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Competition Policy for Labour Markets – Note by Herbert Hovenkamp

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Competition Policy for Labour Markets

By Herbert Hovenkamp*

1. Antitrust law in many jurisdictions defines its consumer welfare goal in terms of low consumer prices. For example, mergers are challenged when they threaten to cause a price increase from reduced competition in the post-merger market.¹ While the consumer welfare principle is under attack in some circles,² it remains the most widely expressed goal of antitrust policy in the United States.

2. We would do better, however, to define the consumer welfare principle in terms of output rather than price. Competition policy should strive to facilitate the highest output in any market that is consistent with sustainable competition.³ That goal is in most ways the same as a goal of pursuing lower consumer prices; that is, as output goes up prices go down. But thinking of consumer welfare in terms of output has other notable advantages. For example, while competitive firms do not control the market price, unless they are in cartels, each firm does control its own output.

3. Further, focusing entirely on price makes it awkward to work the supply side of markets into debates about consumer welfare. Labour markets are a notable example. Labour appears in the market as suppliers, not as purchasers. While consumers-as-consumers benefit from lower prices, combatting restraints in labour markets generally focuses on wage suppression. That is, today the principal problem of competition policy in labour markets is wages that are too low, not those that are too high.⁴ In some minds that creates an antinomy: restraints lead to higher prices on the consumer side of the market. Unrestrained labour markets lead to higher wages, which in turn lead to higher prices. By the same token, labour cartels, including some of the activities of labour unions, tend to raise the costs of labour and may have an upward effect on product prices.

4. But product consumers and labourers have one thing in common: just as consumers benefit from high output because it produces lower prices in product markets, so too labour benefits from high output because it increases the demand for jobs and, in the process, boosts wages. All other things including technology being unchanged, higher output requires more labour. Under perfect competition on both sides of the market, each worker

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¹ See, e.g., U.S. Dept. of Justice and Federal Trade Commission, Horizontal Merger Guidelines (Aug. 19, 2010), available at <https://www.justice.gov/atr/horizontal-merger-guidelines-08192010> (repeatedly expressing concern for higher prices resulting from mergers).

² See Herbert Hovenkamp, *Is Antitrust's Consumer Welfare Principle Imperiled?*, __ J. Corp. L. __ (2020) (forthcoming), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3197329.

³ Under robust competition a firm sets its price at or near marginal cost, just recovering a reasonable return on its fixed and variable costs. This output level is minimally sufficient to sustain a firm while giving it a competitive rate of return.

⁴ For a brief discussion of the problem of excessive wages see discussion *infra* concerning the labour immunity.

receives the marginal value of his or her production. In a very important sense, the fortunes of consumers and the fortunes of labour are linked together.

5. In the United States we have traditionally seen anti-labour policies as coming from the political right, through such means as right-to-work laws that drive wages down⁵ or other forms of anti-union activity. But today the competition policy advocated on the left has its own share of anti-worker sentiment, particularly in the form of attacks on low prices. Higher prices certainly harm consumers, but they also harm labour by reducing output.

1. Labour Markets: Assessing Power and Competitive Effects

6. When we speak of a competitive firm, we usually begin by thinking of its position in the market in which it sells. But firms can exercise market power on both the buying and the selling side of the market. Just as a firm with market power or a cartel restrains trade by reducing output and raising price in the product market where it sells, so to it can restrain trade by reducing its purchasing in an input market in order to suppress prices, including the price of labour.⁶ Some firms may have sufficient power to do this unilaterally. Others might do it by forming a buy-side cartel. In addition, some mergers yield the power to suppress wages.⁷

7. A particular firm does not necessarily have significant market power on both the selling and the buying side at the same time. Similarly, a cartel need not exercise power on both sides of its market. Some firms can have significant power on the buying side, but very little on the sell side, or vice-versa. Further, the boundaries of a market can differ substantially for a firm's buying and selling sides. A good illustration is the United States Supreme Court's 1948 decision in *Mandeville Island Farms*, which involved a cartel among sugar refining companies suppressing their purchases of sugar beets in order to lower input costs. Sugar beets are grown and shipped in small geographic areas because they are perishable agricultural products and transportation costs are high in relation to value. By contrast, the end product of sugar beet refining – table sugar – can be shipped at least nationwide. It need not be refrigerated, and shipping costs are lower in relation to value. This particular cartel of sugar beet refiners was limited to the northern part of the state of California, where there were only three purchasing refiners buying beets from farmers scattered over a small geographic range.⁸ As the Supreme Court observed, the beets subject to the cartel were all located in a small area of California. However, "...the beets

⁵ See, e.g., Elise Gould and Will Kimball, "Right to Work" States Still Have Lower Wages, Economic Policy Institute (Apr 22, 2015), available at <https://www.epi.org/publication/right-to-work-states-have-lower-wages/>. See also Sudheer Chava, Andras Danis, and Alex Hsu, The Impact of right-to-Work Laws on Worker Wages: Evidence from Collective Bargaining Agreements (Oct. 2018), George Tech Scheller college of bus. Res. Paper #18-1, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3088612.

⁶See Roger D. Blair & Jeffrey L. Harrison, *Monopsony in Law and Economics* (2010).

⁷ See discussion infra; and see Ioana Marinescu & Herbert Hovenkamp, *Anticompetitive Mergers in Labour Markets* ____ Ind. L.J. ____ (2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3124483 (impact of mergers in labour markets).

