in price. Data from the Association of Luxury Suite Directors show that luxury suite prices are highly dependent upon the number of other sports facilities with luxury suites available in the

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42 Roger G. Noll, *Attendance and Price Setting*, Government and the Sports Business, 115, 124,150 (Roger G. Noll ed., 1974). Noll defines this as a city with a metropolitan population of 3.5 million and 3 other professional sports teams.

43 Jason A. Winfree, Jill J. McCluskey, Ron C. Mittelhammer, & Rodney Fort, *Location and Attendance in Major League Baseball*, Applied Economics, 36, 2117-2124 (2004) (The study used a travel-cost model to analyze the attendance impacts on MLB of the closest substitute MLB team. The study also found that when a new team moves into the area of an existing team, there is an additional initial reduction in attendance for the incumbent team. The authors found that each mile closer an MLB team moved from the sample average translated to 1,544 fewer attendees for the year, or nearly $47,000 in ticket revenue losses. This is consistent with Rascher et al., who found that NFL teams lose about 2% of local revenues, all else equal, for each additional major professional sports team that is located in its metropolitan area. *See* Daniel Rascher, Matthew T. Brown, Chad E. McEvoy, & Mark S. Nagel, *Financial Risk Management: The Role of a New Stadium in Minimizing the Variation in Franchise Revenues*, J. of Sports Econ., 13, 431 (2012).

44 Some evidence of price competition across sports is found by Mills et al., yet more research needs to be done. Brian M. Mills, Jason A. Winfree, Mark S. Rosentraub & Ekaterina Sorokina, *Fan Substitution Between North American Professional Sports Leagues*, Applied Economics Letters, 22:7, 563-566.

45 *See* SportsEconomics, LLC, *The Effects on SVSE and the City of San Jose from The Oakland Athletics Relocating to San Jose*, 12 (Dec. 11, 2009) (consulting reporting prepared for Silicon Valley Sports and Entertainment (SVSE)).

46 While the 2004 work stoppage may be a cause of this decline, average attendance at NHL games during the season after the lockout was up by 2.5% compared with the year before the lockout. Moreover, the rest of the NHL experienced this increase in attendance while also raising prices by 2.5%. In contrast, the Capitals lowered ticket prices by 9% during the two years after the NHL lockout compared with the previous two years and still experienced a decline when the Nationals came to Washington. *Id.*

marketplace.[47] The Capitals and Wizards had luxury suite prices that were above the average by 17% for combined NBA/NHL arenas in 2001.[48] In 2007 (after the Nationals had moved to Washington D.C.), the luxury suite prices were about 5% lower than the same group.[49] This provides evidence that there exists competition at the luxury suite level across the major sports leagues in the U.S., suggesting that to these customers, a luxury suite in any one sport may indeed be a good substitute for any other sport, if the goal is simply a luxurious suite for entertaining clients. Studies have generally supported the twin ideas that within common geographic regions, teams both within a given sports league and across sports leagues compete with each other, albeit with the economic effects being relatively small.[50]

It is perhaps more evident that companies interested in sponsoring sports teams, leagues, events, and athletes can search for sponsorship opportunities in a competitive market. Not only is sponsorship but one of many forms of marketing, but there are many franchises, facilities, leagues, and events, with which one can partner. There is generally a media frenzy when the media rights to the NFL, for instance, are put into the marketplace. Bidding occurs across the major networks (ABC/ESPN, CBS, NBC, and FOX), with potential new bidders among the major social media, digital media, and ecommerce companies (Twitter, Facebook, Amazon, Netflix, etc.). A network that does not end up with the rights certainly finds a cost-effective way to fill those hours of programming. The NBA, NHL, and MLB appear on many different cable outlets (e.g., TBS, TNT, NBC Sports) as well as the major networks. Historically, when NBC has not won the rights to show NFL games, it has instead focused on the Olympics, horse racing, golf, and tennis. When CBS was the "odd man out" in showing NFL games (prior to regaining an NFL contract in 1998), it offered more college basketball programming. Now, the NFL is contracted with each of the big four broadcasters, earning $6 billion per year from Fox, CBS, NBC, and ESPN (ABC), and also with DirecTV. NBC has also continued with the Olympics, paying over $7 billion to air the Olympics through 2032. The leagues also have Turner Sports as a competitor for their rights, as Turner-owned TNT and TBS show the NBA and MLB, respectively.

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47 Stephen L. Shapiro, Tim DeSchriver & Daniel Rascher, *Factors Affecting the Price of Luxury Suites in Major North American Sports Facilities*, 26 J. of Sport Mgmt. 249, 249 (2012).

48 *See* SportsEconomics, LLC, *The Effects on SVSE and the City of San Jose from The Oakland Athletics Relocating to San Jose*, 12 (Dec. 11, 2009).

49 *Id.* Of course, as with all such natural experiments, this decline may be driven, at least in part, by other factors.

50 *See* Dennis W. Carlton, Alan S. Frankel, & Elisabeth M. Landes, *The Control of Externalities in Sports Leagues: An Analysis of Restrictions in the National Hockey League*, 112 J. of Political Econ. no. 1, S268 (2004); David Boyd & Boyd, Laura, *The Home Field Advantage: Implications for the Pricing of Tickets to Professional Team Sporting Events*, 22 J Econ. & Fin. 169; Ha Hoang & Daniel Rascher, *The NBA, Exit Discrimination, and Career Earnings,* 38 Indus. Rel., no. 1 (Jan. 1999); Daniel Rascher, *A Test of the Optimal Positive Production Network Externality in Major League Baseball,* Sports Econ.: Current Research (1999); Daniel Rascher & Heather Rascher, *NBA Expansion and Relocation: A Viability Study of Various Cities*, 18 J. Sport Mgmt. 274, no. 3 (July 2004); Depken, C. A., III, *Fan Loyalty and Stadium Funding in Professional Baseball*, 1 J. Sports Econ., no.2, 124-138 (May 2002) (using MLB data from 1991-2001); Brian M. Mills, Michael Mondello & Scott Tainsky, *Competition in shared markets and Major League Baseball broadcast viewership*, Applied Economics, 48:32, 3020-3032 (2016).

Even though fans may generally want a single league to watch the best athletes play with/against each other, rival sports compete against each other on at least some dimensions. Thus, while it is in each league's interest to maximize its revenues by enhancing consumer demand for each sport (and thus leagues aim for competitive balance), the revenue-maximizing level of competitive balance is not necessarily an equilibrium that would occur on its own. Therefore, unlike in other industries, in sports rules are seen as needed to maintain competitive balance, such as salary caps, revenue sharing (to be discussed below), and limits to the number of teams in a league. Attempts to break up the nationwide professional leagues to achieve competitive balance through competition won't necessarily be socially beneficial unless fans (i.e., consumers) feel that ultimately the question of who is best is decided on the field.[51] But to the extent that alternative inter-league championships can be developed, multi-league competition might achieve better, more balanced (athletic) competition along with more intense (economic) competition.

III. THE RULES THAT SPORTS LEAGUES USE TO MAINTAIN COMPETITIVE BALANCE

In response to the perceived need to maintain competitive balance, sports leagues have developed numerous rules such as salary caps, revenue sharing, amateur draft, no-cash trades, and the reserve clause or player restrictions. Here, we focus on the history and economics of two rules that are most often heralded as the solution to competitive balance problems: salary caps and revenue sharing.

A. Team Salary Caps and Floors

In response to concerns about free agency's potential impact on competitive balance, professional sports leagues and their union counterparts have agreed upon maximum aggregate payroll limits (known as salary caps) for each team, on the theory that without such caps, large-market teams (or those owned by win-maximizing owners) might "overspend" and destroy competitive balance.[52] Analogously, some leagues have also added a salary floor, i.e., a minimum aggregate payroll for each team. Although much less commonly discussed in the general sports media, salary floors are generally more important for ensuring competitive balance than are salary caps (or revenue sharing, which is discussed below). This is because it is often privately optimal for small market teams to spend far less than their large-market counterparts, even if those teams are subsidized through revenue sharing. A salary floor ensures that teams spend shared money on talent, rather than pocketing it as profit. In the NFL for instance, player salaries have long been guaranteed to hover around 50 percent of revenues,[53] but this was not always the case.

In 1987, immediately after the end of a failed players' strike that resulted in the league and players operating without a collective bargaining agreement, the National

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51 In some sports, such as international soccer and American college sports, regional leagues have been successful despite the tendency for fans to want a single league of best-against-best. European soccer leagues have managed this through the use of the Champions League, while college sports has relied on its post-season (i.e., CFP for football and "March Madness" for basketball, as well as inter-conference (inter-league) play).

52 In some cases, these agreements have also included individual player maximum salaries.

53 With the definition of revenue adjusted based on the collective bargaining process.

Football League Players Association (NFLPA) sued the NFL over rules limiting free agency as being anticompetitive.[54] In *Powell v. NFL*,[55] the Eighth Circuit of Appeals reversed the players' initial victory on partial summary judgment and ruled that although the collective bargaining agreement had expired, the existence of the NFLPA as a union provided the NFL with immunity from antitrust suits.[56] In response, the NFLPA decertified itself as a union and sued again, this time with Freeman McNeil as the plaintiff. [57] When this case (and a follow-up class action led by Reggie White[58]) went the players' way, the ultimate settlement led to a re-certification of the NFLPA and a collective bargaining agreement that allowed free agency.[59] At the same time, the parties recognized the possibility that free agency might harm competitive balance, and so the new collective bargaining agreement included a salary cap and a salary floor to ensure all teams' payrolls fell within a common range.[60]

Thus, in the NFL, the salary floor has existed since the same 1993 collective bargaining agreement (CBA) that also ushered in the more famous salary cap. Article XXIV of that CBA ("Guaranteed League-Wide Salary, Salary Cap and Minimum Team Salary") set up formulaic rules for both the cap and the floor.[61] The salary cap for each season is a function of the upcoming season's expected average league revenue. Per the 1993 agreement, the salary cap rules attempted to limit each team's total player salaries to approximately 63 percent of the average team's defined gross revenues (DGR), while it could not go below 50 percent of DGR.[62] This 1993 agreement was renewed several times until a new CBA was signed for the 2006 season, in which the floor was set to 84% of the cap, increasing by 1.2 percentage points per year, so that it would have reached 90% by 2011 had the owners not exercised their option to end that CBA in 2010.[63] After a lockout that threatened to delay the 2011 season, the CBA that followed set the NFL salary cap at $120.375 million per team, and the team salary minimum at 89% of that upper bound,

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54 Kevin G. Quinn, *Getting to the 2011-2020 National Football League Collective Bargaining Agreement*, 7 Int'l J. of Sport Fin. 141, 145 (2012).

55 *Marvin Powell, et al. v. Nat'l Football League, et al.*, 930 F.2d 1293 (8th Cir. 1989).

56 *Id.*; *see also* Quinn, *supra* note 54.

57 *McNeil et al. v. Nat'l Football League,* 790 F. Supp. 871 (D. Minn. 1992).

58 *White v. Nat'l Football League*, 585 F.3d 1129, 1134 (8th Cir. 2009).

59 *See* Quinn, *supra* note 54, at 146.

60 Collective Bargaining Agreement Between the NFL Management Council and The NFL Players Association, 86-142 (1993), *available at* https://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1572&context=blscontracts.

61 *See id.*; *see also* Scott McPhee, *First Down, Goal to Go: Enforcing the NFL's Salary Cap Using the Implied Covenant of Good Faith and Fair Dealing,* 17 Loy. L.A. ENT. L. J. 449, 457-58 (1997).

62 DGR was an NFL term of art that includes most NFL national revenue but excluded certain local revenues such as luxury suite revenues.

63 John Vrooman, *Theory of the Perfect Game: Competitive Balance in Monopoly Sports Leagues,* 34 Rev. of Indus. Org., 5, 11 (2009), *available at* https://my.vanderbilt.edu/vrooman/files/2016/06/Vrooman-perfectgame.pdf.

climbing to 95% of the upper bound for the last few years of the deal.[64] The players are also guaranteed a league-wide share no less than 47% of total league revenues. That CBA is set to expire in March 2021. The players and league have already been meeting regularly, but none of the purported issues on the table would appear to affect competitive balance.[65]

Salary restrictions that include both caps and floors are the most effective method for maintaining or improving competitive balance because this forces teams to spend similar amounts on player payrolls. Otherwise—and this cannot be stressed enough—revenue sharing to small-market teams is unlikely, by itself, to induce the small-market team to spend more. Without a salary floor, a team spending at the optimum small-market level does not see any reason to spend even one dollar of any additional revenue it gets from other teams' actions. On the other hand, a salary floor creates a constraint that changes the optimum pay level for those small market teams (to the minimum, which is higher than the unconstrained optimum). Thus, while a binding salary maximum puts a restriction on the average salary of a player, and thus decreases the wage per unit of talent, the salary minimum effectively *raises* the pay per unit of talent, if the floor is binding, by pushing up small-market pay levels.

However, a further result is that revenues for some large market teams may decrease because they are forced to field less talented teams than would otherwise be the case. The opposite may occur for small market teams—namely, the team might produce quality in excess of the optimal level associated with maximum profit for the league. By itself, these two will not cancel out, since both small and large market teams have moved to a suboptimal level of pay, so aggregate revenues will shrink. However, the decline in overall league revenues is likely to be smaller than the decrease in salaries, thus increasing profits for each team and the league as a whole.[66] Moreover, competition across sports (especially in markets like sponsorship where sport-specific factors matter less) helps to ensure against extreme degradation in overall quality.

Similarly, salary caps keep the pay of the best players below what a free agent system would pay them. However, team payroll minimums and individual player salary minimums (players earning the league minimum) actually raise some players' salaries above what an open market would pay. In fact, almost 50% of players in the NFL earn the league minimum.[67] If the league were to have moved (via a successful *Brady*[68] lawsuit by the players) to a complete free agent system, some players likely would have gained and some

64 Gary Myers, *NFL Collective Bargaining Agreement Includes No Opt-Out, New Revenue Split, Salary Cap, Rookie Deals,* N.Y. Daily News (July 26, 2011), *available at* http://www.nydailynews.com/sports/football/nfl-collective-bargaining-agreement-includes-no-opt-out-new-revenue-split-salary-cap-rookie-deals-article-1.162495.

65 Dan Graziano, *2021 NFL CBA Negotiations: The Nine Biggest Looming Issues*, ESPN (July 3, 2019), *available at* https://www.espn.com/nfl/story/_/id/27103713/2021-nfl-cba-negotiations-nine-biggest-looming-issues.

66 Daniel Rascher, *A Model of a Professional Sports League*, Advances in the Econ. of Sport, 2 (1997).

67 Adam Schefter, Chris Mortensen, John Clayton & Andrew Brandt, *NFLPA Still Discussing Proposed Deal*, ESPN (July 23, 2011), *available at* http://espn.go/nfl/story/_/id/6793054/nfl-lockout-nflpa-work-weekend-sources-say.

68 *Brady v. Nat'l Football League*, 644 F.3d 661 (8th Cir. 2011).

likely would have lost.[69] Further, *if* league revenues are maximized with more competitive balance, and *if* an open system would have led to less balance, then the marginal revenue product (MRP) of NFL players on average would have likely declined because total revenues would have declined.[70] When MRPs decrease, so does the amount that teams can gain from players, hence their pay is lower.[71] This is ultimately an empirical question.

It is worth noting here that the same logic does not necessarily apply in a sport where there is a player maximum but not a player minimum, such as the college version of football. There, the raising of the cap has no theoretical impact on compensation for athletes at the bottom of the talent pool, unless somehow the increase in pay to stars reduces the MRP of other athletes. This is important to keep in mind, as the layperson's notion "the money has to come from somewhere"[72] is not what drives the potential for downward pay pressure in a move from a CBA outcome to a more open market outcome. Instead, it is the potential for salary floors to be removed, and for the figurative bottom to drop out of the market for marginal talent.

Recognize that in college sports, the compensation limits (which are essentially individual and team "salary" caps) are in some ways more complex than in unionized sports. First, each athlete faces an individual cap, with compensation limited to the full cost of attendance ("COA"), plus ancillary bonuses that can reach up to the tens of thousands per year for star performers. But then each team also faces a total "salary" cap, equal to a certain number of scholarships multiplied by the individual cap. In FBS football, this cap is 85 times the individual cap, whereas in FCS it is 63 times the cap. In other sports, like men's volleyball, the total "salary" cap is so low, at 4.5 times the individual cap, such that it is impossible to pay all six athletes on the starting team the individual maximum. This limit on scholarships is not a roster limit, meaning that essentially, in addition to the limited number of compensated athletes, a team may also take on a large number of "walk ons," which is the term of art for athletes who face a $0 individual cap.

Recent litigation has played a key role in driving up the individual cap level for athletes. *O'Bannon* established that a cap below the full cost of attendance was "patently and inexplicably" unreasonable, even under an "amateurism" defense.[73] *Alston*, went further, showing that since athletic bonuses in the tens of thousands of dollars are being paid today without harm to demand, caps on academic bonuses at lower amounts are also

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69 This may have prevented the class from being certified, given that some players would have benefited from free agency and others may have been harmed.

70 Marginal Revenue Product is the term economists use for the additional revenue that is earned when one more unit of labor is used/employed. Essentially, it measures how much more output is created (e.g., tickets, merchandise, etc. sold) when a "better" player is hired, then converted to revenues when those units of output are sold.

71 Some of the literature shows that league revenues are maximized when large markets have better teams because the incremental gain in revenue from winning is higher in larger markets compared with smaller markets. *See generally* Rodney Fort & James Quirk, *Cross-subsidization, Incentives, and Outcomes in Professional Team Sports Leagues*, 33 J. of Econ Lit., 1265 (Sept. 1995).

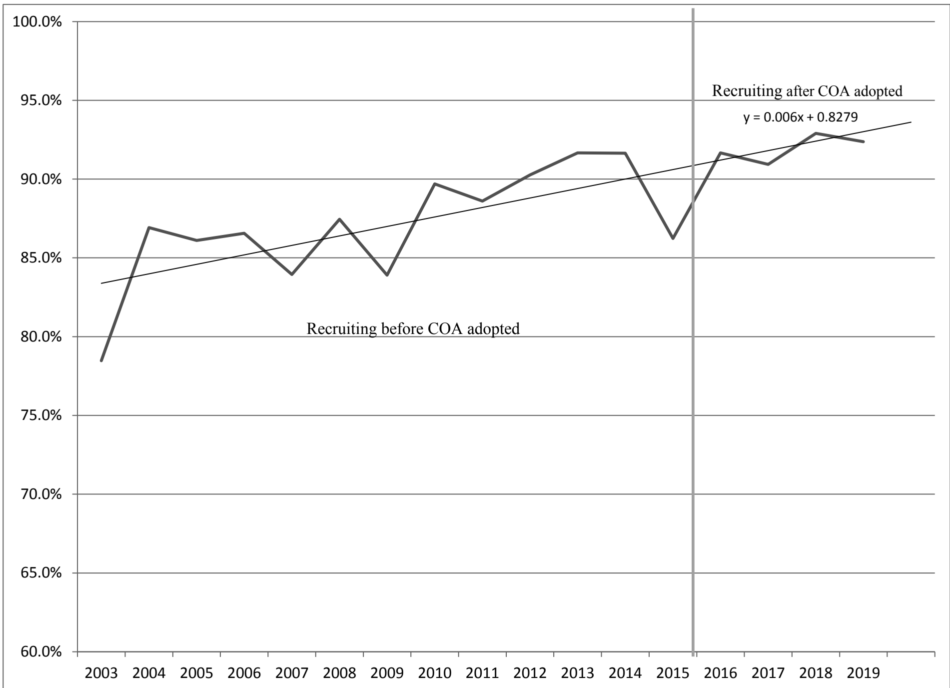
72 Of course, money has to come from somewhere, but that "somewhere" could be sources other than other players' paychecks.

73 *O'Bannon*, 802 F.3d at 1075.

unreasonable.[74] To date, though, the NCAA team "salary" caps, in the forms of limits on the number of such scholarships that can be offered, have remained in place, even though economically, the justifications for limiting quantity are even less valid than those for capping individual "salary." Specifically, they hinge almost entirely on unproven and theoretically dubious claims that limiting the number of scholarships offers improved competitive balance.[75] But as anyone who follows women's basketball can attest, limiting a women's basketball team to 15 scholarships has done nothing to distribute UConn's talent across the 350 or so D1 schools.

Empirically, there is little doubt that capping the number or value of scholarships is not creating a balanced recruiting field. Consider the year-to-year annual recruiting success of major FBS football programs, based on the rankings of incoming athletes. In a world with competitive recruiting balance, there should be little or no correlation between recruiting a good class in year 1 and doing so again in year 2. Instead, in college football, the correlation is nearly perfect (converging on 100%), and has gotten stronger over time (see **Figure 1** below).

Figure 1. Competitive Imbalance in FBS Football, 2003-2019



The year over year success in recruiting goes a long way to (a) explain the persistent dominance of a few schools, notably Clemson and Alabama, in the CFP, and (b) to

74 *In re Nat'l Collegiate Athletic Ass'n Athletic Grant-in-Aid Cap Antitrust Litig.*, 375 F. Supp. 3d at 1102.

75 Sutter, D., & Winkler, S., 4 *NCAA Scholarship Limits and Competitive Balance in College Football*, Journal of Sports Economics, 3-18 (Feb. 2003) (finding no consistent evidence that limits on the number of scholarships improves competitive balance).

demolish the myth that capping pay, or limiting scholarship availability, ensure that UMass and Wake Forest can compete for national championships in football every year.

Outside of the NCAA context, for many leagues, the caps are often not particularly binding, given all of the exceptions and ways of going above the cap (known as a "soft cap").[76] In the NBA, during the 2010-11 season, it is estimated that only six teams were actually at or below the salary cap,[77] resulting in the seemingly paradoxical result that the average team payroll in the NBA during 2010-11 season was $67 million in spite of a salary cap of only $58 million. Even in 2005 in the NFL with a stricter salary cap, nine teams had payrolls above the cap.[78]

It is much clearer that team salary *minimums* help maintain or improve competitive balance. They prevent "free riders" from paying very low payrolls, and thus making money from shared revenues and the brand in general. Free riding is a problem in the NBA, MLB, and the NFL.[79] The potential for this free-riding is well understood by players, and ensuring a true floor was a guiding principle in the NFLPA's 2011 negotiations[80]:

> "We cannot have teams like KC spend only 67% of the cap like they did in 2009," Saints quarterback Drew Brees wrote in an e-mail to his teammates. "It doesn't matter how high the cap is if they are only going to spend that much. So with a minimum in place, it requires all teams to be at or above that minimum. More money in players' pockets."

What is clear is that payrolls are more balanced in the NFL compared to other major professional leagues and that competitive balance is greater than in the NFL other leagues. Noll (1988) concludes that salary caps are sufficient to achieve the goal of equal parity and that revenue sharing has no effect (more on this below).[81] However, for owners who care more about winning than profits, revenue sharing and salary caps have an indeterminate effect depending on whether sportsmen owners (who want to win, even if winning is not optimally profitable) are in small or large markets.[82] The lesson to be drawn may be that the NFL leads the way in competitive balance because of the stricter floor, rather than the existence of the ceiling (although the ceiling is considered stricter than in the NBA).[83]

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76 *Id.*

77 Email from Tom Ziller, NBA writer for SB Nation (Jul. 29, 2011) (on file with authors).

78 Michael Leeds, *Salary Caps and Luxury Taxes in Professional Sports Leagues,* 2 The Business of Sports: Economics Perspectives on Sport, 181, 191 (Brad R. Humphreys & Dennis R. Howard eds., 2008).

79 Daniel Rascher, Matthew Brown, Mark Nagel, & Chad McEvoy, *Free Ride, Take it Easy: An Empirical Analysis of Adverse Incentives Caused by Revenue Sharing*, 25 J. Sports Mgmt. 373, 386 (2011).

80 Mike Florio, *Per-Team Spending Minimum Doesn't Apply Until 2013*, NBC Sports (July 30, 2011), http://profootballtalk.nbcsports.com/2011/07/30/per-team-spending-minimum-doesnt-apply-until-2013/.

81 Roger Noll, *The Economics of Sports Leagues*, Law of Professional and Amateur Sports (Gary A. Uberstine ed. 1988).

82 Daniel Rascher, *A Model of a Professional Sports League*, Advances in the Econ. of Sport, 2 (1997).

83 Alternatively, the NFL's parity may be driven by specific scheduling decisions designed to match poor performers against each other to encourage some number of wins even for woeful teams.

B. Revenue Sharing

Another key tool in leagues' public pursuit of competitive balance is revenue sharing, which involves the sharing of pooled revenues disproportionately to the source of those revenues. Typically, league-wide television contracts are shared equally among all teams even when certain teams drive far more of consumer demand than others. Such revenue sharing has been part of the fabric of the NFL since the first NFL national television contract was negotiated in 1962.[84] While revenue sharing prevents the lowest revenue-generating teams from becoming insolvent, it also causes a "free rider" problem in which a team may enhance profits by fielding relatively less-talented players to keep costs down, while reaping large profits from sharing revenues with the rest of the league.

In more extreme forms of revenue sharing, leagues can share purely local revenues as well. But the greater the revenue sharing, the lower the incentive to invest in quality since dividing revenues dilutes the rewards of any team's investments. This creates a dilemma, and a theoretical question: will the benefits of a more evenly pooled revenue raise or lower league quality? To understand this dilemma, one needs to unpack the impact of revenue sharing on leagues' spending incentives.

First and foremost, revenue sharing lowers the wage paid to players, simply because revenue sharing lowers the return to each team on investments in talent. Revenue sharing decreases the incentive to outbid other teams for a talented player given that part of the financial return on that player will be shared with the league. If a team determines that a certain wide receiver is worth $10 million to the team because that is how much that player can generate in extra revenues (due to increased winning leading to higher attendance, merchandise, and concessions sales), then normally that team would be willing to pay up to $10 million to hire that player.[85] Yet, if the team had to share its revenue, say 40% of the gross gains in revenue, then the player would only be worth $6 million once the sharing is netted out. In this case the team would not bid as high for the player, therefore lowering his salary.

The key driver of this result is the fact that only revenues are shared among owners, rather than both revenues and costs. Taken to the extreme, if 100% of revenues were shared, an owner would never reap any team-specific rewards from signing a better player and the labor market for talent would dry up. In *Silverman*, Judge Sotomayor recognized this effect, noting that it was not simply a harmless exchange of dollars between owners.[86] Her ruling prevented the owners from unilaterally imposing revenue sharing rules without the consent of the players association.

While in theory revenue sharing saps profit-maximizing teams' desire to compete, not all decisions by sports teams are driven by a pure profit motive. Winning matters too. Although NFL owners have to share their revenues, they don't share their wins or Super

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84 Such a coordination is explicitly exempted from antitrust scrutiny by the Sports Broadcasting Act of 1961, revised in 1968. Sports Broadcasting Act, 15 U.S.C. § 1291.

85 The economics are bit more complicated than just this, as the team would need to determine what the MRP is of the next best player available in order to figure out which player was the better value.

86 *Silverman v. Major League Baseball Player Relations Comm., Inc.*, 880 F. Supp. 246, 253 (S.D.N.Y. 1995), *aff'd*, 67 F.3d 1054 (2d Cir. 1995).

Bowl rings. Thus, to the extent that owners care about winning above and beyond their ability to generate profits *and* are willing to make less money (or even lose it) in order to win, they might be willing to pay more for players than they are "worth" in terms of MRP, due to the dampening effect that revenue sharing plays on the relationship between winning and revenue (and thus profit).

Secondly, it is not clear that revenue sharing actually changes the incentive of teams in less lucrative markets to spend on the quality needed to achieve competitive balance. The popular notion is that small-market teams will use the net excess revenue that they receive from large-market teams through the national media and licensing contracts and through gate sharing to improve the quality of their teams. In *Bulls II*, the NBA's justification for its restriction of the Chicago Bulls broadcasts was the need to maintain competitive balance.[87]

However, it has been theorized that in equilibrium, an athlete will play for the team for which he or she generates the most revenue, regardless of who owns the rights to that revenue.[88] Under this theory, small market teams without a mandatory salary minimum will simply pocket their portions of shared revenue as profit, leaving unsolved the "small-market problem" which plagues some sports. If small-market teams are currently choosing the optimal talent level, a transfer of cash will, by itself, provide no incentive for investments in individually sub-optimally high levels of quality. In fact, most owners have enough access to capital to increase their payrolls substantially. Yet, they choose to remain at some level that they have determined makes the most sense for them. Getting an extra $10 million from the league office does not change anything–they should put it to wherever it is most valuable in their life.[89] Revenue sharing along with a salary cap may make the middle more like the top, but the lower third may remain persistent (albeit profitable) cellar-dwellers. Hence the importance, as discussed above, of combining a salary floor with any revenue sharing arrangement.

This is not merely a theoretical concern. Numerous popular press articles detailed how MLB teams that were recipients of revenue sharing money (and also luxury tax sharing, another form of revenue pooling similar to pure revenue sharing) were pocketing the money instead of spending it on players to improve the talent of the team.[90] For instance, a year after MLB's luxury tax/revenue sharing plan was implemented, the Milwaukee Brewers received the most revenue sharing money (about $8.2 million), but it also *lowered* its payroll from about $50 million to $40 million. In other words, the team may have directly used the money to purchase better players, but any such spending was more

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87 *Chicago Prof'l Sports Ltd. P'ship v. Nat'l Basketball Ass'n*, 95 F.3d 593, 603-04 (7th Cir. 1996).

88 This is an application of the Coase Theorem known as the Invariance Principle first put forth by Simon Rottenberg in 1956 (prior to Coase's seminal article). *See* Simon Rottenberg, *The Baseball Players' Labor Market*, 64 J. OF POL. ECON., 242 (1956); *see also* Ronald H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960).

89 MLB, for instance, mandates that owners use their revenue sharing money to improve their clubs, usually by investing more in player development or putting more money toward free agents. However, an owner can simply lower player payroll by $10 million, for example, and then apply the new $10 million received through revenue sharing toward player payroll, effectively doing nothing to improve the team.

90 *See* Andrew Zimbalist, *The Gold in Baseball's Diamond*, N.Y. TIMES (Sept. 30, 2003), *available at* http://www.nytimes.com/2003/09/30/opinion/the-gold-in-baseball-s-diamond.html.

than offset when the team lowered its base payroll down to $32 million (so adding the $8 million brought it up to $40 million) rather than adding the money on top of their previous $50 million level.[91]

On the other hand, research shows that revenue sharing can improve competitive balance if some owners care about winning.[92] A non-disputed finding is that revenue sharing can prevent some clubs from folding, which would, of course, have an effect on competitive balance, since if teams exit small markets, small market teams can't possibly win.[93]

Combining these two effects, the third effect of revenue sharing is that profits increase as the incentive to pay players declines, as long as the league in question does not face serious competition from another league in the same sport. That is, if the distribution of talent is not strongly influenced by revenue sharing but the incentive to spend on talent declines, as long as no rival league can scoop up talent on the cheap, team owners will keep a large share of a relatively unchanged pie.

Fourth, unless the revenue-sharing and salary-cap rules are airtight, the fact that some revenues or costs are shared/regulated by the league but not others can create perverse incentives for owners to generate revenue from sources that are excluded from revenue sharing (e.g. stadium revenues). Similarly, owners would also have incentives to incur costs on inefficient revenue generators if those costs are uncapped. Hence an owner may invest in stadium improvements simply because that spending is uncapped and he or she gets to keep all of the return on that investment, as opposed to investing in a new team logo from which any new revenues from national merchandising would be shared with the rest of the league. One example from the NFL is luxury suites, which remained outside of the revenue sharing/salary cap structure until the most recent CBA. This loophole then played an outsized role in the race to build new football facilities with posh and plentiful luxury suites. The new CBA in the NFL applies the salary cap to all revenues, with additional

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91 Similar articles have appeared about the Pittsburgh Pirates and Tampa Bay Rays making a profit from the revenue sharing, while maintaining a very low payroll (the lowest in MLB at times). *See Buried Treasure: Pirates to Make $12.8M Profit This Year*, 152 Sports Bus. Daily 17 (May 2, 2005), *available at* https://www.sportsbusinessdaily.com/Daily/Issues/2005/05/02/Franchises/Buried-Treasure-Pirates-To-Make-$128M-Profit-This-Year.aspx; *see also Pirates made $29.4M in 2007 and 2008*, ESPN (Aug. 22, 2010), *available at* https://www.espn.com/mlb/news/story?id=5484947; Alan Snel, *As Rays Whiff, Front Office Scores*, Tampa Tribune (April 20, 2005), *available at* https://boards.sportslogos.net/topic/19692-d-rays-among-most-profitable-teams-in-baseball/.

92 *See* Scott E. Atkinson, Linda R. Stanley, & John Tschirhart, *Revenue Sharing as an Incentive in an Agency Problem: An Example from the National Football League,* 19 Rand J. of Econ., 27, 40 (1988); *see also* John Vrooman, *A General Theory of Professional Sports Leagues*, 61 S. Econ. J., 971, 975 (1995); Daniel S. Mason, *Revenue Sharing and Agency Problems in Professional Team Sport: The Case of the National Football League*, 11J. Sport Mgmt., 203, 209 (1997); Daniel Rascher, *A Model of a Professional Sports League*, Advances in the Econ. of Sport, 2 (1997).

93 Mohamed El-Hodiri & James Quirk, *The Economic Theory of a Professional Sports League*, Government and the Sports Business, 57(R.G. Noll ed., Washington, DC: Brookings Institution 1974); *see also* W.L. Holahan, *The Long Run Effects of Abolishing the Baseball Player Draft-reserve System*, J. Legal Stud., 129, 131 (1978); Roger G. Noll, *The Economics of Sports Leagues,* L. J. of Prof. & Amateur Sports, § 17.03[4], 17-20 to 17-28 (Gary A. Uberstine ed. 1988); *Cross-Subsidization, Incentives, and Outcomes in Professional Team Sports Leagues*. 33 J. of Econ. Literature, 1265-1299 (1995); Linda R. Stanley, *Essays in Applied Microeconomics: Evidence of Non-Profit-Maximizing Firm Owners and Bargaining within the Shadow of the Law* (1985) (unpublished Ph.D. dissertation, University of Wyoming).

supplemental revenue sharing among owners. The players want the small market teams to have enough funds to meet the team payroll minimum, but another beneficiary may be cities who might face less pressure to build ever-more-luxurious suites to stave off threat for their football teams to leave town. Counting a broader range of revenue sources in the revenue sharing (and salary cap) formula seems to be a trend in major U.S. sports, which should work to eliminate some of these perverse incentives towards suboptimal revenue sources.

The most egregious example of the perverse incentives of salary caps and revenue sharing comes from college sports. Within most major athletic conferences (e.g. the Big 10 or SEC), revenues from media rights, postseason play, and NCAA sources like March Madness shared equally, other than comparatively small distributions to cover a portion of team's expenses for post-season play. This means that for a lower-revenue school within a conference, shared revenues make up a substantial portion of an individual school's revenues, whereas for the powerhouse schools within a conference, unshared revenues sources such as ticket sales and donations, comprise a much larger share of the pie. Combined with the finding that donations may be driven by winning,[94] this would normally create an incentive for the strongest schools in a given conference, say Alabama in the SEC or Ohio State in the Big Ten, to spend more on player salary. However, the strict salary cap in college football (where players can receive cash compensation of no more than approximately $7,000 in additional to a scholarship) shifts this desire to invest in quality towards less efficient means. This creates a strong incentive for the Alabamas and Clemsons of a conference to spend far more on facilities than, say, a Mississippi State or a Wake Forest. Despite this incentive for schools at the top of the conferences, overall spending is far more balanced within a conference than across conferences, given the fact that shared revenue tends to dominate.

IV. WHETHER A RULE ENHANCES CONSUMER DEMAND IS AN EMPIRICAL QUESTION

The issue of whether the rules that leagues use to maintain competitive balance are pro- or anti-competitive is ultimately answered both by theoretical and empirical economics. While theory can illuminate the issue, ultimately some form of testing how these rules impact markets may also be necessary to know the impact on sports leagues, sanctioning bodies, athletes, suppliers, and buyers. Economic analysis plays an important role in understanding the special structure and economic forces inherent in sports and in analyzing the competitiveness of league conduct. Allegations of wrongdoing need to be viewed through the correct economic prism before a proper evaluation can occur. This analysis requires an understanding of the exogenous factors inherent in sports leagues, and the rules that leagues use to affect competitive balance, as well as careful study of the specifics of a given rule and how its nuances affect the market in question.

Hence, while the economic factors that sports leagues control, e.g., revenue sharing and team salary restrictions, may superficially appear to be anticompetitive—and even be anticompetitive along one dimension—they nevertheless could promote sufficient growth in revenue because their net impact on competitive balance is pro-competitive. On the

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94 Michael L. Anderson, *The Benefits of College Athletic Success: An Application of the Propensity Score Design*, 99 Review of Economics and Statistics, 119-134.

other hand, restrictions designed to address competitive balance may merely lower average cost without improving competitive balance and may have unintended side effects as teams' and leagues' incentives diverge. In a nut shell, this is the reason why the economics of sports restraints typically fall within a rule of reason analysis, because the answer is almost always "it depends." Policy decisions made without the proper understanding of this crucial fact—that the economics of competitive balance is not as clear cut as sports leagues often claim—may prove to be detrimental to consumer welfare.

V. CAN ECONOMICS MEASURE THE ANTICOMPETITIVE IMPACT OF SALARY LIMITS?

In the context of a rule of reason antitrust case related to competitive balance measures, a key question is whether economic models can be used to predict what individual athletes would receive in payment in a world with less restrictive rules. For example, in *O'Bannon*, class certification was denied to the damages class (but granted for injunctive relief) over the court's concern with a model that did not account for the possibility that individual athletes at the low-end of the talent spectrum might have benefitted from restrictions on payments to more talented athletes.[95] But in the interim, economists have moved away from old-style *ex post* models of productivity, where value can only be predicted after the athlete has performed his/her services, to *ex ante* models that better align with how compensation offers would work in a marketplace. Unlike *ex post* models that can sometimes show the result that schools are consistently making irrational scholarship offers, models based on athletes' *ex ante* ratings generates econometric results that comport with schools' revealed preferences. They provide for ways to identify a class of athletes who could allege and prove classwide common impact and model forgone licensing revenues using a common formula, solving the issues raised in *O'Bannon* by showing that each class member would have earned more than the current limits. And given that the NCAA itself may soon acknowledge that some forms of NIL payments are not demand-decreasing, one can easily imagine a hypothetical class action needing such a model to prove their forgone NIL payments for the four years prior to the lifting of the zero-dollar cap on NIL.

Consider the following hypothetical class: male athletes who entered Division 1 basketball in the four years prior to the NCAA finally allowing for athletes to earn some form of revenue from their NIL and athletic reputations, who were also ranked by a major college recruiting service with three stars or more.[96] Further assume that in this new NCAA model, athletes can either choose to market their NIL on their own, or to

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95 *In re NCAA Student-Athlete Name & Likeness Licensing Litig.*, No. C 09-1967 CW, 2013 WL 5979327, at *8 (N.D. Cal. Nov. 8, 2013): "if these [talented] athletes had stayed in college—as they might have done if not for the alleged restraints on competition in the group licensing market—they would have displaced other student-athletes on their respective teams . . . Those displaced student-athletes would have either been forced to play for other Division I teams or simply lost the opportunity to play Division I basketball altogether. In either case, they would not have suffered injuries as members of the teams for which they actually played . . . Indeed, many of these individuals—all of whom are putative members of the Damages Subclass—may have even benefitted from the challenged restraints by earning roster spots that would have otherwise gone to more talented student-athletes.").

96 Rivals.com rates high school basketball players who are being recruited by universities as either five, four, three, two, or zero stars, with five stars being the mostly highly recruited. Rivals.com rarely uses a one-star ranking.

partner with their schools to jointly market the schools' intellectual property (IP) along with that of the athletes. In this world, athletes will choose between these two models (self-marketing or joining with a school) on an *ex ante* basis—that is, prior to the athlete enrolling in college—and schools will thus base their competitive offer on an assessment of the value of adding that athlete to the schools' IP portfolio. Athletes who see their individual value exceeding a schools' offer would choose not to jointly market; athletes who do not will sign up. Thus assessing the *ex ante* value of the athletes' IP to the schools' portfolio establishes a lower bound for forgone revenues. In other words, being able to model each athlete's expected contribution to school revenue[97] essentially establishes a base level of damages experienced by each athlete.

Such a model exists in the sports economics literature. Using data from 2008-2017, Rascher et al. (2019) develop multiple models of college basketball player value to specific schools utilizing what is known in the labor market during recruiting, i.e., their ranking by high school athlete rating services, athletic conference specific effects, and year.[98] Team revenues and winning percentage are also utilized to establish the relationship between winning and revenue. These models all show that above-average and star men's basketball players statistically significantly improve the revenue generated by their programs by hundreds of thousands of dollars and in some cases millions of dollars per year. These models also allow for individual athlete valuations.

With such a model, each athlete who had been recruited prior to the relaxation of the NCAA's rules could establish his own *ex ante* value to the team he ultimately chose. Thus each athlete could: (a) establish his antitrust injury (the fact that he was paid zero for his NIL when his but-for value exceeds zero); and (b) establish his own damages (based on that difference). The identical formula could be used for each such athlete, making it amendable to class certification.

VI. THE FUTURE OF COMPETITIVE BALANCE: WHAT WILL THE WORLD LOOK LIKE IN 2050?

One aspect of the NFL's efforts to achieve competitive balance is a scheduling method called unbalanced scheduling, where teams that do well in a given season are matched against better competition in the following year. This allows for more marquee match-ups. It also allows the worst performing teams to play each other more often, providing those teams' fans with the hope of winning more games. In contrast, for the portion of the college football season in the control of individual schools, college football usually does the opposite—powerhouse schools pay weaker teams to offer themselves up as sacrificial

97 Many will attempt to distinguish an athletes' commercial value as an endorser from his/her value as an athlete (i.e., on the field/court), but this is an artificial distinction. Consider the value of footage of a star quarterback for a local car dealer. If that athlete performs poorly, or worse still, is wearing the uniform of an out-of-town rival, his commercial value to the car dealer is virtually nil. But if he's throwing a touchdown for the hometown team, the marketing value is much higher.

98 Daniel A. Rascher, Andrey Tselikov, Mark Nagel & Andrew Schwarz, *Because It's Worth It: Why Schools Violate NCAA Rules and the Impact of Getting Caught in Division I Basketball*. 12 Journal of Issues in Intercollegiate Athletics, 226-243 (2019).

lambs and generate incremental revenues for the smaller school.[99] In large part, this is a function of perverse incentives in college football's current post-season, where losses, even to quality opponents, are punished much more than "cupcake" wins.