⁸ *Mandeville Island Farms v. American Crystal Sugar Co.*, 334 U.S. 219 (1948).

are converted into sugar and [then] the sugar starts on its interstate journey to the tables of the nation...”⁹ Indeed, the case itself was a challenge to the jurisdiction of the Court under the Constitution’s Commerce Clause, because the explicit restraint covered only the sugar beets grown within a single state, but the basis of jurisdiction was the post-production shipment of the refined sugar that was shipped nationally.¹⁰

8. The practical effect of the price fixing was that the cartel members produced less sugar, but that decrease in output very likely had little effect on the market price or market wide output of refined sugar, because the refined product was resold in a competitive market that was much larger than the market in which the sugar beets were purchased.¹¹

9. Labour markets often have similar characteristics. For example, many geographic markets for labour are relatively small for the simple reason that workers travel over a relatively narrow range.¹² By contrast, the geographic markets in which their employers sell the product can be much larger, although they are not necessarily so. Each market must be calculated individually. Further, firms maximise depending on the amount of power they have in a particular market, and those amounts differ on the buying vs. the selling side. Importantly, most workers who are already hired commute over a fairly narrow market. By contrast, job search distances can be larger, and sometimes much larger, but these are more akin to potential entrants rather than incumbent competitors.

10. This has some important implications for competition policy. First, restraints should be assessed in the particular market that is restrained. A good illustration is *State of California v. eBay, Inc.*,¹³ where the court approved an antitrust settlement shutting down a cartel involving a “no poaching” agreement between eBay, Inc. and Intuit, Inc., covering specialised computer engineers. These two firms are not competitors in the product markets in which they sale. Intuit makes business software, including popular consumer programs such as TurboTax and Quickbooks. By contrast, eBay is a general purpose online auction site that does not manufacture any computer software, although it sells some new and used Intuit products as a broker through some of its auction vendors. That is, the firms have

⁹ 334 U.S. at 228.

¹⁰ The decision thus overruled *United States v. E.C. Knight Co.*, 156 U.S. 1 (1895), which arose under similar facts. Sugar in that case was refined entirely within New York, but then later shipped across state lines. Briefly, earlier interpretations of the Supreme Court’s jurisdiction, including *E.C. Knight*, required that the challenged restraint govern transactions that were in commerce and actually crossed a state line. In its decision in *Wickard v. Filburn*, 317 U.S. 111 (1942) the Supreme Court expanded Commerce Clause jurisdiction to reach activities that were either in or “affecting” interstate commerce. *Mandeville Island Farms* was one of the earlier decisions applying this extended reach to the Sherman Act. See 1B Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶266 (4th ed 2013).

¹¹ Another fact that the Court did not mention is that after refining beet sugar is chemically identical to cane sugar and the two are widely regarded as distinguishable.

¹² Ioana Marinescu & Herbert Hovenkamp, *Anticompetitive Mergers in Labour Markets* __ Ind. L.J. __ (2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3124483; Ioana Marinescu & Roland Rathelot, *Mismatch: Unemployment and the Geography of Job Search*, 10 Am. Econ.J.: Macroeconomics 42 (2018); José Azar, Ioana Marinescu, Marshall Steinbaum & Bledi Taska, *Concentration in US Labour Markets: Evidence From Online Vacancy Data* (Nat’l Bureau of Econ. Research, Working Paper No. 24395, 2018).

¹³ 2014 WL 4273888 (N.D.Cal. Aug. 29, 2014)

virtually no competitive relationship in the product market, and a very limited vertical relationship through the sale of Intuit products on the eBay auction site. On the product side the two firms would not be considered competitors for merger analysis and would very likely be unable to profit from product price fixing.

11. Nevertheless, on the labour side the two firms compete for the same technically trained employees and could profit by agreeing to suppress wages. A no-poaching agreement for labour is the rough equivalent of a market division agreement in the product market. Basically, the firms agreed not to hire away one another's workers in a given specialty. In approving the settlement, the court summarised the allegations:

*eBay's agreement with Intuit eliminated competition for employees, and it harmed employees by reducing the salaries, benefits, and employment opportunities they might otherwise have earned if competition had not been eliminated. The agreement also distorted the competition among employers for skilled employees and likely resulted in some of eBay's and Intuit's employees remaining in jobs that did not fully use their unique skills. Additionally, the agreement harmed California's economy by depriving Silicon Valley of its usual pollinators of ideas, hurting the overall competitiveness of the region.*¹⁴

12. There was no claim that the no-poaching agreement affected product prices to consumers.

13. Cases such as *Mandeville Island Farms* illustrate that firms can operate in very different geographic markets on the buy and sell sides, and *eBay* illustrates that they can operate in very different product markets as well as geographic markets. Today it seems clear that most labour markets are geographically quite small, many of them no larger than the commuting range of employees.¹⁵ One consequence of this is that labour market concentration is in fact quite high, often significantly higher than product market concentration. Often the shipping range of manufactured products is considerably larger than the commuting or job search range of actual and prospective employees.¹⁶ Further, wages are forced down as labour market concentration is higher, just as product margins go higher as concentration goes up.

14. In general, EU law on the subject of competition policy and labour market restraints appears to be less well developed than United States law, although some member states have been more active. While EU competition law is much more enthusiastic about consumer welfare as a competition policy goal, it has tended not to connect this to the welfare of workers. While some fret that EU law is inadequately equipped to deal with worker welfare, the statutory tools seem to be adequate.¹⁷ Further, EU law appears to apply

¹⁴ California v. eBay, Inc., 2015 WL 5168666 (N.D.Cal. Sep. 3, 2015).

¹⁵ See Marinescu & Hovenkamp, *supra*.

¹⁶ See Marinescu & Rathelot, *Mismatch, supra*.