However, now that there is the CFP (a playoff in major college football, albeit with only 4 teams, though widely believed to eventually grow to eight), college football seems to be recognizing the benefits of more competitive balance in the early portion of the season, with the result being that schools are scheduling better non-conference games. At the same time, as the NCAA's compensation limits have been forced to change with each new legal challenge, each new set of rules further tests the idea that pay caps affect balance, and in each case, no evidence has emerged of greater imbalance. As just one example, first dozens and now hundreds of D1 schools have adopted COA payments, but there has been no notably change in the FBS football or D1 basketball pecking order.

The NFL has led the charge in its focus on competitive balance, but the other major sports are addressing it too. Using the Noll-Scully[100] measure of competitive balance, MLB had improved balance in 2014-17 than it had during the prior six years. However, the imbalance it shot up in 2018, mostly driven by the AL's lack of balance that year. It looks as if the big-spending teams are continuing to spend even more, despite the luxury taxes being paid. It remains to be seen if that level of increase spending makes sense or whether the big-spenders will need to come back to pack. In the next five to ten years, MLB should see improved competitive balance because revenue sharing recipients will find it more difficult to avoid using their additional funds to improve their on-the-field product, and large market clubs will be exempt from being recipients of revenue sharing money. MLB owners and players alike recognize the need to grow baseball's fan base, both domestically and internationally. The Industry Growth Fund coming from luxury taxes will help, as will the growth of the Australian Baseball League and domestic leagues in other countries. The World Baseball Classic should help speed up the growth of baseball worldwide, which will position MLB as the premier league for a new generation of fans.[101] These issues, while relatively uncontroversial, will be a focus in future CBAs.

To the extent competitive balance is critical for consumer demand, the need for competitive balance will only be enhanced as sports increasingly compete against each other for domestic and international viewership. Increasingly, soccer, especially the English Premier League, is programmed against major American sports as networks without football or basketball (especially new cable channels dedicated solely to sports) look for new ways to attract viewers to live sports. At the same time, the growing international popularity of American sports, will likely lead to overseas expansion, with perhaps the

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99 These games are commonly called "guarantee games" because the smaller team is guaranteed a specific payment for coming to play the stronger team in the stronger team's stadium. Facetiously, the term is also used because the powerhouse team is virtually guaranteed to win.

100 The Noll-Scully measure of competitive balance is $SD/0.5/\sqrt{m}$, where m is the number of games played and SD is the standard deviation of winning percentages. Stefan Késenne, The Economic Theory of Professional Team Sports: An Analytical Treatment (Edward Elgar Pub.), 10

101 Mark S. Nagel et al., *Expanding Global Market for American Sports: The World Baseball Classic*, Sport and Public Policy: Social, Political, and Economic Perspectives 215, 229 (Charles Santo & Gerard Mildner eds., 2010).

NBA having multiple teams in Europe within the next two decades.[102] As sports across the globe are pitted against each other for viewers and fans, each league may be tempted to emphasize those rules that enhance consumer demand for its sport, and efforts to optimize competitive balance will be in the forefront of that movement. What remains to be seen is whether a foreign league with strong competitive balance has higher or lower demand than a foreign league with few super teams. That is, while competitive balance may matter for local interest in a team, imbalance may help drive outside demand to see truly elite play.

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102 William Bigelow, *Stern: Multiple BA Teams in Europe in 20 Years* (Jan. 5, 2013), *available at* http://www.breitbart.com/Breitbart-Sports/2013/01/05/Stern-NBA-Europe ("I think so . . . I think multiple NBA international teams. Twenty years from now? For sure. In Europe. No place else. In other places I think you'll see the NBA name on leagues and other places with marketing and basketball support, but not part of the NBA as we now know it."). Additionally, the NBA is launching a league in Africa. *See* Jeff Feld, *NBA's Basketball Africa League Gets One Step Closer to Reality with Announcement of Host Cities*, FORBES (July 31, 2019).

SOCIAL MEDIA PRIVACY LEGISLATION AND ITS IMPLICATIONS FOR EMPLOYERS AND EMPLOYEES ALIKE

By Robert B. Milligan, Daniel P. Hart and Sierra Chinn-Liu[1]

I. INTRODUCTION

According to the Pew Research Center, approximately seven-in-ten Americans use social media to connect with one another, engage with news content, share information and entertain themselves.[2] YouTube and Facebook are the most widely used online platforms: these two platforms, respectively, are visited by 73% and 69% of Americans every day.[3] Sites and applications such as Twitter, Instagram, LinkedIn, and SnapChat also garner substantial daily use.[4]

Social media clearly influences and permeates our daily lives–and the workplace is no exception. Companies frequently conduct business via social platforms, and employees often use social media on the job for both personal and work-related reasons.[5] The pervasive use of social media, however, creates a tension between the rights of employees to personal privacy on the one hand, and the needs of companies on the other, to protect corporate intellectual property, comply with regulatory reporting requirements, guard against cyber threats, and maintain appropriate systems and data management practices.

To address these concerns, starting in 2012, twenty-six states enacted social media privacy laws that prevent or limit employers from requesting passwords to current or

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2 *Social Media Fact Sheet*, Pew Research Center (June 12, 2019), https://www.pewinternet.org/fact-sheet/social-media/.

3 *Id*.

4 *Id*.

5 A Pew Research Center survey found that American workers use social media while on the job for a variety of reasons, including (in descending order of percentage of use): (1) to take a mental break from their job (34%); (2) to connect with friends and family while at work (27%); (3) to make or support professional connections (24%) (4) to get information that helps them solve problems at work (20%); (4) to build or strengthen personal relationships with coworkers (17%); (5) to learn about someone they work with (17%); or (6) to ask work-related questions of people inside or outside of their organizations (12%). Cliff Lampe and Nicole Ellison, *Social Media in the Workplace,* Pew Research Center (June 22, 2016), available at https://www.pewinternet.org/2016/06/22/social-media-and-the-workplace/.

prospective employees' personal internet and social media accounts.[6] In varying degrees and differing ways, these laws directly impact an employer's ability to request or require an applicant or employee to disclose his or her username and/or password; to open his or her internet or social media accounts in the presence of a supervisor; to add a representative of the employer to the employee's contact list; or to otherwise alter the privacy settings associated with the employee's internet or social media accounts.[7] Many of the laws include a right of action to an employee subjected to statutory social media privacy violations, and provide various forms of relief—including, but not limited to, money damages, penalties, injunctions, and attorneys' fees. One state (Michigan) has even gone so far as to make it a misdemeanor for an employer to violate its social media privacy statute.[8]

Most social media privacy laws contain liability exceptions and safe harbors for employers, however. For example, a number of state laws only affect access to "personal" social networking accounts, i.e., those accounts which employees do not use for employer business. Many such laws also allow account access by employers, albeit in limited circumstances, such as during investigations into employment-related misconduct or theft of employer data, or to permit access to employer-owned equipment or information systems. Some state laws authorize mandatory employer access to employee internet or social media accounts for required self-regulatory employee screening—such as, for example, broker screening under NASD and FINRA rules. And, a number of state social media laws provide immunity to employers for "innocent discovery" of protected information during ordinary network monitoring, or to employers who decline or fail to demand access to protected accounts.

A chart summarizing the variations among these state laws appears at the end of this article. Because of their relatively recent enactment, however, there is virtually no case law interpreting the applicability, sweep, or limits of these state social media privacy laws. This article highlights some of the issues that employers may face, and that courts may need to grapple with, as they undertake compliance with these state laws. Such issues include:

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6 These states include Arkansas (Ark. Code §§ 11-2-124); California (Cal. Lab. Code § 980); Colorado (C.R.S. 8-2-127); Connecticut (Conn. Gen. Stat. § 31-40x) (2015 S.B. 425, Act 16); Delaware (19 Del. Code § 709A); Illinois (820 ILCS 55/10); Louisiana (La. Rev. Stat. § 51.1951 to §§ 1953 and 1955); Maine (26 M.R.S. § 616 to 619); Maryland (Md. Code Lab. and Emp. Law § 3-712); Michigan (MCL § 37.271-37.278); Montana (Mont. Code Ann. 48-3501 et seq.); Nevada (NRS § 613.135); New Hampshire (N.H. Rev. Stat. § 275:74); New Jersey (N.J. Stat. § 34.68-6); New Mexico (N.M. Stat. § 50-4-34 (covers job applicants only); Oklahoma (40 Okla. Stat. § 173.2); Oregon (O.R.S. § 659A.330); Rhode Island (R.I. Gen. Laws § 28-56-1 to -6); Tennessee (Tenn. Code §§ 50-1-1002 to -1004); Utah (Utah Code § 34-48-201 et seq.); Vermont (21 V.S.A. § 4951); Virginia (Va. Code § 40.1-28.7:5); Washington (RCW §§ 49.44.200 and 49.44.205); West Virginia (W.V. Code § 21-5H-1); and Wisconsin (Wis. Stat. § 995.55).

7 The social media privacy laws in sixteen states, as well as the District of Columbia, afford similar privacy protections to students attending university, by preventing or limiting the ability of an educational institution to access usernames or passwords to students' internet or personal social media accounts: Arkansas (Ark. Code § 6-60-104); California (Cal. Ed. Code § 99121); Delaware (14 Del. Code § 8103); Illinois (105 ILCS 75/10, 105 ILCS 75/15); Louisiana (La. Rev. Stat. §§ 51.1951 to 1952 and §§ 1954 to 1955); Maryland (Md. Code Ed. Law § 26-401); Michigan (MCL § 37.271-37.278); New Hampshire (N.H. Rev. Stat. 189.70); New Jersey (N.J. Stat. § 18A:3-30); New Mexico (N.M. Stat. § 21:1-46); Oregon (O.R.S. §§ 350.272, 350.274); Rhode Island (R.I. Gen. Law § 16-103-1 to -6); Utah (Utah Code § 538-25-101 et seq.); Virginia (Va. Code § 23.1-405); Wisconsin (Wis. Stat. 995.55); and the District of Columbia (B. 578, Chap. 218).

8 MCL § 37.278(1).

- Whether a user's internet or social media account is a "personal" account to which employer access may be limited or prohibited—especially in states (such as California) where the social media law does not define the term.
- The permissible scope of an employer investigation that authorizes (or requires) employer access to employee internet and social media accounts;
- Implications for employer intellectual property and trade secrets, including employer vs. employee ownership of social media account-related information;
- Discovery disputes involving employee social media content; and
- The potential interaction between state social media privacy laws and other laws, such as the federal Computer Fraud and Abuse Act.

II. KEY ISSUES

A. What Does the Term "Personal" Mean in Social Media Legislation?

Many states, including California, Colorado, Nevada, and Washington, have passed social media privacy laws that do not define the term "personal." Although the state laws discussed in this article generally apply only to "personal" social media accounts, the failure by some state legislatures to define the term is problematic, as it can be unclear who in fact owns the particular accounts at issue in the absence of an express policy or agreement governing social media.

Based on recent court decisions in these states, employers likely have at least *some* ownership rights to an employee's social media account, even if the account is used for both employment-related and non-employment-related purposes, specifically where the employer played an important role in creating, maintaining, or developing the account.[9]

Employers could potentially evade the applicability of similar privacy laws by detailing in employee job descriptions company ownership of work-related accounts. By requiring employees to use such accounts in accordance with job descriptions and proprietary information protection agreements, an employer can attempt to ensure that company social media accounts "belong" to the company for purposes of the employer protections afforded by the relevant state social media privacy statute(s).

B. Bring Your Own Device Policies

Employers are likely to face related issues resulting from bring your own device ("BYOD") policies. When an employee uses his or her own device to access company email, files, or other information, the employer does not "own" the device, but may still have an interest in the business-related information residing on the device and protecting that information. Public employers in particular have a heightened interest in restricting employees' use of personal devices to conduct official business. *See Nissen v. Pierce Cty.*, 183

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9 *See, e.g., Cellular Accessories For Less, Inc. v. Trinitas LLC*, No. CV 12-06736, 2014 WL 4627090 (C.D. Cal. Sept. 16, 2014) (discussing employer's potential interest in employee's LinkedIn account); *PhoneDog v. Kravitz*, No. C11-03474 MEJ, 2011 U.S. Dist. LEXIS 129229 (N.D. Cal. Nov. 8, 2011) (discussing former employer's potential interest in employee's Twitter account).

Wash. 2d 863, 869 (Wash. 2015) (en banc) (holding that text messages sent and received by a public employee in her official capacity were public records, even though she was using her personal cell phone).

An effectively written BYOD policy may protect an employer's interest in data accessed on an employee's personal device. A policy that clearly informs employees that all company-related information on the device will remain the sole property of the company, and that the company retains the right to delete company data through the use of monitoring software, may help to establish an employer's control over the information on an employee's personal device, so as to distinguish it from purely "personal" information that may be subject to the reach of an applicable state social media statute.[10]

C. Protectable Trade Secrets

State social media privacy laws may conflict with recent decisions about whether social media content (e.g., contact/customer lists) may be an employer's protectable trade secrets.

1. "Trade Secrets" Defined

Information and data are protectable under the Uniform Trade Secrets Act ("UTSA")—effective in 48 states—if the information derives value from being kept secret, *is* a secret, and is *kept* a secret. In the two states that have not yet adopted the UTSA, New York and Massachusetts, similar protections are provided through the state's common law. Information is kept secret if its owner takes affirmative measures to prevent its unauthorized disclosure, including but not limited to, the following: non-disclosure, restricted-use, and mandatory-return agreements; confidentiality stamps; limited internal distribution and access permissions; and password protection of computers and other devices. These efforts need only be "reasonable under the circumstances"; "absolute" secrecy is not required.

Although there are no bright-line rules for whether information is protectable as a trade secret, courts generally find that information is a trade secret where (i) the information is the result of a substantial investment of time, effort, and expense; (ii) it generates independent economic value for its owner; (iii) it is not generally known in the relevant industry; (iv) it cannot easily be accessed by legitimate means; and (v) it cannot be independently reverse engineered without significant effort and expense. Experience reveals that in many cases, the more egregious a defendant's theft of an alleged secret, the more likely a court will find that the stolen data qualifies as a trade secret.[11] This is the case not merely because of the court's desire to punish egregious behavior, but because an employee's theft and subsequent use of stolen data or information tends to reflect the independent economic value of the stolen information, and also tends to show that the information was not publicly available.[12]

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10 *See, e.g., H.J. Heinz Co. v. Starr Surplus Lines Ins. Co.*, No. 2:15-cv-00631-AJS, 2015 WL 12791338 (W.D. Pa. July 28, 2015) (plaintiff employer successfully maintained custody and control of company (non-personal) data and emails stored on employee devices pursuant to company BYOD policy).

11 *See, e.g.*, *Hallmark Cards Inc. v. Monitor Clipper Partners LLC, et al.*, 758 F.3d 1051, 1055, 1060-61 (8th Cir. 2014).

12 *Id.*

2. Potential Impact on Account-Content "Ownership"

Social media privacy laws also raise questions about account-content ownership (e.g., LinkedIn connections)—especially where, as in several states, the social media privacy statute does not define what is meant by "personal" internet or social media account information.

The *Cellular Accessories* and *PhoneDog* cases, discussed Section II.A., above, held that an employee's LinkedIn account (*Cellular Accessories* and *Eagle*) and Twitter feeds (*PhoneDog*), may "belong to" the employee's employer, due primarily to the employer's investment of time and expense in developing and maintaining the accounts at issue. Similarly, in *Ardis Health, LLC v. Nankivell*, No. 11 Civ. 5013 (NRB), 2011 WL 4965172 (S.D.N.Y. Oct. 19, 2011), the federal district court for the Southern District of New York that an employer "owned" an employee's account content, pursuant to the terms of the employment agreement. More recently, in *Salonclick LLC v. SuperEgo Mgmt. LLC*, 16 Civ. 2555 (KMW), 2017 WL 239379 (S.D.N.Y. Jan. 18, 2017), a case involving trademark infringement and allegedly unauthorized use of the plaintiff's domain names and social media accounts, the Southern District of New York again extended companies' rights to protect their social media accounts and domain names from theft by independent contractors. Such reasoning could be applied to protect an employer that invested to create and maintain certain internet and social media for the benefit of employees *as well as* the company.

Conversely, with the onset of state social media privacy laws, employees may have ammunition to argue that they own their social media contacts, even when used in furtherance of the employer's business—especially in states where "personal" is not clearly defined. That is to say that employees in trade secret cases may be able to argue that an applicable social media privacy law implies a degree of ownership of their social media accounts, even if they use them in part to advertise their employers' business. This presents yet another dimension to be considered in the balancing of respective interests that courts interpreting these state laws will be tasked with.

3. Potential Impact on "Protective-Measure" Analysis

Further, some may argue, that unless employers investigate their employees' social media activities and related data theft, employers have not used "reasonable" efforts to maintain secrecy under the Uniform Trade Secrets Act ("UTSA"), and therefore stand to lose trade secret protection for that data. Section 1(4)(ii) of the UTSA provides that owners of trade secrets must have employed "efforts that are reasonable under the circumstances to maintain [their] secrecy." The "reasonable under the circumstances" requirement is often the central dispute in trade secret litigation; the owner will claim that it used reasonable efforts, and the alleged thief will claim that the owner/plaintiff was "willy-nilly" in handling its so-called secrets. If social media privacy laws permit an employer to investigate an employee's suspected data theft through his or her social media networking account, but the employer does not do so, has the employer failed to use "reasonable efforts" to protect the data's secrets?

On the one hand, information that falls into the public domain, or becomes generally known within the relevant industry, usually loses its status as a trade secret.[13] Similarly, the disclosure of information without imposing a confidentiality obligation on the recipient may result in the loss of trade secret protection.[14] An employee's posting of trade secret information on his or her social media account would pose a significant risk of loss of protection for the information—especially if the employer, after learning of the posting, and otherwise authorized under an applicable social media statute to demand access to the employee's account to investigate and/or pull back the information, fails to act, or the company has in place a policy that does not prohibit such social media activities by employees.

On the other hand, "absolute" secrecy is not required to maintain trade secret status, only "reasonable efforts" to maintain confidentiality.[15] Indeed, two relevant features of many privacy laws are: (1) employer immunity for failure to investigate suspected misconduct (e.g., Michigan, Utah); and (2) no duty to monitor employee activity on social media accounts (e.g., District of Columbia). Employers faced with a waiver argument may cite immunity or safe harbor provisions to counter the argument that they were required to investigate reports or suspicion of employee-account-related data theft, lest they lose statutory protection for that data.

D. Social Media Discovery Issues

Under the Federal Rules of Civil Procedure, parties may request discovery of "electronically stored information" ("ESI") that is within the responding party's "possession, custody, or control." Fed. R. Civ. P. 34(a)(1)(A). Courts have recognized that the information available on social networking websites may be subject to discovery under this rule.[16] According to the U.S. District Court in Oregon, there is "no principled reason to articulate different standards for the discoverability of communications through email, text message, or social media platforms."[17]

Generally speaking, social media is neither privileged nor specifically protected by privacy rights.[18] Content from social networking websites may not necessarily be "shielded from discovery simply because it is 'locked' or 'private.'"[19] "Although privacy concerns may be germane to the question of whether requested discovery is burdensome

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13 *See, e.g.*, *Newark Morning Ledger Co. v. New Jersey Sports & Exposition Auth.*, 31 A.3d 623, 641 (N.J. App. 2011) (trade secrets' "only value consists in their being kept private . . . if they are disclosed or revealed, they are destroyed").

14 *See Seng-Tiong Ho v. Taflove*, 648 F.3d 489, 504 (7th Cir. 2011) (plaintiff's publishing of alleged secrets in trade journals destroyed any trade secret protection the information may have had).

15 *See, e.g.*, *Adivair Helicopter Supply, Inc. v. Rolls-Royce Corp.*, 663 F.3d 966, 974 (8th Cir. 2011) (efforts to maintain secrecy "need not be overly extravagant, and absolute secrecy is not required").

16 *See Davenport v. State Farm Mut. Auto. Ins. Co.*, 3:11-CV-632-J-JBT, 2012 WL 555759, at *1 (M.D. Fla. Feb. 21, 2012); *Mailhoit v. Home Depot U.S.A., Inc.*, 285 F.R.D. 566, 570 (C.D. Cal. 2012).

17 *Robinson v. Jones Lang La Salle Americas, Inc.*, No. 3:12-CV-00127, 2012 WL 3763545, at *1 (D. Or. Aug. 29, 2012).

18 *See, e.g.*, *Adivair Helicopter Supply, Inc. v. Rolls-Royce Corp.*, 663 F.3d 966, 974 (8th Cir. 2011) (efforts to maintain secrecy "need not be overly extravagant, and absolute secrecy is not required").

19 *EEOC v. Simply Storage Mgmt., LLC*, 270 F.R.D. 430, 434 (S.D. Ind. 2010).

or oppressive and whether it has been sought for a proper purpose in the litigation, a person's expectation and intent that her communications be maintained as private is not a legitimate basis for shielding those communications from discovery."[20]

A party's right to discovery is not unlimited, however, and this remains true for ESI as well. Federal Rule of Civil Procedure 26(b)(1) limits the scope of discovery to information "relevant to any party's claim or defense" and mandates that discovery be "proportional to the needs of the case."[21] This rule applies equally to social media.[22] In the context of social media, courts have limited discovery to posts related to contested issues, rather than the entire account history.[23]

Also worth noting are the implications for spoliation in dealing with evidence posted or stored on social media websites or platforms. Recent case law on social media discovery has focused on the importance of maintaining such information and preventing spoliation, adding preservation obligations to the list of challenges for general counsel in dealing with social media issues. In one such case, *Gatto v. United Air Lines*, Civil Action No. 10-cv-1090-ES-SCM, 2013 WL 1285285 (D.N.J. Mar. 25, 2013), the plaintiff sued his employer for injuries allegedly sustained while working. During discovery, the defendants requested the plaintiff's social networking account content, and the plaintiff agreed to provide access to his account. Upon opposing counsel's attempt to login, however, the plaintiff received notice of unauthorized access and immediately deactivated the account. The court subsequently granted spoliation sanctions against the plaintiff and found that, regardless of whether he intended to destroy the account, he had "effectively caused the account to be permanently deleted," thereby giving rise to an appropriate inference of spoliation.[24]

Similarly, in *Lester v. Allied Concrete Co.*, No. CL08-150, 2011 Va. Cir. LEXIS 245 (Va. Cir. Ct. Sept. 6, 2011), a Virginia state court sanctioned a party and his lawyers in a wrongful death suit for intentionally destroying a Facebook page. In that case, the opposing party requested discovery of the contents of the plaintiff's Facebook page after

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20 *Id.; see In re Ford Motor Co. DPS6 PowerShift Transmission Products Liability Litigation*, No. 2:18-ML-02814 AB (FFMx), 2:18-cv-1893 AB (FFMx), 2019 WL 3815721, at *4 (C.D. Cal. May 13, 2019) ("A social media account, which by its nature is intended to be shared, cannot be shielded from discovery on privacy grounds alone.") (Citing *Voe v. Roman Catholic Archbishop of Portland in Oregon*, No. 3:14-CV-01016-SB, 2015 WL 12669899, at *2 (D. Or. Mar. 10, 2015) (discussing same)).

21 *See Fawcett v. Altieri*, 960 N.Y.S. 2d 592, 594 (2013) (Discovery "may be curtailed when it becomes an unreasonable annoyance and tends to harass and overburden the other party").

22 *T.C. on Behalf of S.C. v. Metropolitan Gov't of Nashville and Davidson Cnty.*, No. 3:17-CV-01098, 3:17-CV-01159, 3:17-CV-01209, 3:17-CV-01277, 3:17-CV-01427, 2018 WL 3348728, at *14 (M.D. Tenn. July 9, 2018) ("To obtain discovery of non-social media, a party must show that the information sought is reasonably calculated to be relevant to the claims and defenses in the litigation. The production of a social media account's contents in full will therefore rarely be appropriate."); *Petion v. 1 Burr Road Operating Co. II, LLC*, No. 16 CV 1993 (JBA), 2017 WL 6453398, at *3 (D. Conn. Dec. 15, 2017).

23 *Gordon v. T.G.R. Logistics, Inc.*, Case No. 16-CV-00238-NDF, 2017 WL 1947537, at *3-4 (D. Wyo. May 10, 2017); *Soderstrom v. Skagit Valley Food Co-op*, No. C18-1707 MJP, 2019 WL 3944327, at *2-3 (W.D. Wash. Aug. 21, 2019) (limiting order for the plaintiffs' production of social media content to posts from the relevant period).

24 *Id.* at *4.

obtaining a photo of the plaintiff wearing a T-shirt bearing the phrase "I [heart] hot moms."[25] The plaintiff was questioned about the shirt at his deposition, whereupon his attorney instructed him to "clean up" the account to prevent "blowups of this stuff at trial."[26] The account was removed, and defense counsel was told the plaintiff had no Facebook page.[27] The account was later reactivated and the contents produced, with the exception of several "objectionable" photos.[28] The jury ultimately found in favor of the plaintiff, but the court sanctioned the plaintiff and his attorney for spoliation for deleting the page.[29]

In sum, while state social media privacy laws may have some effect on the discoverability of protected account content, courts will likely still favor disclosure. As the case law in this area develops, so too will the nuanced implications of these laws, such as the introduction and use of heightened protective orders in cases where social media discovery is necessary.

E. Social Media Evidence and Admissibility

For social media evidence to be admissible, the proponent must be able to prove who had ownership and control of the relevant page or content. Federal Rule of Evidence 901 requires the proponent to authenticate evidence by proving the evidence is what the proponent claims it is. This rule applies with equal force to social media evidence; as courts have become more familiar with social media, they have become more skeptical of "self-authentication" arguments.[30]

Additionally, evidence obtained from a social media account is subject to Federal Rule of Evidence 403, which sets forth a balancing test to determine whether the probative value of the evidence is substantially outweighed by the danger of unfair prejudice. Rule 403 applies even when a proponent is introducing evidence to authenticate a social media page, but the bar for admissibility is relatively low.[31] Although "tracing the webpage directly to [its purported creator] through an appropriate electronic footprint or link would provide some technological evidence, such evidence is not required . . . where

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25 *Id.* at *12.

26 *Id.* at *13.

27 *Id.* at *15.

28 *Id.* at *17.

29 *Id.* at *40.

30 *See United States v. Vayner*, 769 F.3d 125, 132 (2d Cir. 2014) (holding that evidence of the existence of a social media page containing the defendant's name and photograph was not enough to prove it belonged to the defendant unless the government could also prove that the defendant had created the page or was otherwise responsible for its contents); *United States v. Browne*, 834 F.3d 410, 411 (3d Cir. 2016) (holding that social media posts are *not* self-authenticating under the business records exception because custodians can only attest to communications taking place between accounts, not who authored the posts, and there is no underlying process by which the information is recorded that would render the posts accurate and trustworthy).

31 *See State v. Ford*, 782 S.E.2d 98, 106-07 (N.C. Ct. App. 2016) (admitting screen shots of the defendant's allegedly vicious dog and a rap video from his MySpace page to prove that the page belonged to the defendant, despite his objections that the content prejudiced the jury to believe that his dog had, in fact, killed the victim).

strong circumstantial evidence exists that [a] webpage and its unique content belong to [such person]."[32]

F. Computer Fraud and Abuse Act and Privacy Implications

The new state social media privacy laws described in this article may affect how courts evaluate employees' allegations against their employers concerning violations of the federal Computer Fraud and Abuse Act ("CFAA") and the employees' common law rights of privacy.

For example, in *Mintz v. Mark Bartelstein & Assocs. d/b/a Priority Sports & Entm't, et al.*, 885 F. Supp. 2d 987, 1002 (C.D. Cal. 2012), the court found that accessing the personal email account of an employee, even one who had allegedly stolen trade secrets, was an invasion of that employee's privacy. The employee (Mintz) resigned from his job and sued his former employer after he left to join a competitor, seeking a declaration to invalidate his non-compete agreement.[33] After Mintz's resignation, his employers accessed his personal email account *without his permission*, and allegedly leaked information found in the account to a third party.[34] The court found that the employer's access to Mintz's Gmail account constituted a violation of California Penal Code section 502, as well as an invasion of privacy (but denied recovery under the CFAA because Mintz had failed to show "loss" within the meaning of the statute).[35]

In a similar case, *Murphy v. Spring*, No. 13-CV-96-TCK-PJC, 2013 U.S. Dist. LEXIS 130231, at *2 (N.D. Okla. Sept. 12, 2013), a federal court in Oklahoma held that an employer's access to an employee's personal email account to obtain information used in recommending her termination was a potential basis for her invasion of privacy claim. The employee, an administrative assistant working in a Tulsa, Oklahoma school district, alleged that two of her superiors had misappropriated funds, thereby endangering the health and safety of the students. Shortly after making these reports, the assistant was suspended, and her supervisor recommended her termination.[36] During the grievance process initiated by the assistant, she was informed by the local police department that her private email account had been hacked.[37] She then sued her employer, alleging that the employer had intentionally accessed her private emails and had used information contained therein to support the termination recommendation.[38] The court denied the employer's motion to dismiss the assistant's Fourth Amendment claim, invasion of privacy claim, and intentional infliction of emotional distress claim, finding that the plaintiff had a reasonable expectation of privacy in her personal account, and the hacking constituted an unlawful search and seizure which could be considered highly offensive to a reasonable person.[39]

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32 *Id.* at 106.

33 *Id.* at 989.

34 *Id.* at 990.

35 *Id.* at 1031-35. Specifically, Mintz's legal fees were being paid by his new employer, and were not "essential to remedying the harm of the unauthorized access." *Id.* at 1030.

36 *Id.*

37 *Id.* at *3.

38 *Id.* at *4-5.

39 *Id.* at *34.

The rulings in *Mintz* and *Murphy* underline the importance of caution when accessing employees' personal internet and social media accounts, as there can be consequences for employers do so. In addition to liability under state social media laws, employers may also face liability under state computer hacking/security laws, as well as relevant laws governing invasions of privacy.

G. Using Social Media in Investigations

When using social media in workplace investigations, employers should stay within the bounds of their own social media policies. Although viewing information from an employee's social media account that is available on the public domain is generally permitted (even in states that have social media privacy laws), employers should exercise care to avoid taking actions that may perceived as retaliation for protected activities.[40]

Social media policies can serve as extensions of other policies. A well-written social media policy can be an effective tool for employers to enforce prohibitions on employee behavior in and outside the workplace.[41] As with any workplace policy, it is important for employers to enforce social media policies consistently.[42]

Having an effective social media policy is the first step an employer can take toward protecting itself during workplace investigations. Simply having a policy, however, is not enough. As illustrated by the cases discussed in this Section, managers must be properly trained in using the policy appropriately and consistently for the employer to realize the full benefits of the policy.

H. Other Issues

In addition to complying with state social media privacy laws, employers should carefully consider whether their social media policies comply with federal and state laws protecting the ability of employees to engage in statutorily protected activities. From the Equal Employment Opportunity Commission ("EEOC") to the Department of Labor ("DOL"), to the Securities and Exchange Commission ("SEC") and the National Labor Relations Board ("NLRB"), federal and state regulatory agencies are increasingly wary of employer policies that limit employees' freedom to engage in whistleblowing and other protected activities. Even with proper policies in place, employers may still run afoul of

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40 *See Jones v. Gulf Coast Health Care of Del., LLC*, 854 F.3d 1261, 1275 (11th Cir. 2017) (holding that employer's proffered reasons for an employee's termination, which included FMLA abuse for posting vacation pictures on Facebook while the employee was purportedly on FMLA leave, poor judgment for posting the pictures, and violation of the employer's social media policy, may have been pretext for discrimination).

41 *See Jackson v. Walgreen Co.*, 516 S.W.3d 391, 394-95 (Mo. Ct. App. 2017) (affirming Labor and Industrial Relations Commission's denial of unemployment benefits where employee was terminated for harassing coworkers online in violation of the company's social media policy, which specifically prohibited such conduct).

42 *See Carney v. City of Dothan*, 158 F. Supp. 3d 1263, 1282, 1292-93 (M.D. Ala. 2016) (granting employer's motion for summary judgment in race discrimination case because employer was justified in taking adverse employment action against employee who violated its social media policy and based on employer's showing that it consistently investigated potential violations without regard to the race of the employee involved).

statutory provisions and the agencies charged with enforcing them, if the policies are overbroad or inadvertently restrict relevant activity.

The NLRB in particular has been taking a hard look at employer policies governing the use of social media. In its 2014 decision in *Triple Play Sports Bar & Grille*, 361 NLRB No. 31 (2014), the NLRB ruled that a Facebook discussion regarding an employer's tax withholding calculations and an employee's "like" of the discussion constituted concerted activities protected by Section 7 of the National Labor Relations Act ("NLRA"), which covers employees' rights to engage in concerted activities regarding the terms and conditions of their employment. In addition, the Board held that the employer's Internet and blogging policy (which provided that in "engaging in inappropriate discussions about the company, management, and/or co-workers, the employee may be violating the law and is subject to disciplinary action, up to and including termination of employment") was overly broad and therefore violated the NLRA.[43] In another decision, *Purple Communications*, 361 NLRB No. 126 (2014), the NLRB ruled that employees who have access to an employer's email system as part of their job generally may, during nonworking time, use the email system to communicate about wages, hours, working conditions, and union issues.

In light of these rulings, employers should carefully consider their policies and practices regarding employee use of social media *even if* they operate only in states that have not yet enacted social media privacy laws.

III. CONCLUSION

Some of the essentials of the social media privacy laws enacted in twenty-six states and the District of Columbia can be found in the summary chart appended at the end of this article. There is little, if any, case law interpreting these statutes. It is anticipated that litigation and additional action by state legislatures will help to define acceptable practices in this area.

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43 *Id.*

State-by-State Chart

STATE	Are personal social media accounts covered by the law?	Is personal social media defined?	Is there a private civil right of action?	Are current employees covered by the law?	Are attorneys fees available?	Does the law cover colleges and universities?	Are public employees covered by the law?	Exceptions for investigations of employee misconduct?
Arkansas	Yes	Yes	Not Mentioned	Yes	Not Mentioned	Yes	Yes	Yes
California	Yes	No	Not Mentioned	Yes	Not Mentioned	Yes	Not Mentioned	Yes
Colorado	Yes	No	Yes	Yes	Not Mentioned	Not Mentioned	Yes Law Enforcement Agencies Exception	Not Mentioned
Connecticut	Yes	Yes	Yes	Yes	Yes	Not Mentioned	Yes Law Enforcement Agencies Exception	Yes
Delaware	Yes	Yes	Not Mentioned	Yes	Not Mentioned	Yes	Yes	Yes
District of Columbia	Yes	Yes	Not Mentioned	Not Applicable	Not Mentioned	Yes	Not Applicable	Not Applicable
Illinois	Yes	Yes	Yes	Yes	Yes	Not Mentioned	Not Mentioned	Yes
Louisiana	Yes	Yes	Not Mentioned	Yes	No	Yes	Yes	Yes
Maine	Yes	No	Not Mentioned	Yes	Not Mentioned	Not Mentioned	Not Mentioned	Yes
Maryland	Yes	Yes	Yes	Yes	Not Mentioned	Not Mentioned	Yes	Yes
Michigan	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Montana	Yes	Yes	Yes	Yes	Not Mentioned	Not Mentioned	Not Mentioned	Yes
Nebraska	Yes	Yes	Yes	Yes	Yes	Not Mentioned	Yes, Law Enforcement Agencies Exception	Yes
Nevada	Yes	No	Not Mentioned	Yes	Not Mentioned	Not Mentioned	Not Mentioned	Not Mentioned

STATE	Are personal social media accounts covered by the law?	Is personal social media defined?	Is there a private civil right of action?	Are current employees covered by the law?	Are attorneys fees available?	Does the law cover colleges and universities?	Are public employees covered by the law?	Exceptions for investigations of employee misconduct?
New Hampshire	Yes	Yes	Not Mentioned	Yes	Not Mentioned	Not Mentioned	Not Mentioned	Yes
New Jersey	Yes	Yes	Yes	Yes	Yes	Yes	Yes Law Enforcement Agencies Exception	Yes
New Mexico	Yes	No	Not Mentioned	No	Not Mentioned	Yes	Law Enforcement Agencies Are Not, Does Not Mention Other Public Employers	Does Not Apply
Oklahoma	Yes	Yes	Yes	Yes	Not Mentioned	Not Mentioned	Not Mentioned	Yes
Oregon	Yes	Yes	Yes	Yes	Yes	Yes	Not Mentioned	Yes
Rhode Island	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Tennessee	Yes	Yes	Yes	Yes	Yes	Not Mentioned	Yes Law Enforcement Agencies Exception	Yes
Utah	Yes	Yes	Yes	Yes	Not Mentioned	Yes	Yes Law Enforcement Agencies Exception	Yes
Vermont	Yes	Yes	Not Mentioned	Yes	Not Mentioned	Not Mentioned	Yes Law Enforcement Agencies Exception	Yes
Virginia	Yes	Yes	Not Mentioned	Yes	Not Mentioned	Yes	Yes	Yes
Washington	Yes	No	Yes	Yes	Yes	Not Mentioned	Yes	Yes
West Virginia	Yes	Yes	Not Mentioned	Yes	Not Mentioned	Not Mentioned	Not Mentioned	Yes
Wisconsin	Yes	Yes	No	Yes	No	Yes	Yes	Yes

COMPLIANCE WITH THE CALIFORNIA CONSUMER PRIVACY ACT IN THE WORKPLACE: WHAT EMPLOYERS NEED TO KNOW

By Lydia F. de la Torre and Lauren Kitces[1]

I. INTRODUCTION

The California Consumer Privacy Act (CCPA) represents a quantum leap in consumer privacy and a major change in the regulatory framework applicable to companies doing business in California. The CCPA goes into effect on January 1, 2020, and imposes limits on the collection and sale of personal information by organizations that meet certain thresholds ('businesses') and provides certain individuals ('consumers') with four different rights and asserts an obligation on businesses: the right to opt-out of data sales (opt-in for minors), the right to delete, the right to know, the right to not be discriminated against for exercising any of the preceding rights and the obligation to inform. While the law contains certain limitations, at its core, it is based on the idea that consumers should have transparency regarding the use of their personal information, and control over aspects of its use.

The CCPA regulates the processing of data of 'consumers' and defines consumer to mean: (i) a natural person who is a California resident, as defined in Section 17014 of Title 18 of the California Code of Regulations, as that section reads on September 1, 2017, (ii) '*however identified, including by any unique identifier*'.[2] The term 'resident,' as defined in the law, includes (1) every individual who is in the State for a reason other than a temporary or transitory purpose, and (2) every individual who is domiciled in the State and is outside the State for a temporary or transitory purpose.[3] Accordingly, the CCPA applies to employee data, contractor data, applicant data, and the data of company officers and directors who are residents of California.

The core of the CCPA is the broad definition of 'personal information.'[4] Due to this expansive definition, employers should assume that any information they might collect

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2 Cal. Civ. Code Sec. 1798.140(g).

3 For an article providing a detailed explanation on what is a 'consumer' under the CCPA, see https://medium.com/golden-data/what-is-a-consumer-under-the-ccpa-fcdcfec776f0.

4 Under Cal. Civ. Code Sec. 1798.140(o)(1) "Personal Information" means information that identifies, relates to, describes, is reasonably capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household.' There is pre-existing California law that aligns with this definition. In particular, Cal Civ. Sec. 1798.80 (e) defines personal information as "any information that identifies, relates to, describes, or is capable of being associated with, a particular individual, […]."

and keep on any California resident who applies to work, works, or has worked for them is subject to the CCPA.

Guidance on the applicability of the CCPA in the workplace context will evolve as the Office of the Attorney General of California ('Attorney General') promulgates rules during 2020 and beyond. The CCPA requires rulemaking to be issued on specific topics, and also empowers the Attorney General to issue rules and provide guidance to address any aspect of the CCPA.[5] Public forums were held January through March of 2019. A notice of Proposed Regulatory Action ('Notice') is expected during the fourth quarter of 2019. After that, a new period for comments will open. Final rules are expected mid-2020. On October 2019 the Attorney General filed a notice of proposed rulemaking action[6] and published a proposed text for the CCPA regulations ("Proposed Rules").[7] The comment period on the Proposed Rules will be open through December 6, 2019.

This article provides a high-level overview of how the CCPA will impact an employer's privacy obligations under California law and identifies steps that employers should consider taking in order to minimize regulatory risks. The recommendations discussed in this article will not suffice to provide a complete picture of how any given individual organization will be impacted by the CCPA and does not constitute legal advice. It is essential for impacted employers to consult experienced privacy counsel in order to understand their specific exposure to the CCPA and plan accordingly.

II. EMPLOYEE PRIVACY IN CALIFORNIA PRIOR TO THE CCPA

In California, workers[8] have greater rights of privacy than in many other states. A worker's right of privacy begins with the California Constitution and is bolstered by various laws. In addition to the employee privacy regulations specified in the California Labor Code (cited below), employers have an obligation to comply with all general California privacy laws (i.e., laws that apply outside of the employment area such as the Fair Credit Reporting Act ('FCRA') and the Health Insurance Portability and Accountability Act ('HIPAA')).

Pre-CCPA privacy laws were typically conditioned on the existence of a 'reasonable expectation of privacy' and informing workers through handbooks, log-in scripts, and other means was generally sufficient to dismantle such expectations. Notwithstanding existing statutes, employers could, relatively easy, effectuate a waiver of California workers' privacy rights through unilateral notices disclosing data practices, which effectively meant workers could expect limited privacy in the workplace.

5 Cal. Civ. Code Sec. 1798.185.

6 Available online at https://oag.ca.gov/sites/all/files/agweb/pdfs/privacy/ccpa-nopa.pdf

7 Available online at https://oag.ca.gov/sites/all/files/agweb/pdfs/privacy/ccpa-proposed-regs.pdf

8 For the purposes of this article, the term "worker" will be used to refer to *all* the following categories of individuals (provided that they are residents of the State of California): applicants (successful and unsuccessful), former applicants (successful and unsuccessful), workers (current and former), agency staff (current and former), casual staff residing in California (current and former), and independent contractors/consultants (current and former). Similarly, the term "employer" refers to an entity who has a worker providing their personal information.

Additionally, in certain circumstances California employers are expected (or legally required) to take actions that further limit workers' privacy rights. This includes, for example, taking affirmative steps to protect workers from harassment by co-workers, monitoring and enforcing compliance obligations under securities and financial laws, responding to government investigations, and producing evidence in discovery proceedings.