¹⁷ E.g., FREDERIK ALBERT HENDRIK VAN DOORN, THE LAW AND ECONOMICS OF BUYER POWER IN EU COMPETITION POLICY §§ 1.4, 4.2 (2015), <https://dspace.library.uu.nl/bitstream/1874/312604/1/Doorn.pdf>.

to buyer power generally;¹⁸ it simply has not been very much brought to bear on power vis-à-vis workers.

15. If consumer welfare is measured in terms of output rather than price, then a link between consumer welfare and worker welfare is easily seen. In general, the consumer welfare principle should encourage maximum output consistent with sustainable competition.¹⁹ That outcome would produce both lower prices for consumers and greater demand for workers.

2. Restraints on Output in Labour Markets

16. Nearly the full range of restraints that antitrust law has traditionally condemned in product markets can also be actionable in labour markets. These include mergers, collusion of various kinds,²⁰ information exchanges,²¹ and vertical exclusionary restraints analogised to exclusive dealing. Measurement problems are sometimes more difficult on the buy side of the market, particularly when reductions in purchasing can be explained by either increased efficiency or as an exercise of monopsony power. Although fact finding can be difficult, a welfare standard that focuses on output can appropriately check restraints in the labour market that result in lower output and suppressed wages and salaries. Restraints in the labour market are anticompetitive when they tend to suppress wages by reducing the output of labour.

2.1. Horizontal Mergers

17. Analysing the impact of horizontal mergers in labour markets promises to be a large growth area in merger enforcement. Proposed amendments to the United States merger statute would add a concern for “monopsony” to the monopoly concerns expressed in §7 of the Clayton Act.²² In fact, however, the provision already reaches monopsony. It simply has not been applied to purchasing market power very frequently.²³ While both §3 of the

¹⁸ E.g. Case No IV/M.784, *Kesko/Tuko*, 1997 O.J. (L 110) 53, ¶ 136).

¹⁹ See Herbert Hovenkamp, *Is Antitrust’s Consumer Welfare Principle Imperiled?*, __ J. Corp. L. __ (2020), available at https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=2987&context=faculty_scholarship.

²⁰ One important set of decisions not discussed at any length here are restraints, including wage and salary restrictions, placed on collegiate athletes. See *In re NCAA Grant-in-Aid Cr Antitrust Litigation*, 2019 WL 1747780 (N.D.Cal., Nov. 8, 2019) (condemning NCAA restrictions on athletic compensation under the rule of reason). See also *OBannon v. NCAA*, 802 F.3d 1049 (9th Cir. 2015) (similar).

²¹ E.g., *Todd v. Exxon Corp.*, 275 F.3d 191 (2d Cir. 2001) (sustaining complaint that petroleum companies exchanged information about certain classes of higher paid professional employees, with intent of limiting competition).

²² Consolidation Prevention and Competition Promotion Act, S. 1812, 115th Cong. (2017).

²³ See 4A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶980-982 (4th ed. 2016). There are a few decisions. See, e.g., *United States v. Pennzoil Co.*, 252 F. Supp. 962 (W.D. Pa. 1965) (granting preliminary injunction against merger alleged to suppress the merging firms’

Clayton Act (tying and exclusive dealing) and Clayton Act §2's Robinson-Patman price discrimination statute apply exclusively to sellers, the merger provision contains no such limitation.²⁴ It applies to any merger whose effects may be substantially to lessen competition or create a monopoly in any line of commerce, not distinguishing buyer from seller effects.

18. In appropriate cases merger analysis should include an investigation into the proposed merger's impact on the output of labour, and thus on wages. The evidence at this time suggests that the correlation between higher labour market concentration and downward pressure on wages is a strong or perhaps even stronger than the correlation between product market concentration and higher product prices.²⁵ Labour market merger analysis may also have an analogue to the rationale for higher market prices from "unilateral effects," although much of that work remains to be done.²⁶

19. One caution about analysing mergers in labour markets relates to the treatment of merger-specific efficiencies. Here is where focusing on output provides a good tool for analysis, although measurement problems should not be trivialised. Often mergers provide an opportunity for technical consolidation or streamlining that serves to reduce the demand for labour even though it increases the firm's output in the product market. For example, when two manufacturing firms that each have well developed dealership networks, such as automobile manufacturers, merge, one likely effect will be consolidation of dealerships. If each merger partner had one dealership in a community prior to the merger, the post-merger firm might close one of them, combining various services into one. The cost savings that result from such streamlining might reduce the demand for labour. But this could be consequence of efficient elimination of duplication, not an exercise of monopsony power. In that case, such a merger should increase the post-merger firm's product output to the extent that its costs are lower.

2.2. Horizontal Agreements; Anti-Poaching Clauses

20. Horizontal agreements involving labour should be subject to the ordinarily classification of naked and ancillary restraints.²⁷ Just as antitrust law distinguishes price fixing from various joint purchasing and selling activities on the sell side of the market, it needs to develop similar distinctions respecting the purchase of labour. For example, antitrust policy distinguishes price-fixing from joint bidding. The latter occurs when two people bid jointly for an asset that they intend to share or develop jointly. By the same token, certain types of employment agencies engage in joint bidding for the purchase of

purchases of crude oil after finding that the geographic market in which the firms purchased was much smaller than the one in which they sold).

²⁴See 15 U.S.C. §14 (tying and exclusive dealing, making it unlawful "to lease or make a sale..."); 15 U.S.C. §13 (applying to price discrimination "between different purchasers").

²⁵See Marinescu & Hovenkamp, *supra* note.

²⁶For a brief discussion, see Suresh Naidu, Eric A. Posner, & Glen Weyl, *Antitrust Remedies for Labour Market Power*, 132 *Harv. L. Rev.* 536, 578- 583 (2018).