The pre-CCPA California laws specifically relevant to employee privacy include:

- **California Labor Code Section 96(k)**: Prohibiting employers from taking action against employees for lawful conduct that occurs away from the employer's premises during non-working hours.

- **California Labor Code Section 138.7(a)**: Regulating employer's access to worker compensation records.

- **California Labor Code Section 226:** Generally requiring employers to provide an employee's wage statement, but mandating that only the last four digits of an employee's social security number or identification number be printed on the statement.

- **California Labor Code Section 432.2**: Restricting the use of polygraphs on employees (similar restrictions exist at the federal level).

- **California Labor Code Section 432.7**: Including anti-discrimination provisions mandating that employers not consider juvenile criminal records as a factor in hiring, promoting, or terminating (subject to certain restrictions).

- **California Labor Code Section 435:** Generally prohibiting employers from causing an audio or video recording to be made of an employee in a restroom, locker room, or room designated for workers to change their clothes.

- **California Labor Code Section 980**: Generally prohibiting employers from demanding passwords and accessing social media accounts of employees and job applicants, except where it is reasonably believed to be relevant to an investigation of misconduct or violation of the law.

- **California Labor Code Section 1026:** Requiring employers to *'make reasonable efforts'* to safeguard the privacy of employees if the employee has enrolled in an alcohol or drug rehabilitation program.

- **California Labor Code Section 1198.5:** Granting employees the right to expect and receive copies of the personnel records that the employer maintains.

- **California Labor Code 6408(d):** Allowing access by employees or their representatives to accurate records of employee exposures to potentially toxic materials or harmful physical agents.

- **California Civil Code Section 52.7**: Prohibiting anyone from requiring, coercing, or compelling any other individual to have an identification device subcutaneously implanted, particularly by conditioning employment, employee benefits, or a promotion when consenting to the implant.

- **California Code of Civil Procedure Section 1985.6**: Mandating some specific rules that employers must observe when responding to subpoenas for the release of employee records.

- **California Fair Employment and Housing Act.**[9] Precluding employers from asking candidates about their age, national ancestry, religion, marital status, sexual orientation, or health conditions (subject to certain exceptions; similar restrictions exist at the federal level).

The CCPA expands workers' rights in various significant ways that are discussed in Section VIII below.

III. CCPA'S APPLICABILITY TO EMPLOYEE AND CONTRACTOR DATA AND THE WORKER DATA MORATORIUM

Following the enactment of the original version of CCPA in June 2018, the applicability of the CCPA to workers' data was the subject of debate. Reading the plain language of the CCPA, it was clear that the law regulated the personal information of consumers and defined 'consumer' to mean a resident of the State of California, which includes workers. However, a number of arguments were advanced to support the proposition that it was not the intent of the legislature to regulate workers' data.

The reasoning behind this argument centered mainly on the *'common understanding'* of the concept of a consumer as an individual who buys products or services for personal use. Following the passage of the CCPA, some organizations lobbied for a narrower definition of 'consumer' that would exclude both employees and contractors. Their efforts eventually resulted in the passage of a moratorium (hereinafter, the 'worker data moratorium') that partially carves out worker data until January 1, 2021. The worker data moratorium was enacted through consolidated bills Assembly Bill 25,[10] Assembly Bill 1355,[11] and Assembly Bill 1146.[12] Subsection (h) has been added to Cal. Civ. Code Sec. 1798.145, to state:

'(n) (1) This title shall not apply to any of the following:

> *(A) Personal information that is collected by a business about a natural person in the course of the natural person acting as a job applicant to, an employee of, owner of, director of, officer of, medical staff member of, or contractor of that business to the extent that the natural person's personal information is collected and used by the business solely within the context of the natural person's role or former role as a job applicant*

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9 Cal. Gov. Code Sec 12900-12996

10 Assembly Bill 25. Introduced by Assembly Member Chau (Coauthors: Senators Dodd and Hertzberg) on December 03, 2018, and available online at https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml? bill_id=201920200AB25.

11 Assembly Bill 1355. Introduced by Assembly Member Chau on February 22, 2019, and available online at https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB1355.

12 Assembly Bill 1146. Introduced by Assembly Member Berman on February 21, 2019, and available online at https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB1146.

to, an employee of, owner of, director of, officer of, medical staff member of, or a contractor of that business.

(B) Personal information that is collected by a business that is emergency contact information of the natural person acting as a job applicant to, an employee of, owner of, director of, officer of, medical staff member of, or contractor of that business to the extent that the personal information is collected and used solely within the context of having an emergency contact on file.

(C) Personal information that is necessary for the business to retain to administer benefits for another natural person relating to the natural person acting as a job applicant to, an employee of, owner of, director of, officer of, medical staff member of, or contractor of that business to the extent that the personal information is collected and used solely within the context of administering those benefits.

(2) For purposes of this subdivision:

(A) "Contractor" means a natural person who provides any service to a business pursuant to a written contract.

(B) "Director" means a natural person designated in the articles of incorporation as such or elected by the incorporators and natural persons designated, elected, or appointed by any other name or title to act as directors, and their successors.

(C) "Medical staff member" means a licensed physician and surgeon, dentist, or podiatrist, licensed pursuant to Division 2 (commencing with Section 500) of the Business and Professions Code and a clinical psychologist as defined in Section 1316.5 of the Health and Safety Code.

(D) "Officer" means a natural person elected or appointed by the board of directors to manage the daily operations of a corporation, such as a chief executive officer, president, secretary, or treasurer.

(E) "Owner" means a natural person who meets one of the following:

(i) Has ownership of, or the power to vote, more than 50 percent of the outstanding shares of any class of voting security of a business.

(ii) Has control in any manner over the election of a majority of the directors or of individuals exercising similar functions.

(iii) Has the power to exercise a controlling influence over the management of a company.

(3) This subdivision shall not apply to subdivision (b) of Section 1798.100 or Section 1798.150.

(4) This subdivision shall become inoperative on January 1, 2021.'

The worker data moratorium settles the question of whether the CCPA regulates worker data: it clearly does. The exclusions in the moratorium are limited, as discussed more fully in sections IV and V below. Absent further legislative developments, after 2020 all CCPA provisions will be fully applicable to worker data.

IV. WHICH EMPLOYERS ARE REGULATED BY THE CCPA?

The CCPA only applies to employers that qualify as a 'business.'[13] A 'business' can either qualify directly (if it meets certain requirements) or indirectly (if it controls or is controlled by a business that qualifies directly and operates under the 'common branding').

- To qualify directly, an entity must: operate for-profit, directly or indirectly collect data of *'consumers'*, *'alone, or jointly with others'*, determine *'the purposes and means of the processing'* (i.e. be a controller),[14] be established (*'do business'*[15] in the State of California), and meet one of three thresholds: (1) annual sales of $25M or more; (2) buy, sell, or share for *'commercial purposes'*[16] 50,000 or more personal records; or (3) derive 50% or more of its annual revenue from selling *'personal information'*.
- To qualify indirectly, an entity must be a parent or a subsidiary of an entity that qualifies directly and share common branding with that entity. A 'business' that qualifies 'indirectly' need not be established in California (i.e. do businesses[17] in the State), operate for profit, or determine *'the purposes and means'* of the processing.[18]

Even employers that operate mainly in the business-to-business space will be deemed a 'business' as to their workers' data if they meet the thresholds described above. Nonprofit entities will be exempt from compliance provided that they do not belong to a business group that qualifies directly as a 'business' and operate under the same brand. The Attorney General may issue further guidance or rules clarifying the applicability of the CCPA that could possibly exempt certain entities from compliance.

V. WHAT WORKER DATA IS REGULATED BY THE CCPA?

The broad definition of personal information means that employers should assume that any information they might collect and keep on any California resident who applies

13 Cal. Civ. Code Sec. 1798.140(c)(1)&(2)

14 For an explanation of the concept of controller under EU law, see https://medium.com/golden-data/what-is-a-controller-afd99a8ebd0a

15 For an explanation of the concept of 'doing business' in California, see https://medium.com/golden-data/what-is-a-doing-business-in-california-under-ccpa-90ddd964115b

16 For an explanation of what constitutes 'commercial purposes' under CCPA, see https://medium.com/golden-data/what-are-business-and-commercial-purposes-under-ccpa-ed45728aad0

17 *Id* at 13.

18 For an article on the general concept of 'controller,' see https://medium.com/golden-data/what-is-a-controller-afd99a8ebd0a.

to work, works, or has worked for them is subject to the CCPA. This would include the data of:

- applicants (successful and unsuccessful) who are residents of California;
- former applicants who are residents of California (successful and unsuccessful);
- employees who are residents of California (current and former);
- agency staff residing in California (current and former);
- casual staff residing in California (current and former);
- contract staff (i.e., independent contractors or consultants) residing in California (current and former);
- individuals acting as owners, directors, or officers who reside in California (current or former); and/or
- medical staff residing in California (current and former).

Since employers are generally required to identify the residency of their employees in order to comply with tax retention obligations, identifying whether an employee is a resident of California should not be problematic. However, identifying residency for staff hired through agencies, contractors, directors, and officers may require the employer to take additional steps.

Since the applicability of the CCPA is not limited to information collected or kept in electronic form,[19] employers also should assume that the CCPA applies to information kept in paper form.

Examples of personal information covered by the CCPA

Types of personal information relevant to the employment context include: traditional identifiers (e.g. name, address, phone number, social security number, email address etc.), job applicant information, benefits information, professional or employment-related information (e.g. compensation, performance reviews), geolocation information, internet activity (e.g. browsing history, interactions with websites), medical information not covered by HIPAA and/or characteristics of protected classifications and disabilities, employee emails, records of internal investigations, whistleblower hotline complaints, records of disciplinary proceedings, and even CCTV footage to the extent it captures images of workers.

Examples of personal information likely to be covered by the CCPA include:

- details of a worker's salary and bank account details held on an organization's computer system;

19 Cal. Civ Code Sec. 1798.175.

- an e-mail or handwritten notes about an incident involving a named employee in a supervisor's notebook which contains information on the employee, whether or not there is an intention to put that information in that worker's computerized personnel file;
- an individual worker's personnel file where the documents are filed chronologically by date, whether there is an index to the documents at the front of the file or not;
- an individual employee's personnel file where at least some of the documents are filed behind sub-dividers with headings such as: application details, leave record, and performance reviews;
- a set of leave cards where each worker has an individual card regardless of whether the cards are kept in alphabetical order or not; and
- a set of completed application forms, filed in alphabetical order within a file of application forms for a particular vacancy.

Examples of information unlikely to be covered by the CCPA include:

- information on the entire workforce's salary structure, given by grade, where individuals are not named and are not otherwise identifiable;
- a report on the comparative success of different recruitment campaigns where no details regarding individuals are held; or
- a report on the results of 'exit interviews' where all responses are anonymized and where the results are impossible to trace back to individuals.

VI. CCPA EXCLUSIONS RELEVANT TO WORKER'S DATA

In addition to the worker data moratorium, several of the CCPA exclusions are particularly relevant in the employment context:

- **Health Data exclusion:** Personal information regulated by HIPAA and related federal and state health information laws is excluded from the CCPA.[20]
- **Fair Credit Reporting Act exclusion:** The FCRA generally preempts state level legislation, but the CCPA actually contains an explicit carve out for data subject to the FCRA (for example, employers obtaining consumer reports on prospective employees need not modify their practices to account for the CCPA).[21]
- **B2B communications moratorium:** There is a limited moratorium on CCPA's applicability to certain B2B information, which will expire on January 1, 2021. The exception is limited to communications and transactions occurring solely within the context of due diligence and situations where a product or service is provided or received. Under this moratorium, businesses will not have

20 Cal. Civ. Code Sec. 1798.145(c).

21 Cal. Civ. Code Sec. 1798.145(d).

to comply with their obligation to inform, provide access, or honor deletion requests with respect to B2B information. Businesses will still have to comply with opt-out and non-discrimination obligations.[22]

- **General exclusions:** The obligations imposed by the CCPA on employers do not apply to the extent that they could restrain the business's ability to: comply with federal, state, or local laws; comply with a civil, criminal, or regulatory inquiry, investigation, subpoena, or summons by federal, state, or local authorities; cooperate with law enforcement agencies concerning conduct or activity that the business, service provider, or third party reasonably and in good faith believes may violate federal, state, or local law; or exercise or defend legal claims.[23]

- **De-identified or aggregate data (as defined under CCPA):** De-identified and aggregate data are both excluded from the applicability of the CCPA. But the CCPA does define both categories in a narrow way. Therefore, employers wishing to rely on this carve out should carefully analyze if the data in question meets the CCPA de-identification or aggregation standards.[24]

CCPA and the California Workers Compensation System

The California Workers Compensation System (CWCS) is not expressly excluded from applicability of the CCPA. The Attorney General has broad authority to identify additional exemptions and a number of organizations have specifically requested that the CWCS be exempted.[25]

Given the fact that CWCS is a Constitutional mandate (under Section 4 of Article XIV of the California Constitution) and is already regulated under California law (see section II above), it would be logical for the Attorney General to include a full or partial CCPA exemption in updates to the Proposed Rules or in future rule-making. However, the Proposed Rules do not include any exemption for CWCS.

VII. HOW SHOULD EMPLOYERS PREPARE FOR CCPA COMPLIANCE?

The CCPA will take effect on January 1, 2020. With regards to workers' personal information however, given the worker data moratorium, the CCPA will go into effect in two phases:

- From January 1, 2020 to December 31, 2020 the CCPA will apply to worker data subject to the partial exclusion provided by the worker data moratorium.

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22 Cal. Civ. Code Sec. 1798.145 (n).

23 Cal. Civ. Code Sec. 1798.145(a).

24 Cal. Civ. Code Sec. 1798.145(a)(5).

25 *See, for example*, comments filed by Kammerer and Company Inc., on behalf of American Association of Payers, Administrators and Networks (AAPAN); Anthem Workers' Compensation; Coventry; MEDEX; Healthcare Risk and Insurance Management Society (RIMS)–California; and Small Business California, at page 344 of the combined PDF, including all written submissions available online at https://www.oag.ca.gov/sites/all/files/agweb/pdfs/privacy/ccpa-public-comments.pdf

- From January 1, 2021 onward all of the CCPA provisions will apply to worker data absent further legislative developments.

Accordingly, it is advisable for employers to organize their CCPA compliance efforts into two different phases: Pre-2020 and post-2020.

A. What Should Employers Do On Or Before January 1, 2020?

The worker data moratorium will significantly reduce certain qualifying employers' CCPA obligations, depending on their existing data management practices. The carve-out is generous, but not unlimited. Specifically, the following limitations apply to the worker data moratorium:

- **Context of the worker role limitation:** In general, the use of worker personal information by employers outside "*the context of the natural person's role or former role as a job applicant to, an employee of, owner of, director of, officer of, medical staff member of, or a contractor of that 'business'* is not covered by the carve out.[26]

- **Emergency contact information:** Personal information collected for emergency contact purposes is only excluded if '*collected and used solely within the context of having an emergency contact on file.'*[27]

- **Benefits administration data:** Personal information necessary to retain and administer benefits is only carved out '*to the extent that the personal information is collected and used solely within the context of administering those benefits.'*[28] That said, if such information were subject to HIPAA, it would be deemed permanently excluded from the CCPA as described in section VI above and remain subject exclusively to HIPAA instead.

Therefore, employers should bear in mind that using worker data for any purposes other than employment related purposes will likely result in the data falling outside of the scope of the worker data moratorium. Where worker data falls outside of the worker data moratorium, all the rights and obligations identified in Section VII.B. will apply on January 1, 2020.

In addition, the worker data moratorium is subject to two significant carve outs:

- **The right to be informed:** The worker data moratorium requires employers to provide certain information to workers. Employers may not undertake any new information collection protocols or use the already collected information without providing notice.[29] If the employer activities qualify for the worker data moratorium, a narrow reading of the relevant provisions leads to the conclusion that the notice obligations may be modest (i.e. limited to information surrounding

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26 Cal. Civ. Code Sec. 1798.145 (h)(1)(A).

27 Cal. Civ. Code Sec. 1798.145 (h)(1)(B).

28 Cal. Civ. Code Sec. 1798.145 (h)(1)(C).

29 Cal. Civ. Code Sec. 1798.100 (b).

what worker data is collected and how it is used).[30] However, providing a full CCPA notice on or before January 1, 2020 constitutes best practice.

- **Data breach litigation risks:** The CCPA creates a private right of action in the event of a data breach resulting from the failure to put in place reasonable security measures.[31] Remedies include injunctive relief and damages of no less than $100 and no more than $750 per consumer per incident. The worker data moratorium does not limit the applicability of this right. Employers' litigation risks in the event of a breach involving worker data will therefore increase significantly as of January 1, 2020.

It is important to note that the private right of action under the CCPA[32] is not predicated on the definition of personal information under CCPA, but on the more narrow definition of personal data under subparagraph (A) of paragraph (1) of subdivision (d) of Section 1798.81.5 of the California Civil Code.

Steps employers should take prior to January 1, 2020

- **Understand if you qualify for the worker data moratorium:** As above, using (or allowing others to use) worker data for any purposes other than employment related purposes will likely result in the data falling outside of the scope of the worker data moratorium. Accordingly, the first step that employers should take is to identify any situations in which they use or allow others to use worker data for non-employment purposes. This may include, for example, worker's contract details shared with third-party benefit providers where the contract permits the third party to use the details to market additional services to the worker. If the data falls outside of the worker data moratorium, all the rights and obligations identified in Section VII.B. apply as of January 1, 2020.

- **Know your data:** As the CCPA requirements are predicated on how employers collect, use, and share worker data, employers intending to comply with the CCPA should take stock of their data practices. This is typically achieved through a data inventory and mapping exercise. Employing a standardized taxonomy to catalog the data and, where possible, tagging the data is advisable as it can greatly facilitate compliance with the rights to know and delete. Once employers collect the necessary information, they can accurately assess their risks, identify their legal obligations, detect security issues, and isolate any problematic practices or operational inefficiencies. The discovery process should reveal what personal information employers hold about their workers, in which systems it is being held, and how that information flows within and outside of the employer's technology ecosystem. To the extent that worker data has already been mapped for compliance with other laws (such as the European Union's General Data Protection Regulation (GDPR)), employers may able to leverage the information they already have on hand.

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30 Cal. Civ. Code Sec. 1798.100(b).

31 Cal. Civ. Code Sec. 1798.150.

32 *Id.*

- **Adjust practices or provide full rights:** Employers that wish to take full advantage of the worker data moratorium, but may be sharing or using worker data outside of the context of employment, should adjust their practices before January 1, 2020. Employers that prefer not to adjust their practices should prepare to provide full CCPA rights to workers regarding data that falls outside of the scope of the worker data moratorium as of January 1, 2020.

- **Identify the notification process:** Employers should consider the need for different notification processes depending on whether the workers are applicants, employees, contractors, casual workers, officers, etc. The process selected should ensure that such individuals receive the notice. If the employer maintains an intranet page, providing notice through that portal may suffice for workers who have access to it. If data for applicants is collected through an online portal, posting notice on that portal may suffice to notify applicants. In any event, workers should have access to the notice and be informed of where it can be found.[33]

- **Draft the language:** As discussed above, if the employer moratorium applies, a narrow reading of the relevant provisions supports taking the position that employers need only identify the categories of personal information and the purposes (business or commercial) for which the categories are used. However, the best practice would be to provide a full CCPA privacy notice as described in Section VII.B.

- **Notify:** Before January 1, 2020, employers should notify workers of their privacy practices.

- **Reasonable security:** As of January 1, 2020, workers will have the right to bring a private right of action against any employer that suffers a breach of security, caused by a lack of reasonable security, which leads to: unauthorized access and exfiltration, theft, or disclosure of non-encrypted or non-redacted personal information of workers. Reviewing and strengthening existing security practices and implementing state-of-the-art controls during 2019 and beyond will be an important factor in reducing reputation, regulatory, and litigation risks. In particular, employers should explore how technical measures such as redaction or encryption could limit their potential liability.

- **Review record retention policies and practices:** Employers should evaluate their record retention (destruction/deletion) policies and practices to determine what periods are legally mandated and how long each category of personal information is in fact retained under current practices. A good record retention policy should identify the legal obligations that apply to maintaining worker's records and, if records must be kept for other reasons, the basis for the retention time frames. If the employer does not have a written record retention policy and schedules, or if the policy and schedules have not been updated recently, it is

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33 CCPA notification requirements are somewhat misaligned with an employer/worker scenario. For a detailed discussion on what may or may not constitute sufficient notification under CCPA, see Section VII.B.

advisable to address these shortcomings as soon as possible. Where there are no legal obligations to retain, employers should delete data as soon as it is no longer needed. Limiting retention to the extent possible during 2019 will significantly lessen the burden of compliance with the full CCPA rights in 2020 and beyond while simultaneously mitigating risks in the event of security breaches.

- **Review contracts with vendors:** Although the CCPA does not require that specific language be added to contracts with vendors that process worker data, it provides certain safe harbors for organizations that do. In addition, in order to operationalize the CCPA rights (such as the rights to know or delete), employers will need the cooperation of certain vendors. An initial step is to inventory all contracts in which the employer shares worker personal information with a vendor.

- **Training:** Although the obligation to provide training in regard to worker personal information is delayed by the worker data moratorium until January 1, 2021, it would be prudent for employers to take the steps necessary to ensure that their human resources staff is sufficiently knowledgeable to be able to respond to questions related to the applicability of the worker data moratorium during 2020.

B. What Should Employers Do Starting January 1, 2021?

New bills aimed at either expanding or extending the applicability of the worker data moratorium will likely be introduced during the 2021 legislative session in California. However, because it is uncertain whether such efforts will succeed, employers should prepare for full CCPA applicability to workers' data as of January 1, 2021.

Employers must understand the full scope of the individual CCPA rights that will be afforded to workers in 2021 and be ready to implement the systems and processes that will be necessary to respond to situations where workers exercise those rights.

VIII. WORKERS' RIGHTS UNDER THE CCPA

Once the CCPA is fully applicable to worker data (i.e., once the worker data moratorium has expired or the employer uses or plans to use worker data outside the context of their employment), workers will be entitled to exercise all their rights under the Act. These rights may raise particular issues in the employer/worker context, which will need to be carefully assessed. This section provides a high-level description of the workers' rights and identifies some of the issues they will raise in the workplace context.

In order to enable workers to effectuate their rights, the CCPA imposes certain related obligations on employers such as verifying the requesting worker's identity (authentication), promptly acting on worker requests, and updating privacy notices to include, among other things, a description of the California workers' rights, the purpose(s) of personal information collection, and identification of the categories of personal information that are 'sold' (as broadly defined by CCPA), collected, or disclosed for 'business purposes'.

In certain situations, the CCPA authorizes employers to decline to respond to workers' requests submitted under CCPA. Specifically:

1. an employer can assert that it is not subject to the CCPA (i.e. the employer is not a 'business' under CCPA);[34]

2. an employer can assert that the worker is not protected by the CCPA (e.g., the worker is no longer a resident in the State of California);[35]

3. the worker's request to exercise a right is not verifiable (i.e., the employer cannot properly authenticate the requesting individual);

4. the request would require the employer to re-identify data or otherwise link information that is not maintained in a manner that is considered to be personal information.[36]

A. Right to Know

Under the CCPA, workers will have the right to know, which provides them with access to their personal information and includes a limited right to data portability.[37] At a high level, workers will be able to (i) obtain confirmation of whether their personal information is being sold and other supplementary information, and (ii) access personal information about them that is being held by the employer.

This right must be exercised through a 'verifiable consumer request'. The employer must properly verify the requesting worker's identity, and then comply with the request within 45 days of receipt (an extension is possible if 'reasonably necessary,' but the worker must be notified). An employer may provide personal information to a worker at any time, but is not required to provide it more than twice in a twelve-month period.

The specifics of the access rights provided under the CCPA are complex but, at a high-level, they can be broken down into two categories:

- **Confirmation of data sold and general information:** For employers that 'sell' or disclose personal information for a 'business purpose,'[38] workers have the right to request the disclosure of the categories of personal information collected and sold, and the categories of third parties to whom the data is sold. In addition, workers have the right to be informed about the categories of personal information disclosed for a 'business purpose.'[39] Once the requesting worker's identity is verified, the employer must create two separate lists: one including the categories and sources of personal information sold and a separate list of categories and sources of personal information disclosed for 'business purposes.'[40]

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34 For more details, see Section IV above.

35 For more details, see Section V above.

36 Cal. Civ. Code Section 1798.145(i).

37 Cal. Civ. Code Section 1798.100.

38 For an explanation of what 'business purpose' means under CCPA, see https://medium.com/golden-data/purposes-for-processing-under-ccpa-3e329ddd218

39 Cal. Civ. Code Sections 1798.115(a)&(c) and 130(a)(5)(c).

40 Cal. Civ. Code Section 1798.130(a)(4).

In addition, employers must disclose the categories of third parties with whom the information is shared.

- **Specific pieces of information:** Finally, workers will have a right to request the disclosure of the specific pieces of personal information 'collected' (as broadly defined under CCPA) about them in the preceding twelve months. The information may be delivered by mail or electronically. If provided electronically, the information must be in a portable and, to the extent technically feasible, readily usable format that allows the worker to transmit this information to another entity without hindrance (this requirement is typically referred to as the CCPA's right to 'data portability'.)[41]

Under the pre-CCPA privacy laws, employment records are deemed confidential in California and disclosure is restricted absent a subpoena and notice. Workers have certain access rights under various California laws other than the CCPA but, until the CCPA, the right was limited to specific categories of data. In particular, a right to inspect exists for the following employment records: payroll records (Lab. Code § 226); documents signed during employment (Lab. Code § 432); personnel records including records related to performance or a grievance (Lab. Code § 1198.5); and OSHA records for employee exposures to potentially toxic materials (Lab. Code § 6408(d)). Failure to comply with these inspection rights gives rise to statutory damages. For example, Labor Code 226 requires employers to allow inspection of payroll records within 21 days after a request is made, or else the employee is entitled to $750 in statutory damages.

The CCPA's right to know significantly expands the right of access under existing California law and raises specific questions in the workplace context. For example, under the CCPA, workers can request access to confidential performance reviews or internal correspondence about themselves, with no exception for confidential information. Employers can generally deny access, however, if providing the information requested could *'adversely affect the rights and freedoms of other consumers.'*[39] It may sometimes be challenging for an employer to know when the right to know might adversely affect someone else's rights but, at a minimum, redactions to eliminate references to other identifiable individuals that may be referenced in the information that must be disclosed will be necessary. The Attorney General has broad authority to issue rules providing clarity on this point but the Proposed Rules do not address it.

B. Obligation to Inform

At a high level, the CCPA obligation to inform[42] requires, among others, the following elements to be included in the privacy notice:

- Information surrounding what worker data is collected and how it is used.[43]

41 Cal. Civ. Code Sections 1798.100(d) and 1798.130(a)(2).

42 Cal. Civ. Code Sections 1798.130(a)(5) and 1798.100(b).

43 *Ibid.*

- Details on what worker data is both sold and disclosed and if selling and/or disclosing is not happening, then a statement reflecting this.[44]

- A description of the worker's rights, and appropriate contact methods to effectuate those rights.[45]

- Information on the right to opt-out of the sale of worker data, and a link to the *'DO NOT SELL MY PERSONAL INFORMATION'* button that is required to be made available on the homepage.[46]

Disclosure of privacy practices to workers though policies and other documents is not new in California. For example, notices and policies are currently used to disclose the use of workplace monitoring in order to diminish expectations of privacy as mentioned in Section II above. The California courts have reinforced the importance of employers maintaining and widely publicizing notice with respect to the use of technology in the workplace and have upheld an employer's right to monitor its workers' computer use so long as there is a policy in place that makes it clear that workers have no expectation of privacy in regards to data transmitted on company systems.

The CCPA and Proposed Rules impose detailed notification obligations on employers and requires the notices to include very specific language. Although the CCPA requires a detailed breakdown describing data practices, it does not directly restrict the ability of employers to monitor workers. However, to the extent that such monitoring involves the use of vendors that gain access to worker personal information, the CCPA could impose indirect restrictions on monitoring. This is due to the fact that the CCPA imposes restrictions on data transfers to third parties that are deemed to constitute a 'sale' (see Section VII.B.1.c.).

C. Right to 'Opt-Out' ('Opt-In' for Minors Under 16) of Data 'Sales'

The CCPA gives workers, or their authorized agents, the ability to direct employers to stop selling[47] their personal information to third parties[48]. For children under 16 (whose personal information may be collected in certain workplace environments, such as a minor working at the local movie theater), employers must not sell personal information unless or until the employer obtains authorization from a parent or guardian (if less than 13) or the minor (when 13 or older) before selling.

Once the requesting worker's identity (or the identity of its representative and the authorization to represent) is verified, the employer must stop selling personal information to third parties. The worker may subsequently provide express authorization for the sale of personal information. The employer must respect the worker's decision to opt-out for

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44 Cal. Civ. Code Sections 1798.115(c)(1), 115(c)(2), and 130(a)(5)(C).

45 Cal. Civ. Code Section 1798.130(a)(5)(A).

46 Cal. Civ. Code Section 1798.135(a)(1)-(a)(2).

47 For an explanation of what constitutes a data sale, see https://medium.com/golden-data/what-is-a-sale-under-ccpa-b27fbe8a527.

48 Cal. Civ. Code Section 1798.120.

at least 12 months before requesting a new authorization from the worker to the sale.[49] The personal information collected in connection with the exercise of the right to opt-out may be used by the employer for complying with the request, even where such use could be otherwise considered a sale under the CCPA.[50]

Most employers do not actively sell their workers' data in the usual sense of the word. Given the broad definition of sale under the CCPA, however, sharing agreements that may not be perceived by the employer as data sales could fall under the scope of the right to opt-out. Employers should carefully review all transfers of worker data to vendors to ensure that they do not fall within the CCPA definition of 'sale' in order to determine whether they are required to offer an opt-out to their workers.

D. Right to Delete Data

The CCPA gives workers a general right to request their employer delete personal information that the employer collected from them.[51]

The obligation to comply with a deletion request is subject to various exceptions, including the right of the employer to keep data if necessary to meet a legal obligation or for the employer's internal use if otherwise lawful and compatible with the context in which the information was provided by the worker. The majority of employee or applicant data will likely fall under one of these two exceptions.

In addition, employers can generally deny a deletion request if erasing the information could *'adversely affect the rights and freedoms of other consumers.'*[52] It sometimes may be challenging for an employer to know when erasing worker's personal information might adversely affect someone else's rights. Consider, for example, situations when a worker requests deletion of disciplinary records that are outside of a statutorily prescribed retention period, but potentially relevant to future situations involving allegations of workplace harassment. The Attorney General has broad authority to issue rules and guidelines providing clarity on this point, but the Proposed Rules do not address it.

E. Right to Not Be Discriminated Against for Exercising a Right Under CCPA

The CCPA generally prohibits discrimination against a worker for exercising his or her rights under the CCPA[53]. The examples of discrimination provided under the CCPA are not geared toward the employment context and include situations such as denying goods or services, charging different prices or rates for goods or services, or providing a different level or quality of goods or services. CCPA permits charging a different price, rate, level or quality of service in certain circumstances and also allows providing incentives in specific cases.

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49 Cal. Civ. Code Section 1798.135(a)(5).

50 *Ibid.*

51 Cal. Civ. Code Section 1798.105.

52 Cal. Civ. Code Section 1798.145(j).

53 Cal. Civ. Code Section 1798.125.

Although the CCPA anti-discrimination provision does not specifically refer to firing, declining promotion opportunities, or offering different terms of employment to workers who exercise their rights under the CCPA, any of those actions could be considered discriminatory if found to constitute retaliation against workers for exercising their CCPA rights. One of the open questions that will have to be addressed is which party bears the burden of proof in these situations. If any disciplinary decision taken after a worker exercises a CCPA right is to be conceived as retaliatory in nature absent proof to the contrary provided by the employer, the liability risk could be significant. The Proposed Rules do not address these issues.

IX. OTHER CONSIDERATIONS

In addition to requiring employers to respond to California workers' requests and give effect to their CCPA rights, the CCPA includes several additional obligations that apply to employers subject to limited exceptions summarized below.

A. CCPA Training

Employers are required to train and educate workers that handle CCPA consumer (including worker) inquiries about rights and related obligations prescribed by the CCPA[54]. In the context of employment, employers must ensure that their human resources team is knowledgeable about worker rights under the CCPA, and can assist workers wishing to exercise their rights under the law.[55]

Although the obligation to provide training in regard to worker personal information is delayed by the worker data moratorium until January 1, 2021, it would be prudent for employers at least to take the steps necessary to ensure that their human resources staff is sufficiently knowledgeable to be able to respond to questions related to the applicability of the worker data moratorium during 2020.

B. Designate Methods for Consumers to Assert Their Rights

An employer must implement two or more designated methods for workers to submit requests for information, including a toll-free telephone number (subject to certain exceptions not relevant in the employment arena).[56]

C. Contracts Containing Specific Criteria to Protect Privacy and Limit Exposure

There is no specific requirement in the CCPA to execute contracts. However, CCPA provides certain benefits where contracts containing specific language are executed[57] (e.g. in order to qualify as a 'service provider' as defined in the CCPA a written contract is required and, absent such contract, the sharing of personal data could potentially be

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54 Cal. Civ. Code Section 1798.130(a)(6).

55 Cal. Civ. Code Sections 1798.130(a)(1) and 1798.140(i).

56 Cal. Civ. Code Sections 1798.130(a).

57 *See, e.g.,* Cal. Civ. Code Section 1798.140(i) and (w).

deemed a sale subject to the right to opt-out/opt-in[58]). Careful drafting and signing of CCPA compliant contracts may have the additional benefit of reducing the liability of the employer in the event of lack of compliance by a vendor.

Because specialized CCPA compliant contract terms may be beneficial, employers should evaluate whether to enter into them, as well as examine the particular language to be included carefully.

D. Employee Responsibility and the CCPA

Although the CCPA does not directly impose any obligation on workers, it is important to remember that organizations are made up of individuals. Therefore, workers—as well as employers—must take responsibility if full compliance with the CCPA is to be achieved. For example:

- Managers are responsible for the type of personal information they collect and how they use it.
- No one at any level should disclose personal information outside the organization's procedures, or use personal information in company records for their own purposes.
- Anyone disclosing personal information without the authority of the organization may expose the organization to liability, unless there is a legal justification (for example, under 'whistle-blowing' legislation). Individual liability may also be an issue.

As a result, employers should consider developing and implementing policies that provide clear guidance to employees as to their responsibilities to support compliance with the CCPA in the specific context of their particular companies' lines of business.

X. RE-THINKING WORKER PRIVACY POST-CCPA: MOVING TOWARDS A BEST PRACTICES CODE

The CCPA represents a quantum leap for worker privacy in California, and employers should not put off self-examination of practices in light of the new rules. Moving forward, privacy compliance should become an integral part of employment practices. Focusing on fostering a culture in which respect for private life, security, and confidentiality of personal information are the norm is the key.

The Attorney General has not issued guidance on best practices for privacy compliance in the workplace context. However, the UK Information Commissioner's Office (the 'ICO') has published a useful Employment Practices Code[59] that outlines a number of recommendations. Although not modeled after the CCPA, the code is a useful resource to benchmark practices for employers wanting to understand the privacy issues and options in the workplace context.

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58 Cal. Civ. Code Section 1798.140(v); 1798.140(t)(2)(C).

59 The ICO Employment Practices Code is available online at https://ico.org.uk/media/for-organisations/documents/1064/the_employment_practices_code.pdf.

Some instructive recommendations contained in the ICO's Code, as adapted to California practice, are as follows:

1. Identify the person or group within the organization responsible for ensuring that the organization's employment policies and procedures comply with the CCPA and put in place a mechanism for checking that procedures are followed in practice.

2. Ensure that business areas and individual line managers who process worker information understand their own responsibility for privacy compliance and, if necessary, amend working practices and procedures in the light of this.

3. Assess what categories of personal information about workers are collected and maintained and who is responsible for it.

4. Eliminate the collection of personal information that is irrelevant or excessive to the employment relationship. If sensitive data is collected, ensure that it is strictly necessary and subject to appropriate access controls and security measures.

5. Ensure that all workers are aware that they can be liable if they knowingly or recklessly disclose personal information outside their employer's policies and procedures. Make serious breaches of data protection rules a disciplinary matter.

6. Consult workers, and/or trade unions or other representatives, about the development and implementation of employment practices and procedures that involve the processing of personal information about workers.

XI. CONCLUSION

The CCPA applies to worker data and will require employers to strike a balance between the legitimate privacy expectations of workers and their own interests in deciding how best to run their businesses, within the confines of the law. The legal requirements related to the applicability of CCPA in the context of employment will continue to evolve. The public comment period on the Proposed Regulations is open through December 6, 2019, and there is no definite date on which final regulations will be issued. The Attorney General is able to continue to issue proposed changes to the regulations once the final version is released, and further legislative developments are also possible.

In the meantime, employers should take immediate steps to reduce risks and embed privacy compliance in their employment policies and practices. Fostering a culture in which respect for private life, security, and confidentiality of personal information is the norm is key for organizations wishing to adapt to the stringent demands of the CCPA.

PROTECTING COMPANY CONFIDENTIAL DATA IN A FREE EMPLOYEE MOBILITY STATE: WHAT COMPANIES DOING BUSINESS IN CALIFORNIA NEED TO KNOW IN LIGHT OF RECENT DECISIONS AND EVOLVING WORKPLACE TECHNOLOGY

By Bradford K. Newman[1]

I. INTRODUCTION

California's long standing public policy of encouraging employee mobility is a hallmark of the state's start-up, tech-focused industry, and it is well understood that California Business & Professions Code section 16600 prohibits "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void[.]" However, when it comes to protecting a company's intellectual property ("IP"), and particularly trade secrets, from potential "insider" (i.e. employee) threats, employee mobility that includes the movement of employees to and from competitors poses unique challenges. The legal limits of specific measures designed to protect IP can be unclear and confusing. And many companies are not aware of the latest developments concerning protective measures they have long taken for granted as permissible. This article addresses some of steps companies should be utilizing to protect their valuable trade secrets, and explains a very recent but important change in the law regarding the enforceability of employee non-solicitation agreements.

II. ACCOUNTING FOR CORE TRADE SECRETS—WHAT PRECISELY WARRANTS PROTECTION?

Trade secrets are valuable corporate assets in the form of "information, including a formula, pattern, compilation, program device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."[2]

Such assets are often intangible, and before they can be protected, a company must internally identify precisely what constitutes its non-public, commercially valuable information. This can be a daunting task, especially when courts generally disfavor

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2 U.T.S.A. § 1(4); Cal. Civ. Code § 3426.1.

overbroad classifications of purported trade secrets.[3] Once core trade secrets are identified, companies can use a number of means to protect them, including, for example: (1) drafting, distributing and enforcing company policies designed to protect confidential information; (2) requiring employees to sign confidentiality agreements; (3) restricting internal access to confidential information; (4) restricting the use of certain computer media like cloud storage and USB devices; (5) electronically or physically tracking access to and disclosure of confidential information; (6) using confidentiality agreements with customers and licensees; and (7) implementing a high risk departure program, explained below. Based on recent developments in California jurisprudence, confidential information agreements can be especially valuable, as they can be used to prohibit an employee's use of confidential information even if the information does not rise to the level of a trade secret. Protective measures are a legal necessity, as courts increasingly focus not only on the substance of the alleged trade secret, but on what steps the corporation takes to protect them.[4]

III. UNDERSTANDING THE CAPABILITIES, AND GAPS, IN CORPORATE IT INFRASTRUCTURE: ESTABLISHING THE RULES AND A MONITORING PROGRAM FOR EXISTING EMPLOYEES

In light of the numerous and ever-evolving methods of data storage and transmittal, today's companies face significant hurdles in protecting their confidential information from potential exfiltration by current and departing employees. As one means of protecting IP, companies should engage in some form of forensic monitoring of their own systems. While companies should consult with local counsel regarding legal limits on certain forms of monitoring, this article sets out a few potential means of data theft of which employers should be aware.

At a minimum, companies should institute and distribute a computer usage and/or acceptable use policy that details the company's computer monitoring rules and various restrictions on an employee's activity. Monitoring for misuse of the corporate email system alone, through standard third party data loss prevention programs, is not sufficient. Companies must also determine what will be allowed as far as "off-server" storage and transmission of critical company data through cloud storage, attached USB drives, and

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3 *See*, *e.g.*, *Swarmify, Inc. v. Cloudflare, Inc.*, No. C 17-06957 WHA, 2018 U.S. Dist. LEXIS 91333 (N.D. Cal. May 31, 2018) (denying preliminary injunction where plaintiff's trade secrets encompassed "broad, sweeping *concepts* about streaming in general") (emphasis in original); *Founder Starcoin v. Launch Labs, Inc.*, No. 18-CV-972 JLS (MDD) (S.D. Cal. July 9, 2018) (denying preliminary injunction upon finding plaintiff's alleged trade secret was not particular enough to warrant protection as commoditizing celebrities through blockchain and cryptocurrency is general knowledge and not a novel idea).

4 *See*, *e.g.*, *Way.com, Inc. v. Singh*, No. 3:18-cv-04819-WHO, 2018 U.S. Dist. LEXIS 215243, at *28-29 (N.D. Cal. Dec. 20, 2018) (denying plaintiff's preliminary injunction and holding that "[e]ven if Way could successfully show that the information constitutes trade secrets, it is unlikely to be able to show that it used reasonable means to protect them. Way's person most knowledgeable testified that it protects all its asserted trade secrets by requiring employees to sign an Employee Handbook and PIAA agreement . . . It uses no other methods of protection."); *Natera, Inc. v. Progenity, Inc.*, 2014 Cal. Super. LEXIS 2179, *3 (granting motion for judgement on the pleadings without leave to amend relating to trade secret misappropriation claim under CUTSA upon finding plaintiff's "cautionary message" in its emails transmitting its purportedly secret customer lists were not reasonable efforts to protect its trade secrets).

mobile applications. Employees can easily transfer an almost unlimited amount of company data off the company systems through these means. Questions that must be answered include, for example, whether the company will ban (and electronically block) the usage of attached storage devices, restrict access to and use of third party hosted cloud storage providers, outlaw the use of mobile messaging applications like WhatsAPP, prohibit the transfer of data sets above a certain designated size, and store especially sensitive data on segregated servers to whom only specifically designated employees will be provided access credentials. Once these risks are accounted for, they must be implemented from an IT perspective and then monitoring and notification mechanisms put in place. Once this is accomplished, clear policies placing employees on notice of the rules should be disseminated and all employees should be educated and sign acknowledgement forms.