²⁷ It appears that EU law has not yet addressed the issue.

labour services.²⁸ United States antitrust law has begun to address naked no poaching agreements, finding most of them to be unlawful per se. EU law is somewhat less developed.²⁹ A few cases have considered and upheld agreements attending a merger that for a relatively short term forbid the seller of a business from poaching off of that business's employees.³⁰ But these are best treated as ancillary restraints attending the sale of a business, which are ordinarily valid if they reach no further than necessary to protect the buyer's investment.

21. In markets for selling products and services, price information exchanges have been litigated many times because of the threat that they will facilitate collusion.³¹ By the same token, some employers might wish to exchange wage and salary information as a device for suppressing wages and these can be found unlawful, if their purpose or effect is to soften competition in wages or salaries.³²

22. Anti-poaching agreements among two or more competitors are increasingly common and just as dangerous to competition as product price fixing. No-poaching agreements among independent firms are analogous to market division, which, if naked, is unlawful per se. The equivalent would be if two firms agreed not to attempt to steal away each other's established customers. If two independent firms agree not to hire one another's employees, the agreement should be unlawful because it limits the ability of workers to take advantage of mobility in order to bargain for higher wages.

²⁸ E.g., *All Care Nursing Servs. v. High Tech Staffing Servs.*, 135 F.3d 740 (11th Cir. 1998), cert. denied, 526 U.S. 1016 (1999) (joint purchasing of nursing services). Cf. *Sewell Plastics, Inc. v. Coca-Cola Co.*, 720 F. Supp. 1196 (W.D.N.C. 1989), aff'd mem., 912 F.2d 463 (4th Cir. 1990), cert. denied, 498 U.S. 1110 (1991) (approving joint purchasing of bottles from a common facility where joint purchasing enabled scale economies in bottle production).

²⁹ See Dr. Petra Linsmeier & Dr. Cathrin Mächtle, *Non-poaching and Antitrust Law*, 37 EUR. COMPETITION L. REV. 145, 146 (2016) (noting that as of that writing EU competition law has not addressed the issue). See also Jean-Nicolas Maillard & Chiara Conte, *New Year's Resolution for EU Antitrust Compliance Teams: Putting HR on My Radar Screen*, STEPTOE ANTITRUST & COMPETITION BLOG (Jan. 8, 2019), <https://www.steptoiantitrustblog.com/2019/01/new-year-resolution-eu-antitrust-compliance-teams-putting-hr-practices-radar-screen/>. See also "War for Talents" in the Crosshairs of Competition Authorities, NOERR (Oct. 25, 2018), <https://www.noerr.com/en/newsroom/News/war-for-talents-in-the-crosshairs-of-competition-authorities.aspx> ("In the past on European level, no-poaching agreements were either reviewed as ancillary restraints to transactions or were occasionally examined in cartel proceedings along with other competition law infringements. In any case, there has been no decision by the European Commission dealing exclusively with no-poaching agreements."). There are, however, some cases in the national courts. See, e.g. *Abwerbverbot*, BGH, I ZR 245/12, BGHZ 201, 205–216 (Germany). Some other decisions are discussed in Dr. Petra Linsmeier & Dr. Cathrin Mächtle, *Non-poaching and Antitrust Law*, 37 EUR. COMPETITION L. REV. 145, 146 (2016).

³⁰ E.g., Case No IV/M.2386, *MEI/Phillips*, 2001 O.J. (C 332) 22, ¶¶ 1-2, 17; Case No IV/M.1482, *Kingfisher/Großlabour*, ¶ 1, 24 (April 12, 1999), http://ec.europa.eu/competition/mergers/cases/decisions/ml1482_en.pdf; Case No IV/M. 1167, *ICI/Williams*, ¶ 1 (Apr. 29, 1998), http://ec.europa.eu/competition/mergers/cases/decisions/ml1167_en.pdf.

³¹ See 12 Herbert Hovenkamp, *Antitrust Law* ¶¶2111-2114 (4th ed. 2019) (in press).

³² *Todd v. Exxon Corp.*, 275 F.3d 191 (2d Cir. 2001)

23. To be sure, firms may have an interest in protecting investment in employee education or some intellectual property rights such as trade secrets, which could be transported by a switching employee to another firm. However, employers do not need agreements with *each other* in order to achieve these results. It is in each individual employer's best interest to protect itself from improper theft of its own employees. As a result, a purely vertical noncompetition agreement should be sufficient for this purpose.

2.3. Purely Vertical Noncompetition Agreements

24. We speak of an arrangement as “purely” vertical when there is only one person on each side. That is, the agreement has no horizontal element. Of course, an employer may have a large number of identical agreements with its numerous employees, and then we must consider whether these employees can be said to be in agreement with each other. In the product market, the closest analogue to a vertical noncompetition agreement is exclusive dealing, although there are some differences. For example, exclusive dealing typically prevents a dealer or intermediary from dealing in the goods of multiple suppliers at the same time. For example, a dealer in Ford automobiles might be prohibited from selling new Toyotas or BMWs out of the same facility. One can imagine an agreement with an employee forbidding that employee from working for a competitor at the same time. In fact, however, labour non-compete agreements generally apply to sequential rather than simultaneous employment. That is, a worker may be forbidden by the agreement from terminating its employment with one firm and then going to work for a rival, often for a period of several months or even years.

25. Under United States antitrust law purely vertical agreements are treated under the rule of reason.³³ EU law is, if anything, even more benign than United States law.³⁴ That treatment has been justified with the explanation that a trained employee or one who has access to trade secrets or other confidential information may be in a position to harm a former employer or free ride on employer-provided training by taking it elsewhere.³⁵

26. Nevertheless, that leaves the question of what to do when an employer imposes noncompetition agreements on employees who have none of these characteristics. It does not seem unreasonable to require an employer claiming free riding of this sort as a defense

³³ *Nynex Corp. vs. Discon, Inc.*, 525 U.S. 128 (1998). An arguable exception remains for some tying arrangements. See 9 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶1720 (4th ed. 2018).