It should be noted that there are several additional technical means for preventing data theft that are beyond the scope of this article, and which will not be right for every company. Careful strategic thought, from a legal, technical and human relations perspective, is required before crafting the optimal and individualized plan for each company. The common requirements are the ability to identify what data requires the most protection and a complete understanding of the technology available to the employee base. Without this understanding, a company will never be able to craft a best-of-breed data loss program.

IV. PROTECTING INTELLECTUAL PROPERTY THROUGH CONTRACT

It is well-understood that a critical part of protecting data from insider threats involves requiring employees to sign agreements acknowledging the IP to which they will be exposed, confirming the company's legitimate need to protect such information, and agreeing to hold it in confidence and to use it only for the company's benefit. What many companies that operate in California do not know is that special language is required when it comes to protecting information that does not rise to the level of a trade secret and which in many other jurisdictions is colloquially referred to as "proprietary information" and often and incorrectly confused with a statutory "trade secret." And in light of recent case law, there is considerable confusion about the use of employee and customer non-solicitation agreements. Since almost every company uses some sort of contract as part of the effort to protect its IP, and too often times relies on a template form drafted years ago by outside counsel or a now departed in-house attorney, a clear understanding of California law in this regard is mandatory since the risk is that the company's "Confidential Information Agreement" will be deemed void and/or violative of the law, which can expose the company to liability under California's Private Attorney General Act (PAGA), Business and Professions Code section 17200 *et seq.* (unfair business practices) and a host of other potential risks.

A. Protecting Information That Does Not Rise to the Level of a Trade Secret

In data theft cases, for different reasons, both plaintiffs and defendants regularly argue over whether the information at issue is protectable when not a trade secret. To avoid preemption of common law claims under California's Uniform Trade Secret Act, the plaintiff-corporation in a trade secret case may argue that some or all of what is

at issue is merely "proprietary" rather than a statutorily protected trade secret. The defendant-employees and competitors may argue that the data is not a trade secret, and thus not protectable in any manner. This distinction between trade secret information and information that is non-public but does not rise to the level of a trade secret is a nuanced but important one that courts have grappled with over the years. In California specifically, a key Court of Appeal case and its progeny articulate the complexities of the issue that attorneys advising clients on data protection must thoroughly understand and account for when reviewing contracts designed to protect IP.

In *Silvaco Data Systems v. Intel Corp*,[5] the California Court of Appeal held that Silvaco's common-law claims (including claims for conversion, unlawful business practices, and conspiracy) were preempted because they overlapped with the plaintiff's trade secret misappropriation claim. In issuing its order, the Court found that there was no attempt "to identify any 'Silvaco property' other than the trade secrets supposedly used to create [the product]. The non-CUTSA claims therefore. . . . attempt to evade the strictures of CUTSA by restating a trade secrets claim as something else."[6]

In often cited *dictum*, the Court in *Silvaco* noted that "[i]nformation that does not fit [the statutory definition of a trade secret], and *is not otherwise made property by some provision of positive law*, belongs to no one, and cannot be converted or stolen. . . ."[7] How that bears in practice is somewhat an open question. Some cite to *Silvaco* for the proposition that all common law claims premised on the misappropriation of information that does not rise to the level of trade secret protection are preempted, as only trade secrets are afforded protection under California law.[8] However, others argue that, based on the Court's carve out for information "otherwise made property by some provision of positive law," the Court intended to exclude certain confidential information from preemption when it is affirmatively made the property of the company.[9]

Silvaco was followed by *SunPower Corp. v. SolarCity Corp.*, decided by the United States District Court for the Northern District of California.[10] In *SunPower*, Judge

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5 *Silvaco Data Systems v. Intel Corp.*, 184 Cal. App.4th 210 (Cal. App. 2010).

6 *Id.*, 184 Cal. App.4th at 240.

7 *Id.*, 184 Cal. App.4th at 239 n.22 (emphasis supplied).

8 *See e.g., Alta Devices, Inc. v. LG Elecs., Inc.*, No. 18-CV-00404-LHK, 2019 U.S. Dist. LEXIS 72952, at *19 (N.D. Cal. Apr. 30, 2019) ("CUTSA supersedes claims based on the misappropriation of information, regardless of whether such information ultimately satisfies the definition of trade secret.") (citing *Silvaco Data Systems v. Intel Corp.,* N. 8 *supra*, 184 Cal. App.4th at 236–240); *Heller v. Cepia, L.L.C.*, 2012 U.S. Dist. LEXIS 660 at *22 (N.D. Cal. Jan. 4, 2012) ("Therefore, Heller's common law claims against Cepia premised on the wrongful taking and use of confidential business and proprietary information, regardless of whether such information constitutes trade secrets, are superseded by the CUTSA." (citing *Silvaco Data Systems v. Intel Corp.*, supra, 184 Cal. App.4th at 236–240)).

9 *See PQ Labs, Inc. v. Yang Qi*, 2012 U.S. Dist. LEXIS 79354 at *12 (N.D. Cal. June 7, 2012) ("If a claim is based on confidential information other than a trade secret, as that term is defined in CUTSA, it is not preempted."); *TMX Funding, Inc. v. Impero Technologies, Inc.*, 2010 U.S. Dist. LEXIS 60260 at *13 (N.D. Cal. June 17, 2010) (holding that plaintiff could "continue to pursue [his] [tort claims] so long as the confidential information at the foundation of the claim is not a trade secret, as that term is defined in [the UTSA].").

10 *SunPower Corp. v. SolarCity Corp.,* 2012 U.S. Dist. LEXIS 176284 (N.D. Cal. Dec. 11, 2012).

Lucy Koh noted that the Court agreed with *Silvaco*'s holding that claims based on the misappropriation of information that ultimately fails to qualify as a trade secret may be superseded.[11] But Judge Koh concluded that, in light of *Silvaco*'s language regarding information "made property by some provision of positive law," claims based on "non-trade secret proprietary information" are not preempted if a defendant can allege facts that show that "the [non-trade secret proprietary] information . . . was 'made property by some provision of positive law,'" on grounds different from the UTSA, or that there is a material distinction between the wrongdoing alleged in the UTSA claim and that alleged in the non-UTSA claim.[12]

To avoid the pitfalls explained by Judge Koh in *SunPower*, it is critical that companies utilize contracts that specifically delineate the difference between the entity's trade secrets and less confidential information that the company nevertheless seeks to protect through contract. Specific language must be utilized, and experienced counsel familiar with this issue should be consulted to draft and/or review key provisions. Similarly, when asserting claims based on theft of information that does not rise to the level of a trade secret, a plaintiff-company in California should consider affirmatively pleading that the information has been made its property by "positive operation of law" vis-à-vis confidential information agreements.

B. Protecting IP Through Restrictions on Post-Employment Solicitation

1. California's Historic Prohibition on Non-Competition Agreements

In addition to specific contractual provisions protecting against disclosure of confidential information, companies should also consider the efficacy and enforceability of specific post-employment restrictive covenants that prohibit or limit customer and employee solicitation. This analysis will depend largely on where the company is located and where the employees in question primarily work and reside, as the law on restrictive covenants varies widely from state to state. While most states permit restrictive covenants that adhere to a rule of reasonableness,[13] in enacting California Business and Professions Code section 16600, the legislature long ago made clear that California's public policy strongly favors free employee mobility. Nevertheless, over the years the Ninth Circuit

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11 *Id*. at *13.

12 *Id*. at *14.

13 *See, e.g.*, *In re Document Technologies Litigation*, 275 F.Supp.3d 454 (S.D.N.Y. 2017) (applying rule of reasonableness to invalidate employee non-solicitation provision); *Miner, Ltd. v. Anguiano*, 383 F.Supp.3d 682 (W.D. Tex. 2019) ("[A] covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee."); *Emerick v. Cardiac Study Ctr., Inc.*, 170 Wash. App. 248, 254 (2012) ("Courts will enforce a covenant not to compete if it is reasonable and lawful."); *Lae Beauty v. Giansanti*, 2017 Fla. Cir. LEXIS 8980, *5 ("The Court may not refuse to give effect to a valid non-compete agreement on the ground that enforcement would have an overly burdensome effect on employee and the only authority the court possesses over the terms of a non-compete agreement is to determine the reasonableness of the time and area limitations.").

Court of Appeal created a judicial exception to the statutory prohibition against non-competes that colloquially became known as the "narrow restraint" exception to Section 16600. Under this exception, courts would enforce narrowly tailored non-compete agreements that prohibited employees from working in specified parts of a market, based on the logic that "only contracts that totally prohibit an employee from engaging in his or her profession, trade or business are illegal."[14]

In the landmark *Edwards* decision in 2008, the California Supreme Court rejected all attempts by courts to fashion judicial exceptions to Section 16600 that were not found in the statute itself.[15] Thus, in *Edwards*, the California Supreme Court unanimously held that a provision in an employment agreement that "partially" or "narrowly" restricted an employee from providing services to only particular (not all) customers in competition with a former employer was invalid under California Business & Professions Code Section 16600.[16] As the Court explained, the only exceptions to non-compete agreements between an employer and employee are the statutory exceptions the legislature explicitly included in § 16600 *et seq.*[17]

2. The Historical Approach to Employee Non-Solicitation Agreements

In *Edwards,* the Supreme Court declined to make any ruling as to the enforceability of Arthur Andersen's employee non-solicitation agreements, which operated to prevent the poaching of Arthur Andersen's workers by a recently departed employee.[18] Thus, between 2008, when *Edwards* was decided, and 2018, when *AMN* was decided, in unpublished and federal trial court decisions, California courts continued to follow the historical approach to enforcing post-employment employee non-solicitation agreements according to the Sixth District of the Court of Appeal's analysis in the seminal 1985 case of *Loral Corp. v.*

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14 *IBM Corp. v. Bajorek*, 191 F.3d 1033 (9th Cir. 1999) (restricting work for only one competitor); *General Comm. Packaging v. TPS Package* 126 F.3d 1131(9th Cir. 1997) (restricting work for only one customer and related entities introduced through that relationship); *Latona v. Aetna U.S. Healthcare Inc.*, 82 F. Supp. 2d 1089 (C.D. Cal. 1999) (declining to uphold a non-solicitation provision that was not narrowly tailored and would dramatically impact employee's ability to obtain future employment).

15 *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 942 (2008).

16 The pertinent provision at issue in *Edwards* stated: "If you leave the Firm, for eighteen months after release or resignation, you agree not to perform professional services of the type you provided for any client on which you worked during the eighteen months prior to release or resignation. This does not prohibit you from accepting employment with a client. For twelve months after you leave the Firm, you agree not to solicit (to perform professional services of the type you provided) any client of the office(s) to which you were assigned during the eighteen months preceding release or resignation." *Id.*

17 In *Edwards*, the California Supreme Court held that "[n]oncompetition agreements are invalid under section 16600 in California, even if narrowly drawn, unless they fall within applicable statutory exceptions of sections 16601, 16602, or 16602." *Id.* at 955.

18 *Id.*

Moyes,[19] in which the Court adopted a rule of reasonableness standard to enforce the use of the non-solicitation provision that prohibits departing employees from "raiding" the former employer's employees.[20] The Sixth District further held this restriction did not run afoul of Section 16600 as the "restriction only slightly affects employees. They are not hampered from seeking employment with [the defendant's new employer] nor from contacting [the defendant]. All they lose is the option of being contacted by him first."[21]

Following the *Loral* decision, California courts did not really adopt a strict "who contacted whom first test," but rather examined the particularized facts of each clause and controversy, and generally found that Business and Professions Code Section 16600 "invalidates agreements which penalize a former employee for obtaining employment with a competitor," but "does not necessarily affect an agreement delimiting ***how*** that employee can compete."[22] Under California law, "a former employee may engage in a competitive business for herself and compete with her former employer, provided such competition is fair and legal."[23] Further, such employee non-solicitation restrictions impact former employee's "conduct in a very limited way. [The employee] is not prohibited from recruiting anybody, just those within the employ of [former employer]."[24]

3. The Fourth District Changes Everything in *AMN*

For more than thirty years, *Loral* remained the standard in California for contractual employee non-solicitation agreements. But in November of 2018, everything changed. In *AMN Healthcare, Inc. v. Aya Healthcare Servs., Inc.*,[25] the California Court of Appeal for the Fourth District affirmed a lower court ruling that an employer's non-solicitation agreement constituted an unenforceable non-compete in violation of Business and Professions Code Section 16600.[26] *AMN* involved recruiters in the medical field, and soliciting nurses was part of the core job responsibilities of the employees at issue. The Fourth District found that the employees "were in the business of recruiting," and so the restriction on employee

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19 *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268, 278-79 (1985); *see, e.g.*, *Gartner, Inc. v. Parikh,* No. CV 07-2039-PSG, 2008 WL 11336333, at *9 (C.D. Cal. Oct. 10, 2008) (upholding the validity of an employee non-solicitation provision); *Am. Home Shield of California, Inc. v. Fid. Nat. Home Warranty Co.*, No. D039241, 2003 WL 21085278, at *8 (Cal. Ct. App. May 14, 2003) (unpublished) (noting that a provision prohibiting solicitation of employees could be enforceable); *Robinson v. Jardine Ins. Brokers Int'l Ltd.*, 856 F. Supp. 554, 558 (N.D. Cal. 1994) (declining to grant a preliminary injunction on an overbroad customer non-solicitation provision, but noting that "an employer may under certain circumstances contractually prohibit an employee from soliciting its clients or raiding its workforce for a limited period of time following termination of employment.").

20 *See id.* at 179 (noting that the former employee in that case was appropriately "restrained from disrupting, damaging, impairing or interfering with his former employer by raiding [his former employer's] employees under his termination agreement.").

21 *Id.*

22 *John F. Matull & Assocs., Inc. v. Cloutier,* 194 Cal. App. 3d 1049, 1054, 240 Cal. Rptr. 211, 214 (Ct. App. 1987) (emphasis added).

23 *Id.*

24 *Gartner, Inc. v. Parikh*, No. CV 07-2039-PSG, 2008 WL 11336333, at *9 (C.D. Cal. Oct. 10, 2008).

25 28 Cal. App. 5th 923 (Nov. 1, 2018).

26 *Id.* at 939.

solicitation "restrained [them] from engaging in their chosen profession."[27] Importantly, although the *AMN Healthcare* court took into account the defendants' specific profession as recruiters in making its ruling, the Court also broadly questioned the "continuing viability" of *Loral'*s use of a reasonableness standard in evaluating the enforceability of non-solicitation provisions in the wake of *Edwards v. Arthur Anderson LLP*, 44 Cal. 4th 937 (2008).[28]

In January 2019, two months after *AMN* was decided, Judge Beth Labson Freeman of the United States District Court for the Northern District of California issued her decision in *Barker v. Insight Glob., LLC*.[29] Relying on the California Court of Appeal's logic (and *dicta*) in *AMN Healthcare*, Judge Freeman revived the plaintiff-employee's previously dismissed claim brought pursuant to California Business & Professions Code Section 17200 challenging his employer's post-employment non-solicitation agreement. The District Court reasoned that in California, the "law is properly interpreted post-*Edwards* to invalidate employee nonsolicitation provisions."[30] Further, the District Court specifically rejected the notion that the *AMN Healthcare* holding was limited to the profession of recruiting: "the Court is not persuaded that the secondary ruling in AMN finding the nonsolicitation provision invalid under *Loral* based upon those employees'" particular job duties "abrogates or limits the primary holding."[31]

Even after *Barker*, some still questioned whether a new trend was at hand. Then, in April 2019, the Northern District applied *AMN Healthcare* and *Barker* in another case to invalidate an employee non-solicitation agreement. In *WeRide Corp. v. Huang*,[32] a different judge sitting in the Northern District of California denied a request by an employer for a preliminary injunction based on the company's employee non-solicitation provision because "the clause is void under California law."[33] The decision, authored by Judge Edward J. Davila, held that "the Court finds the reasoning of *Barker* and *AMN*, including their application of *Edwards,* to be persuasive," and noted that the plain language of Section

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27 *Id*.

28 *Id*. at 938-39 ("Because the *Edwards* court found section 16600 'unambiguous' (*Edwards, supra*, 44 Cal.4th at p. 950), it noted that 'if the Legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect' (*ibid*); and that it was up to the 'Legislature, if it chooses, either to relax the statutory restrictions or adopt additional exceptions to the prohibition-against-restraint rule under section 16600.' (*Ibid*.). We thus doubt the continuing viability of *Moyes* post-*Edwards*. But our decision in the instant case does not rest on that analysis alone. Even if *Moyes's* use of a reasonableness standard survived *Edwards*, we find *Moyes* factually distinguishable to our case. Unlike the former employee in *Moyes*, who was an executive officer of the plaintiff employer, in the instant case individual defendants were in the business of recruiting and placing on a temporary basis medical professionals, primarily nurses, in medical facilities throughout the country. If enforced, section 3.2 of the CNDA thus restrained individual defendants from engaging in their chosen profession, even in a "narrow" manner or a "limited" way. We thus independently conclude section 3.2 of the CNDA is void under section 16600.").

29 No. 16-cv-07186-BLF, 2019 U.S. Dist. LEXIS 6523 (N.D. Cal. Jan. 11, 2019).

30 *Id*. at *8.

31 *See Barker v. Insight Glob. LLC,* No. 16-CV-07186-BLF, 2019 WL 176260, at *3 (N.D. Cal. Jan. 11, 2019).

32 No. 5:18-cv-07233-EJD, 2019 WL 143934, at *10 (N.D. Cal. April 1, 2019).

33 *Id*.

16600 clearly prohibits restrictions on trade "of any kind" including post-employment contractual employee non-solicitation agreements.[34]

4. The Circuit Split Creates Additional Complications

As explained above, there is currently a split between two different districts within California's unified Court of Appeal. The Sixth District follows *Loral*, which holds that properly drafted employee non-solicitation provisions are lawful; the Fourth District follows *AMN Healthcare*, which holds all such agreements are void under Bus. & Prof. Code Section 16600. In California, where a split like this exists as to the same issue between two districts of the Court of Appeal and the Supreme Court has not weighed in, trial courts throughout the state must choose which of the decisions to follow.[35] And as to the federal district court rulings in *Barker* and *WeRide,* they will no doubt be persuasive in the Northern District of California, but from a purely legal perspective, are not binding on other California federal courts. In fact, other California federal courts, such as the Central District of California, have *permitted* employee non-solicitation agreements—although not since the *Barker* and *WeRide* cases.[36]

From a practical standpoint, until the California Supreme Court decides the issue, employers seeking to use and/or enforce these provisions must make some difficult, but hopefully informed, decisions that properly account for the trifecta of recent decisions, whether the other four districts of the Court of Appeal will follow *Loral* or *AMN*, and the risks of continued usage of employee non-solicitation agreements. These concerns are addressed below.

5. Risks for Employers Until the Supreme Court Decides This Issue

Throughout California, both foreign and domestic companies continue to utilize employee non-solicitation clauses, and employees continue to challenge them in the trial courts. Some major tech companies like Google have notified their employees that they will no longer use or enforce post-employment employee non-solicitation clauses.[37] Each company must make its own decision on the use and enforcement of these provisions

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34 *Id.*

35 *See Auto Equity Sales, Inc. v. Superior Court,* (1962) 57 Cal.2d 450 (holding that "[c]ourts exercising inferior jurisdiction must accept the law declared by courts of superior jurisdiction. It is not their function to attempt to overrule decisions of a higher court . . . [however] the rule under discussion has no application where there is more than one appellate court decision, and such appellate decisions are in conflict. In such a situation, the court exercising inferior jurisdiction can and must make a choice between the conflicting decisions.").

36 *See Sonic Auto., Inc. v. Younis*, 2015 WL 13344624, at *2 (C.D. Cal. May 6, 2015) ("[A] contract may prohibit employees, upon termination of their employment, from soliciting other employees to join them at their new employment.").

37 Google Ends 'No Poaching' Requirement for Former Employees, June 12, 2019, Hassan Kanu (https://news.bloomberglaw.com/daily-labor-report/google-ends-no-poaching-requirement-for-former-employees); Google says it's no longer punishing former employees who poach their colleagues; *see also* June 12, 2019 Luke Stangel (https://www.bizjournals.com/sanjose/news/2019/06/12/google-no-poach-clause-goog.html).

pending guidance from the California Supreme Court. To assist the decisional calculus, the following are some of the considerations that should be included in a risk matrix:

- **A PAGA Claim for Violation of Labor Code Section 432.5**. The Private Attorneys General Act ("PAGA") allows a private citizen to pursue civil penalties for violations of the California Labor Code that do not independently provide for damages.[38] Under Labor Code § 432.5, it is unlawful for an "employer, agent, manager, superintendent, or officer thereof" to require "any employee or applicant to agree, in writing, to any term or condition known" to be prohibited by the law. Thus, an essential element of establishing a PAGA claim based on a violation of Section 432.5 is a showing that the employer knew the term was prohibited by law. Based on the Court of Appeal split, employers may be able to defend against such claims by noting it is far from clear whether in fact these provisions are *prima facie* void as violative of Bus. & Prof. Code Section 16600.
- **Individual and Putative Class Actions Under Section 17200**. California courts have recognized that an employer's business practices concerning its employees are within the scope of Cal. Bus. & Prof. Code Section 17200 *et seq*. and have previously found non-compete agreements to be unlawful under this statute.[39] The *AMN Healthcare, Barker* and *WeRide* decisions increase the risk that employee non-solicitation agreements will likewise be the subject of UCL individual and collective actions.