³⁴ For more detailed information about how individual jurisdictions treat restrictive covenants in Europe, see *Guide to Employee Non-Compete Agreements in Europe, Middle East and Africa*, MERITAS (2017), https://www.fcblegal.com/xms/files/Meritas_Guide_to_Employee_Non-Compete_Agreements_in_EMEA_2017.pdf. See also *A comparison of Laws in Selected EU Jurisdictions Relating to Post-Contractual, Non-Competition Agreements Between Employers and Employees*, NORTON ROSE FULBRIGHT (August 2017), <https://www.nortonrosefulbright.com/en/knowledge/publications/9807eea3/a-comparison-of-laws-in-selected-eu-jurisdictions-relating-to-post-contractual-non-competition-agreements-between-employers-and-employees>.

³⁵ See, e.g., *Golden Rd. Motor Inn, Inc. v. Islam*, 376 P.3d 151 (Nev. 2016) (acknowledging free rider justification for employee non-compete agreement but striking down challenged agreement as excessive); *Delaware Elevator, Inc. v. Williams*, 2011 WL 1005181 (Del. Chanc. March 16, 2011); *Amazon.com, Inc. v. Powers*, 2012 WL 6726538 (W.D.Wash. Dec. 27, 2012) (partially enforcing employee non-compete agreement).

to point to precisely the skills or proprietary information that an employee might have that justifies such a substantial restriction. For example, an employer who imposes a noncompetition agreement on a low level unskilled employee who has no training or protectable secret to share seems excessive. At the very least this requires a hard look at the employment market. The problem is much more severe when the agreement includes a horizontal element, including agreements that apply to several individually owned franchisees of a common franchisor.

2.4. Intra-Franchise Agreements

27. For completely independent firms to agree with each other to restrain employee mobility among themselves is and should be unlawful in most cases. Intra-franchise no-poaching agreements are more complex, however, because they have some of the characteristics of both vertical and horizontal restraints.³⁶ In a franchise system a single franchisor, or upstream party, enters into contractual agreements with numerous local franchisees to distribute the franchisor's product and also take advantage of the franchisor's branding and other intellectual property. Economically, a franchise can achieve most of the production efficiencies of a single firm, even though the franchise is organised as a contractual relationship among multiple firms rather than as a single entity.³⁷ Historically there was some ambiguity about whether the various franchisees and franchisor in such an arrangement should be regarded as a single entity lacking conspiratorial capacity for purposes of the Sherman Act, and thus subject only to §2's prohibitions for unilateral conduct.³⁸ In the United States, that question has been settled by the Supreme Court's *American Needle* decision, which found conspiratorial capacity between the NFL and its individual team franchises. These individual teams were separately owned and had

³⁶ In *Williams v. I.B. Fischer Nevada*, 794 F.Supp. 1026 (D. Nev. 1992), aff'd, 999 F.2d 445 (9th Cir. 1993) the court found that a franchisor and its franchisee were a single entity who could not conspire, and the Ninth Circuit affirmed on that basis. That conclusion is incorrect in light of *American Needle, Inc. v. NFL*, 560 U.S. 183 (2010). In any event, the no hire clause was apparently limited to managers that received significant training by each franchisee. The court then justified the restraint because they "prevent the franchises from 'raiding' one another's [] employees after time and expense have been incurred in training them. 794 F.Supp. at 1029.

³⁷ See Paul H. Rubin, *The Theory of the firm and the Structure of the franchise Contract*, 21 J. L. & Econ. 223 (1978). Cf. Ronald H. Coase, *Nature of the Firm*, 4 *Economica* 386 (1937).

³⁸ E.g., *Williams v. I.B. Fischer Nevada*, 794 F.Supp. 1026 (D. Nev. 1992), aff'd, 999 F.2d 445 (9th Cir. 1993) (concluding that franchisor and franchisee were single entity who lacked conspiratorial capacity). See Barry M. Block & Matthew D. Ridings, *Antitrust Conspiracies in Franchise Systems After American Needle*, 30 *Franchise L.J.* 216 (2011). For further economic criticism of *Fischer*, see Benjamin Klein, *Single Entity Analysis of Joint Ventures After American Needle*, 78 *Antitrust L.J.* 669, 678-679 (2013):

This rejection of contractual control as a basis for single entity treatment by the Supreme Court is fully consistent with the economics of the firm, which makes a similar fundamental distinction between control achieved through ownership and control achieved through a contractual arrangement. No matter how extensive a franchisor's contractual control may be over franchisee conduct, the contractual relationship between a franchisor and its franchisees is considered in economics to be an agreement between two separate firms, and not to involve a single integrated firm.

contractual arrangements with the NFL, but their activities were tightly controlled.³⁹ While franchise systems have some of the attributes of a single firm they also have distinct management and profit centers. Under *American Needle* some of a franchisor's decisions, such as the location of a corporate headquarters, belong to the firm as a single entity, but decisions that pertain to the operation of the franchisees individually are to be regarded as collaborative rather than unilateral. Employee movement among franchisees belongs in the latter category.