6. Prohibiting Solicitation Through the Use of Confidential Information

It is well-settled that an employer can prevent trade secret information from being misused (in the context of employee solicitation or otherwise). Further, with regard to information that does not rise to the level of a statutorily-protected trade secret, but that is otherwise treated as confidential, nothing in the *Barker* or *WeRide* decisions prevents an employer from restricting misuse or dissemination.

However, whether employers in the Fourth District may bar post-employment solicitation of employees through use of confidential information that does not arise to the level of a statutorily protectable trade secret, remains an open question in light of the particular verbiage of the Court's decision in *AMN Healthcare*.[40] After finding the

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38 Cal. Lab. Code § 2699.

39 *See Application Group v. Hunter,* 61 Cal. App. 4th 881 (finding that an unlawful covenant not to compete was a violation of Section 17200).

40 *See, e.g. Destinations to Recovery v. Evolve Initiatives LLC*, No. B259011, 2015 Cal. App. Unpub. LEXIS 7946, at *17 (Cal. App. 2nd, Nov. 5, 2015) ("To be sure, defendants might use Destinations' trade secrets and proprietary information to solicit its patients and employees to migrate over to Evolve; to that extent, the nonsolicitation provisions are valid."); *Snelling Servs., LLC v. Diamond Staffing Servs.*, No. A135049, 2013 Cal. App. Unpub. LEXIS 5425, at *56 (Cal. App. 1st, July 30, 2013) (rejecting argument that CUTSA preempted unfair competition claim upon finding that it is possible that "some or all of the information alleged to have been misappropriated did not constitute trade secrets, but that the solicitation of Snelling employees using confidential salary information for the purpose of luring away Snelling's customers constituted unfair competition nevertheless.").

contractual prohibition on employee solicitation violated Section 16600,[41] the Court turned to AMN's tort claims, which were predicated on the defendant's alleged disclosure of AMN's confidential information prior to her resignation. In finding each claim failed as a matter of law, the Court noted that "section 16600 precludes an employer from restraining an employee from engaging in his or her profession, trade, or business, *even if such an employee uses information that is confidential but not a trade secret*."[42] But in subsequently addressing the claim for breach of the duty of loyalty specifically, the Court stated that, "to the extent defendant owed any duty to AMN not to disclose alleged AMN confidential information, the duty arose from [the contract] *and any breach of such duty would be grounded in contract, not tort*."[43]

7. The Use of A Foreign Law Selection Clause to Get Around the Non-Compete Ban: An Impermissible Workaround?

Because of California's pro-employee mobility policies and strict restrictions on the use of non-compete and non-solicitation agreements, historically, many companies (particularly those headquartered in other states) tried to protect their IP by utilizing restrictive covenants and confidentiality agreements that intentionally contained foreign choice of law provisions. In doing so, these companies would include a choice of law provision applying a law of a state that is regarded as more "employer friendly." California courts responded by often refusing to apply foreign laws that offended the state's fundamental public policies. Some companies then turned to mandatory forum selection provisions. Employees could still try to invalidate the forum selection clause in California state court. But the employers' odds of success were far better in federal court, because federal law strongly favors forum selection clauses.[44]

However, in 2017, California adopted the California Labor Code Section 925, which prevents employees from including foreign choice of law provisions with California-based employees so as to prohibit employee mobility. Specifically, companies that enter contracts with employees primarily living or working in California can no longer include foreign choice of law or forum provisions in non-negotiable, low-level agreements designed to protect intellectual property, prohibit customer solicitation, assign inventions, and the like. The law specifically empowers an employee to void foreign choice of law or forum selection provisions in an employment contract entered as a condition of employment, and if successful, to recover an award of reasonable attorneys' fees and costs.

While Labor Code Section 925 dramatically minimizes the use of foreign choice of law provisions, this Labor Code Section does not apply if the employee is represented by counsel in negotiating the terms of the agreement. Further, the provision only applies to contracts entered into, modified or extended after January 1, 2017, and as such, many long-term employees are not affected.

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41 Though the court dismissed AMN's breach of contract claim, it did not address the fact that a basis for the breach of contract claim was the asserted disclosure of confidential information under provision 2 of the contract (a separate provision than the non-solicitation provision in section 3.2).

42 *AMN Healthcare, Inc.*, 28 Cal. App. 5th at 940.

43 *Id.* at 941.

44 *See, e.g., Atlantic Marine Const. Co., Inc. v. U.S. Dist. Court for W. Dist. of Texas*, 571 U.S. 49 (2013).

V. THE NECESSITY FOR A HIGH RISK EMPLOYEE DEPARTURE PROGRAM

Data theft sometimes occurs at the moment when employees decide to leave for a competitor. The more senior the employee, and the more data to which they have access, the greater the risk. The goal of a high risk departure program is to proactively identify areas of risk, and then formulate and institute mitigating measures designed to avoid data theft where possible and to detect it early should it occur. The first step is to identify which employees (and/or job classifications) qualify as "high risk", and institute safeguards according to what is called a "high risk departure program."

High risk employees will vary by company, but often include those who leave the company on bad terms, employees who have a monopoly over niches of core company confidential information or lead in next-gen product development, short-term key hires, employees hired by a competitor who has a history of raiding, remote employees, and employees with exclusive or intimate key client or customer relationships.

Upon learning a high-risk employee might depart the company, internal processes should trigger a multi-layered and cross-disciplinary response. First, through communication with the employee's supervisor, human resources and the legal department, the company should immediately be able to answer three questions: (1) was the high risk employee privy to sensitive information; (2) did the high risk employee disclose she accepted a position with a competitor, or was evasive when asked, or do other reasons raise a concern she is going to work for a competitor; and (3) did the employee leave on good terms.

Second, as soon as a high risk employee gives notice, or when other signs indicate the high risk employee is leaving (including where the company decides to terminate the high risk employee for performance reasons), it is imperative that the company compile a list of relevant computer media, including all company and personal computers, electronic storage devices, phones, etc. that the employee has used in connection with her work for the company and make sure they are accounted for and returned prior to the final date of employment. A forensic image should be made of corporate emails and Internet usage over the company's servers and computer media. This data set should then be inspected for potential data theft and usage of unauthorized storage devices, cloud storage accounts and similar conduct that often accompanies improper data transfer. Throughout this process, companies should work with counsel to ensure the right forensic expert is retained, and where the employee works remotely in another state, pay particular attention to jurisdictional requirements relating to licensing of forensic investigators. The forensic expert must use software and protocols that have been proven reliable to courts. The hard drive of the high risk employee's company computer should be preserved for at least six months.

Once the termination or resignation is official, the employee should participate in an exit interview and sign an exit certification, detailing physical (hard copy documents) and digital company property still in the employee's possession, and affirming her agreement to work with company to ensure return of the property and continue abiding by the confidentiality and non-use obligations in the relevant contracts. Depending on the circumstance, the company should also conduct interviews with, and potentially inspect

and monitor the computers of, the employee's team members. It is also important to review (or send to outside counsel to review) confidential information agreements and other applicable contracts. IT, with buy-in from the high risk employee's supervisor, HR and legal departments, should also determine when and how to disable the employee's access and passwords. It is important to note that there are several other aspects of a high risk departure program, beyond the noted examples, that can be optimized on an individual company basis depending on the specific data at issue and the nature of the workplace.

VI. POTENTIAL APPROACHES FOR CIVIL LITIGATION: TROS AND PRELIMINARY INJUNCTIONS

Where litigation arises in data theft cases,[45] many plaintiff-companies seek a temporary restraining order ("TRO") at the outset of the litigation. This process often involves a significant amount of activity, with detailed briefing, expedited discovery, and evidentiary hearings that closely resemble a trial.

Typically, the request for a TRO is made alongside or immediately following the filing of the complaint. In other cases, a party may file a request for an evidence preservation order *ex parte*, and then request an order to show cause as to why a TRO should not be granted. In deciding to grant an *ex parte* evidence preservation order, the court does not look to the merits of the underlying claims.[46] Instead, the inquiry "concerns whether there is evidence in the [defendant's] computer[s] and other electronic storage media that [plaintiff] will be able to discover."[47] Courts are more likely to grant such *ex parte* orders where there is a risk that the defendant may destroy evidence, such as a case involving a defendant who previously lied about possessing company data or deleted such data.[48]

To the extent a party elects to move for a TRO, the motion must be supported by specific admissible evidence of misconduct evidence, usually in the form of a sworn declaration, of the irreparable harm a plaintiff will suffer if the TRO is not granted. In a trade secret case, as discussed above, the plaintiff must also describe the trade secrets with reasonable particularity, as well as the misappropriation that occurred. In deciding whether to issue a TRO pursuant to California Civil Procedure Code Section 527 (or Rule 65 of the Federal Rules of Civil Procedure), a court must weigh: (1) the likelihood that plaintiff will ultimately prevail on the merits; and (2) the relative interim harm to the

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45 Note that in trade secret cases filed in California, before commencing discovery on trade secret claims, plaintiffs must identify their alleged trade secrets "with reasonable particularity." Cal. Civ. Proc. Code § 2019.210. A recent Northern District of California case suggests that trade secret plaintiffs who significantly change their trade secret disclosure do so at their own peril, and courts may allow the opposing party to use the original disclosure to show the "shifting-sands nature" of the plaintiff's case. *See Swarmify*, No. C 17-06957 WHA, 2018 U.S. Dist. LEXIS 91333. As a result, it is important for employers to conduct a careful investigation, including forensic examination, before bringing suit for trade secret misappropriation.

46 *Dodge, Warren, & Peters Ins. Servs., Inc. v. Riley*, 105 Cal. App. 4th 1414, 1420 (2003).

47 *Id.*

48 *See ReadyLink Healthcare v. Cotton*, 126 Cal. App. 4th 1006, 1023 (2005) (where the defendant has already engaged in misconduct, courts are especially inclined to recognize the existence of a threat of future misconduct and issue injunctive relief).

parties from issuance or nonissuance of the injunction.[49] These factors are interrelated, such that "the greater the [] showing on one, the less must be shown on the other."[50] The moving party bears the burden of proof, and the court will balance the harms to each party in order to determine whether granting the TRO is appropriate.

In the event the TRO is granted, there is usually a statutory limit as to how long the TRO may remain in effect. Before the TRO expires, the court will schedule a hearing for a preliminary injunction. The hearing on the preliminary injunction is typically a full evidentiary hearing, with live witnesses, and pre-hearing discovery is typically very important as a result. In order to obtain expedited discovery, a plaintiff may wish to file a motion for expedited discovery alongside the request for a TRO. The plaintiff may also wish to file a proposed protocol for forensic inspection and a proposed protective order to ensure the parties' privacy is preserved.

A preliminary injunction is intended to prevent irreparable harm until the trial. "A preliminary injunction is an extraordinary remedy never awarded as of right."[51] The standard for obtaining a preliminary injunction is typically similar to the standard for obtaining a temporary restraining order. Generally, the movant must establish (1) likelihood of success, (2) irreparable harm, for which there is no adequate remedy at law, and (3) that denial will cause greater irreparable harm and suffering to the defendant than if the injunction is granted, and that (4) granting the requested relief serves the public interest more so than denial.[52] The ultimate determination of whether a preliminary injunction should issue thus turns on a careful balancing of all factors.

Although a preliminary injunction hearing bears some similarity to a trial, in that live witnesses, documentary evidence, and experts are presented, an injunction is "customarily granted on the basis of procedures that are less formal and evidence that is less complete than in a trial on the merits."[53] As such, courts may allow otherwise inadmissible evidence to be introduced at a preliminary injunction hearing.[54]

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49 *See Cohen v. Board of Supervisors,* 40 Cal. 3d 277, 286 (1985); *see also* Cal. Civ. Proc. Code § 513.010(b) (to obtain a TRO, the plaintiff need only show: (1) "the probable validity of [its] claim to possession of the property;" and (2) a probability of "immediate danger that the property . . . [will be] transferred, concealed, or removed, or may become substantially impaired in value").

50 *Butt v. State of California*, 4 Cal. 4th 668, 678 (1992); *Pleasant Hill Bayshore Disposal, Inc. v. Chip-It Recycling, Inc.,* 91 Cal. App. 4th 678, 696 (2001) (injunction appropriate where plaintiff demonstrated a high "likelihood of success on the merits," even if plaintiff could not "show that the balance of harm tips in [their] favor") (citation omitted).

51 *Winter v. Nat. Resources Def. Council, Inc.*, 555 U.S. 7, 24 (2008).

52 *Id.*

53 *U. of Texas v. Camenisch*, 451 U.S. 390, 395 (1981).

54 *Flynt Distribg. Co., Inc. v. Harvey*, 734 F.2d 1389, 1394 (9th Cir. 1984) ("The urgency of obtaining a preliminary injunction necessitates a prompt determination and makes it difficult to obtain affidavits from persons who would be competent to testify at trial. The trial court may give even inadmissible evidence some weight, when to do so serves the purpose of preventing irreparable harm before trial.") (citing 11 C. Wright and A. Miller, *Federal Practice and Procedure*, *Civil*, § 2949 at 471 (1973)).

VII. CRIMINAL ENFORCEMENTS

When a company discovers employee data theft, it must decide whether to pursue criminal charges. One benefit of referring a matter to law enforcement is a potential felony conviction for the former employee. However, a criminal case also requires a higher burden of proof, likely requiring more extensive evidence of data theft. It also limits the employer's control over case decisions and the evidence associated with the data theft. In pursuing criminal charges, the government typically relies on three main statutes: (1) the Economic Espionage Act;[55] (2) the Computer Fraud and Abuse Act;[56] and (3) the Mail and Wire Fraud statutes.[57] None of these statutes require a plaintiff to meet exactly the same elements as the Uniform Trade Secrets Act, but all three criminalize similar misconduct, including the theft or improper dissemination of confidential or sensitive information.

In recent years, federal prosecutors have focused extensively on combating economic espionage from foreign nationals. In today's political climate, there is a clear focus on international economic espionage, especially as it relates to China, perpetrated by "insider" employees.[58] Since 2012, more than 80% of cases have implicated China.[59] In light of this shift, companies should keep in mind the availability of criminal prosecution where there is evidence of serious data theft, particular where foreign entities are involved.

VIII. RECRUITING A COMPETITOR'S EMPLOYEES

On the other end of the spectrum, it is inevitable that a company will hire from a competitor at some point. Just as companies maintain data theft policies, programs and protocols, they should implement internal policies to ensure the company avoids legal liability where possible in connection with hiring from a competitor.

First, companies should carefully manage the recruiting process, particularly where third-party recruiters are involved. Regardless of whether an internal or third-party recruiting function is utilized, companies should implement an internal executive-level owner of the recruiting policy, who is also charged with training recruiters and updating the policy as technology evolves. Additionally, companies should manage the recruiting and advertising approach—under no circumstances should a company advertise

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55 18 U.S.C. §§ 1831 *et seq*. Note that the DTSA amends the federal economic espionage act to create a civil cause of action.

56 18 U.S.C. § 1030.

57 18 U.S.C. §§ 1341, 1343.

58 *See*, *e.g.*, *United States of America v. Weiqiang Zhang & Wengui Yan*, Case No. 2:13-mj-08318 (U.S. District Court for the District of Kansas) and *United States of America v. Hailong*, Case No. 4:13-mj-00267 (U.S. District Court for the Southern District of Iowa) (sentencing researchers trying to smuggle valuable trade secrets, in the form of rice seeds used to treat gastrointestinal diseases to prison time for conspiracy to steal trade secrets, conspiracy to commit interstate transportation of stolen property, and interstate transportation of stolen property); *United States v. Sinovel Wind Grp. Co.*, Case No. 13-cr-00084-jdp, 794 F.3d 787 (7th Cir. 2015) (defendants convicted of conspiracy to commit trade commit trade secret theft, theft of trade secrets, and wire fraud because Sinovel conspired to obtain AMSC's trade secrets so it could use them in the manufacture and retrofitting of their turbines without having to pay the more than $800 million dollars that they owed pursuant to the parties' contract).

59 https://www.cnbc.com/2019/09/23/chinese-theft-of-trade-secrets-is-on-the-rise-us-doj-warns.html.

a preference for hiring employees of a particular company, and recruiters should be trained carefully on appropriate questions to ask a candidate. Second, before the interview process, companies should know how the company learned of the candidate. Where there are particular risks involved, like if the candidate and referring employee both formerly worked for the candidate's current employer, the legal department should be involved.

Once the interview process has started, the company should take precautions to ensure the candidate does not disclose a third party's confidential information or trade secrets. At the outset of the interview, the candidate should review and execute a Candidate Letter and Certification, affirming that he or she can perform the outlined job functions without breaching any contractual agreements or disclosing third parties' intellectual property. The company should train its interviewers on protocols that assure the candidate that the company has no need to learn of, and does not want any, confidential or trade secret information the applicant has received at a current or prior employer. Further, the applicant should confirm she did not bring to the interview and will not use or disclose any prior employers' confidential information or trade secrets.

Before making an offer, the company should review the motivation for hiring the employee, particularly in light of potential accusations of trade secret misappropriation or unfair competition. Where there are concerns about potential liability, the company's legal department should be involved. In the offer letter and as part of the employee's onboarding process, the company should reiterate that it has no need or desire to learn any third parties' trade secrets or confidential information. Once the company makes a formal offer and the employee accepts, the company should ensure that the employee signs a Confidential Information and Inventions Assignment agreement. The provisions relating to third party information should be orally reinforced with the employee. The employees' managers and team should also be instructed on how to avoid breaching applicable contractual agreements pertaining to the new hire.

In some cases with high-risk new hires, it may make sense to use the company's IT Department or third-party forensic experts to conduct a random audit of a new hire's devices to ensure that the new hire has not violated company policies by porting a third party's trade secrets onto company computer media. Even absent full-blown "audits," it is important to check an employee's activity after he or she is hired to determine whether the employee has placed large amounts of data on company computers or shared drives or has solicited third-party confidential information from former colleagues.

IX. CONCLUSION

Companies doing business in California must be aware of the readily developing law that impacts their ability to protect their intellectual property. Particularly in light of major shifts in California courts' treatment of post-employment employee non-solicitation provisions, employers should revisit and optimize their contractual and other internal processes for protecting intangible assets.

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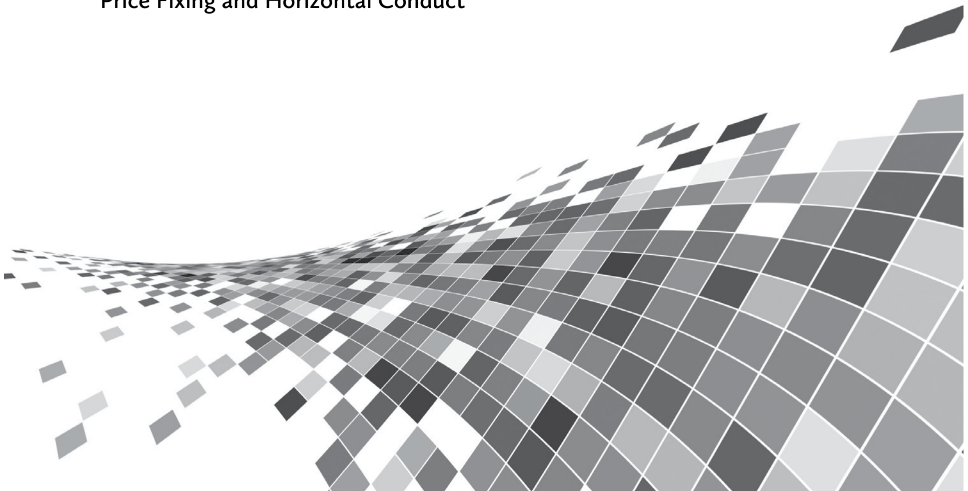

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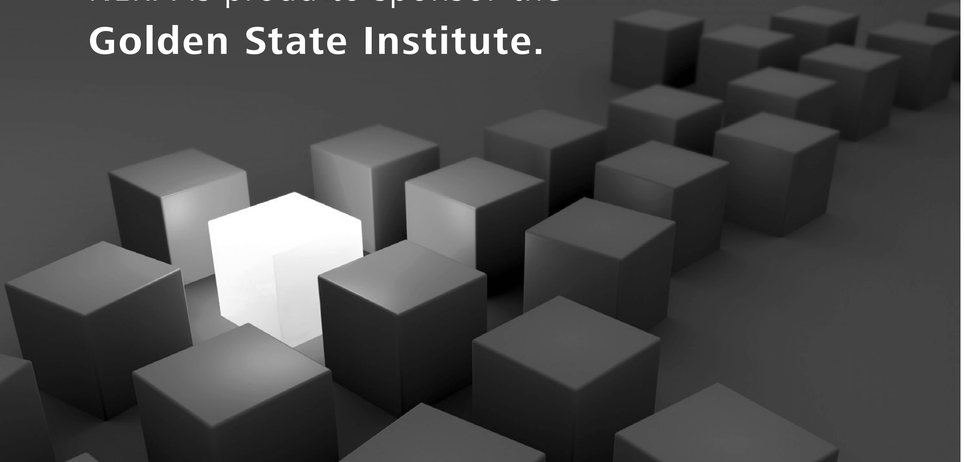

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