28. As contract partners rather than wholly owned subsidiaries of a common owner, the individual franchisees may have different interests than those of a similarly structured unitary firm. The story here is quite similar to the story of resale price maintenance or other vertical intrabrand restraints imposed upon dealers authorised to sell the same brand. Speaking of RPM, the dealers themselves have an incentive to keep their margins up, perhaps by fixing prices. By contrast, the manufacturer is incentivised to maximise its output, which is inconsistent with dealer price fixing. As a result, the contract arrangement can create conflicts and opportunities for anticompetitive behavior that full common ownership does not.

29. In recent years United States courts have confronted agreements among the franchisees of a single franchisor prohibiting the transfer of employees from one franchisee to another. For example, McDonald's, a major fast food franchisor, is involved in antitrust litigation attacking a scheme in which each individual franchisee's agreement contains a provision prohibiting that franchisee from hiring away the employees of a different franchisee of the same franchisor. The agreements are very broad, not limited to employees who have valuable training or trade secrets that could be subject to free riding.⁴⁰

30. A related issue governing intra-franchise agreements is whether they should be regarded as horizontal or vertical. Formally, the agreements are contained in franchise contracts between the franchisor and each individual franchisee, which would appear to make them vertical. At the same time, the numerous franchise agreements contain substantially identical provisions and, to the extent they involve restraints on movement among otherwise competing franchisees, they appear to be horizontal in effect.

31. In *Deslandes v. McDonald's*, the defendants argued that franchise-wide noncompetition agreements which applied to a wide variety of employees across McDonald's franchise system should be viewed, not as a horizontal agreement among franchisees but rather as a series of vertical agreements between McDonald's as franchisor

³⁹ *American Needle, Inc. v. NFL*, 560 U.S. 183 (2010).

⁴⁰ *Deslandes v. McDonald's USA, LLC*, 2018 WL 3105955 (N.D.II. June 25, 2018). The challenged clause in the McDonald's franchise agreement provides:

Interference With Employment Relations of Others. During the term of this Franchise, Franchisee shall not employ or seek to employ any person who is at the time employed by McDonald's, any of its subsidiaries, or by any person who is at the time operating a McDonald's restaurant or otherwise induce, directly or indirectly, such person to leave such employment. This paragraph [] shall not be violated if such person has left the employ of any of the foregoing parties for a period in excess of six (6) months.

and each of its individual franchisees.⁴¹ The agreement applied even to low skill employees and forbade them from going to work for a different McDonald's restaurant for six months after their employment at the previous restaurant terminated. As the court observed, given their low wages for most employees this six month period effectively prevented them from moving at all.

32. The issue of inter-franchise transfer of employees exposes an important difference between firms and franchises. A single firm that owns multiple plants or stores might certainly have a policy governing employee transfers from one plant to another, but typically, it would permit or even encourage some of them in order to optimise overall productivity. As a result unitary firms do not typically have blanket prohibitions on the movement of employees from one plant or store to another.⁴² As a general matter it is in a firm's best interests to use its employees in the most profitable way, and if an employee is valued more at a different location the firm will agree to the move or sometimes even reassign an employee to the different location. That observation is simply an example of the general proposition that economic actors continuously move their resources from positions of lesser value to those of great value. For example, if production of a given product is cheaper at one plant than another, the plants' owner will have an incentive to move production to the lower cost plant. By the same token, if an employee promises to contribute more to the value of the firm in a different location, the employer will have an incentive to move that employee. By contrast, individual franchisees maximise the value of their individual locations. This inclines them to be more resistant to inter-firm movement that might deprive them of valued workers.

33. One rationale for employee noncompetes is of course that the employee has received significant training or perhaps possess trade secrets or other valuable information. As a result, the noncompete agreement controls free riding that might occur when a second employer takes advantage of the first employer's investment in this training. In the case of employees at the different locations of a common franchisor, the employee training and trade secret rationales for noncompetition agreements are more difficult to defend. As a general matter franchising is developed in order to create a system where all the stores of a particular franchisor are more or less the same. As a result, one would not expect to find that a particular franchisee of, say, McDonald's had trade secrets or specialised training that was not communicated to all franchisees. Indeed, it would generally be in a franchisor's best interest to have valuable learning communicated across its individual franchisee, just as a unitary firm would ordinarily profit from communicating efficiency-enhancing information to all of its various plants. This fact alone suggests that broad limitations on inter-franchisee transfer of employees be regarded with suspicion. In any event, the usual free rider rationales for limiting inter-employee transfer should not be accepted without clear proof that they apply in a particular case. The tribunal should also ask whether such policies are overly broad in relation to any articulated and provable justifications.

34. What all of this suggests is that the real initiative for these franchise wide agreements covering all types of employees is not the protection of learning at all, but rather

⁴¹ See Defendant's Reply Brief in Support of its Motion to Dismiss, 2017 WL 6379219 (N.D.Ill. Dec. 11, 2017). See also *Deslandes v. McDonald's USA, LLC*, 2018 WL 3105955 (N.D.II. June 25, 2018).

⁴² See John Lai, Steven S. Lui, and Eric W.K. Tsang, Intrafirm Knowledge Transfer and Employee Innovative Behavior: the Role of Total and Balanced Knowledge Flows, 33 *J. Prod. Innov. Mgmt.* 90 (2016), available at <https://onlinelibrary.wiley.com/doi/pdf/10.1111/jpim.12262>.

cartel suppression of wages. In this context, a blanket prohibition on inter-franchisee hiring seems egregiously excessive and raises significant competitive concerns.

3. Anticompetitive Occupational Licensing

35. On topic that needs more empirical study is the effect of excessive occupational licensing on the mobility and earnings of some groups of employees. While the issue has arisen numerous times in United States antitrust decisions, it came to a head in the Supreme Court's 2015 decision in *FTC v. North Carolina Dental Assn.*⁴³ A divided Supreme Court struck down a rule promulgated by a professional association controlled by dentists that declared the service of teeth whitening to be a part of the practice of dentistry, with the result that only licensed dentists could engage in it. The case applied U.S. antitrust law's "state action" doctrine, which condemns private restraints unless they are both "authorised" by the state itself and adequately "supervised" by a disinterested state agency.⁴⁴

36. The basic problem is easily understood. Governments rightfully leave certain aspects of control of the so-called learned professions to participants in those professions. At a basic level that makes sense because regulation requires knowledge that only the trained professionals are likely to have. At the same time, however, it creates significant opportunities for anticompetitive overreaching, particularly when associations that have quasi-legislative power and are dominated by market participants pass rules that protect themselves at the expense of others. For example, the record in the *North Carolina Dental Association* case show numerous complaints from dentists about the lower prices charged by non-dentists provision of teeth whitening, mainly dental hygienists and cosmetologists. However, it showed no evidence that these providers as a group had more complaints about the quality of their service or were more likely to be a public danger. In sum, the dentists were protecting themselves as individuals from low prices; they were not protecting their profession from people offering deficient treatment.

37. In the United States this presents mainly a problem of federalism – namely, to what extent should the competition-reinforcing norms of federal antitrust law override local rules that are often more protectionist, and thus more exclusionary. As a related matter, however, these rules often serve to limit both the mobility and the earnings of individuals who are capable on the merits but may lack education or certification that is costly or difficult to acquire.

4. Conclusion: Competition Policy, Consumer Welfare and Employees

38. The consumer welfare principle today identifies low prices as the principal goal of antitrust policy. That has not always been the case. In the late 1970's Robert H. Bork used the term "consumer welfare" to describe the *sum* of producer profits and consumer gains. By using this peculiar nomenclature he was able to identify an improvement in "consumer welfare" even when consumers themselves were harmed via higher prices, provided that

⁴³ *North Carolina State Bd. of Dental Exam'rs v. FTC*, 135 S. Ct. 1101 (2015).

⁴⁴ See generally 1 & 1A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶221-231 (4th ed. 2013 & Supp.).

these losses were offset by producer gains.⁴⁵ Further, Bork concluded, a relatively small gain in productive efficiency would be sufficient to offset even significant consumer losses. As a result, even output reducing practices such as price-increasing mergers could be said to increase consumer welfare if these practices produced sufficiently large producer gains.

39. Bork's approach seriously underestimated the consumer harm that comes from anticompetitive practices and also paid inadequate attention to the measurement problems assessing the very complex "tradeoff" between higher prices and increase economic welfare that his approach entailed. Perhaps coincidentally, the adoption of Bork's approach coincided with ever increasing price-cost margins in the United States, with the attendant output reduction and harm to both labour and consumers. To be sure, today's high margins are not purely a consequence of wrong headed antitrust policy, but antitrust must be acknowledged as a factor.⁴⁶

40. Today's understanding of consumer welfare looks only at the welfare of consumers as consumers. While that is a significant step forward it continues to pose some conceptual difficulties. For example, how should we assess the affects on labour or other input providers? While the modern consumer welfare principle favors low prices, antitrust policy regarding labour is troubled mainly by wages that are too low. Further, many people instinctively relate higher wages to higher consumer prices, although that correlation is highly imperfect and often wrong.

41. One solution to this problem is to define "consumer welfare" in terms of output rather than price. On the demand side of the market, lower prices translate into higher output. On the supply side, however, an absence of restrictions on supply also lead to higher output. Practices such as anti-poaching agreements are harmful because they suppress wages by reducing the demand for labour. Speaking more theoretically, in a perfectly competitive market each factor on both the demand side and the supply side receives the marginal value of its contribution.

42. *Ceteris paribus*, both consumers and labour benefit from practices that tend to increase output to its maximum sustainable level, which is a level sufficient to ensure competitive returns to business without excessive capture of monopoly (monopsony) profits on either the buyer or seller side of the market. When "consumer welfare" is defined in terms of output it becomes much easier to articulate a defensible competition policy that

⁴⁵ See ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF 66, 90-97 (1978); Oliver E. Williamson, Economies as an Antitrust Defense: the Welfare Tradeoffs, 58 AM. ECON. REV. 18, 21 (1968); and see Herbert Hovenkamp, Is Antitrust's Consumer Welfare Principle Imperiled, ___ J.Corp.L. ___ (2020), available at [file:///C:/Users/hhovenka/Downloads/SSRN-id3197329%20\(4\).pdf](file:///C:/Users/hhovenka/Downloads/SSRN-id3197329%20(4).pdf).

⁴⁶ See ram Shivakumar, The Market Powr of "Superstar" Companies is Growing, ChicagoBoothReview (Oct. 26, 2017), available at <http://review.chicagobooth.edu/economics/2017/article/market-power-superstar-companies-growing>; David Autor, David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen, The Fall of the Labour Share and the Rise of Superstar Firms (MIT working paper, May 1, 2017), available at <https://economics.mit.edu/files/12979>. On the European experience, which is in many ways similar, see Cyrille Schwellnus, etc al., Labour Share Developments over the Past Two Decades: The Role of Technological Progress, Globalisation and "Winner-takes-most" Dynamics (OECD Economics Dept. Working Papers, No. 1502, Sep. 2018), available at <https://www.oecd-ilibrary.org/docserver/3eb9f9ed-en.pdf?expires=1556143083&id=id&accname=guest&checksum=E7AD7F7BB1E806B0DBACC146FB8450CB>

does everything that antitrust can properly do to ensure a healthy economy, reflecting both the buy and sell sides of market.

43. But might there be worthwhile policies that deviate from this definition? Perhaps, although at least in the United States antitrust law is not the best way to identify or effectuate them. For example, should antitrust policy be involved in putting the brakes on labour-reducing technologies or distribution innovations to the extent that they reduce the demand for jobs? As a substantive matter, I doubt it, but in any event such a policy would lie outside of the scope of antitrust law.

44. By the same token, policies that protect smaller businesses or older technologies from larger or lower cost firms are bad for both consumers and labour and thus violate any antitrust principle concerned with maintaining competitive output. The current hostility toward large platforms exhibits some of this.⁴⁷

45. On the one hand, firms like Google, Amazon, and Facebook have grown very large. On the other hand, for the most part their prices to consumers are very low or even zero, which tends to maximise the output not only of consumers but also of many other firms that deal either with or through these companies.

46. Amazon, which has been the target of antitrust attention in the United States, is a good example. Antitrust is an extremely large online retailer of nearly every conceivable consumer product except automobiles and a few other very large items. Its prices to consumers are very low and consumer satisfaction ratings are high. The story with respect to businesses is more complex. One of the largest areas of Amazon's business is as a broker for thousands of smaller sellers. Here, Amazon offers a choice of fulfilment options. It can take items from other sellers, keep them in inventory, sell and ship them, take care of billing, and remit the price less its commission to the seller. Under another option the seller takes care of inventory and shipping and Amazon principally supplies advertising and billing assistance. Many of these businesses undoubtedly sell more as a result of Amazon's assistance.⁴⁸

47. The question then becomes, what is a wise antitrust policy with respect to Amazon? Some proposals seem to me to be distinctly wrong headed. For example, Presidential Candidate Elizabeth Warren proposes segregating Amazon's business of selling its own products from its business of acting as a broker for other sellers. Under her proposal, very large platform sellers who sell goods for other sellers would be forbidden from selling their own goods on the same platform. The apparent thinking behind this proposal is that Amazon would have a big competitive advantage over these other smaller firms unless Amazon's own products are segregated from the products offered by competing firms that Amazon represents as a broker.

48. Many of Amazon's own products that it sells as a house brand, such as Amazon Basics, compete with name brand products for which Amazon acts as a buyer-reseller or broker. Many of these products are sold at high margins and Amazon's entry has served chiefly to give Amazon's customers a lower price alternative. A good example is the AmazonBasics brand of household alkaline batteries, which are the types of batteries that are used in many consumer electronic products, including cameras, remote controls, or

⁴⁷ See, for example, Herbert Hovenkamp, The Warren Campaign's Antitrust Proposals, *The Regulatory Review* (Mar. 25, 2019), available at <https://www.theregreview.org/2019/03/25/hovenkamp-warren-campaigns-antitrust-proposals/>.

⁴⁸ Ibid.

smoke detectors. The name brand batteries sold on the Amazon website are some of the very firms whose high margins have contributed to the monopoly problem. For example, Duracell is owned by Berkshire-Hathaway. Three other brands, Rayovac, Eveready, and Energizer, are sold by a holding company that is one of the largest producers of household batteries in the world. Duracell, the market leader, controls about 45% of the market. The energizer and Rayovac brands, which are owned by the same company, control roughly another 40%.⁴⁹ Recently the AmazonBasics brand of “generic” batteries has had remarkable sales growth and accounts for nearly a third of online battery sales.⁵⁰

49. As is frequently the case with generic or house brands, Amazon’s sales are eating into the value of the large branded manufacturers’ trademarks.

50. What is missing from candidate Warren’s proposal is any good empirical work on how the AmazonBasics and other Amazon house brands are affecting the online markets for manufactured goods. To the extent that these house brands target small family owned businesses with low profit margins, they may of course cause competitor distress. One would predict, however, that Amazon’s target for new entry is branded products that enjoy a high margin between manufacturing costs and prices. Those would be the most attractive candidates for new entry. That certainly seems to be the case of household batteries. In this case, permitting Amazon to sell its own “generic” batteries in competition with the name brand seems to be an unqualified good for consumers. To the extent that lower prices stimulate higher output, it is also good for labour. Forcing Amazon’s house brand to be segregated from the brand names will almost certainly lead to higher name brand pricing.

51. For other products the story may be different. For example, a company called Rain Design was selling a laptop stand on Amazon for a price of \$43. Amazon then entered with its own AmazonBasics brand at about half that price.⁵¹ While the Rain Design product had at least one patent, Amazon’s product apparently did not infringe it. Some of the literature describes this as a form of predatory behavior.⁵² But assuming that Amazon’s price is not predatory, and nothing suggests that it is, the subtext must be that Rain Design was entitled to margins of more than 100% on a product that was easy to invent around and for which there are many competitive alternatives.

52. The best antitrust policy for labour markets is one that simultaneously makes product markets as competitive as possible by minimising high costs and high markups, and that also makes labour markets as competitive as possible by eliminating undue labour market concentration and condemning restraints that unreasonably impair labour mobility.

⁴⁹ See <https://www.statista.com/statistics/380309/market-share-of-the-leading-alkaline-battery-brands-in-the-us/> (2016 figures).

⁵⁰ <https://clark.com/shopping-retail/amazon-batteries-online-sales/>

⁵¹ <https://www.bloomberg.com/news/articles/2016-04-20/got-a-hot-seller-on-amazon-prepare-for-e-tailer-to-make-one-too>

⁵² See, e.g. Olivia Solon and Julia Carrie Wong, Jeff Bezos vs. the World: Why All Companies Fear ‘Death by Amazon,’ The Guardian, April 18, 2018, available at <https://www.theguardian.com/technology/2018/apr/24/amazon-jeff-bezos-customer-data-industries>