

NON-SOLICITATION AGREEMENT BETWEEN LUCASFILM AND PIXAR ALLEGED TO BE *PER SE* UNLAWFUL UNDER SECTION 1 OF THE SHERMAN ACT

By Todd R. Seelman¹

SUMMARY

As part of its continuing investigation into the employment practices by high-tech companies, the Antitrust Division of the U.S. Department of Justice ("Antitrust Division") recently filed a civil lawsuit in U.S. District Court for the District of Columbia² against Lucasfilm Ltd. The suit filed on December 21, 2010 alleged that Lucasfilm entered into a non-solicitation agreement (a protocol) with Pixar the effect of which restricted each company's employee recruiting practices in violation of Section 1 of the Sherman Act.³ Lucasfilm and Pixar are both involved in the business of digital animation and were alleged to be direct competitors of one another for the hiring of highly skilled digital animators.⁴ Contemporaneous with its filing, the Antitrust Division announced its settlement with Lucasfilm.⁵ This case, like *U.S. v. Adobe Systems, Inc.* (filed on September 24, 2010),⁶ underscores the application of the federal antitrust laws to restrictive covenants in the employment context.

BACKGROUND

According to the Complaint, beginning in January of 2005, Lucasfilm and Pixar entered into an express protocol whereby the companies agreed that: (1) each company not cold call the other's current employees, (2) each company notify the other when making an offer to the other's current employee and (3) the company making the offer to the other's current employee not counteroffer above its initial offer.⁷ According to the Complaint, this express agreement was not ancillary to any legitimate collaboration between the companies nor was it limited by geography, job function, product group or time.⁸ Further, the Complaint alleged that during the term of the agreements, high-level executives at each company actively policed the agreements to ensure compliance, without the consent of the affected employees.⁹ The Complaint also emphasized the horizontal (direct competitor) nature of the relationship between each company.¹⁰ Finally, the Complaint alleged that the agreement restrained the price and supply of available high-tech digital animator labor in the U.S. market (the agreement "reduced [each company's] ability to compete for employees and disrupted the normal price-setting mechanisms that apply in the labor setting"), and as such, the agreement constituted a *per se* violation of Section 1 of the Sherman Act.¹¹

TRADITIONAL STATE LAW ANALYSIS

Employee restrictive covenants, including non-solicitation agreements, are traditionally analyzed under state law.¹² The enforceability of these types of restrictive covenants under state

law is largely dependent on the balancing of the legitimate business interests of the employer against the degree of the restriction placed upon the departing employee. Generally, to the extent that state law enforces these types of restrictive covenants, the courts focus on four considerations: (1) the state's public policy to protect the mobility of its labor force, (2) the legitimacy of the former employer's business interests, (3) the precise restrictions placed upon the departing employee, and (4) whether the restrictions go no further than necessary to protect the employer's legitimate business interests in terms of (a) time, (b) geography, and (c) scope.

ANTITRUST LAW IMPLICATIONS

The non-solicitation agreement at issue in *Lucasfilm* was between employers who directly competed (as buyers) for employees within the U.S. digital animator labor market.¹³ The restraint allegedly substantially affected (a) the price-setting mechanism for employee wages and (b) the free flow of labor within that market. Analyzed under the federal antitrust laws, the Antitrust Division construed the non-solicitation agreement as a horizontal agreement between direct competitors to restrain the price and supply of interstate commerce, and thus, unlawful *per se* under Section 1 of the Sherman Act.¹⁴

FUTURE CONSIDERATIONS AS TO RESTRICTIVE COVENANTS

Lucasfilm (December 21, 2010) and *Adobe System* (September 24, 2010) both arose out of a broader, on-going investigation by the Antitrust Division into the unlawful employment practices by high-tech employers. The agreements in *Adobe Systems* (bilateral agreements between Adobe, Apple, Google, Intel, Intuit, and Pixar) and the agreement in *Lucasfilm* (between Lucasfilm and Pixar) share almost identical attributes: (1) the parties to the agreements were direct competitors of one another for the retention of certain high-tech employees in a particular labor market, (2) the high-tech employees were unaware of the agreements and thus never consented to them, (3) the agreements were express (written), (4) the agreements were actively policed by high-level executives of each company, (5) the agreements were not ancillary to any legitimate collaborative efforts between the companies, and (6) the agreements were not limited in terms of geography, job function, product group or time.

Both *Lucasfilm* and *Adobe Systems* illustrate the application of the federal antitrust laws to restrictive covenants in the employment context. It is critical to note that the Antitrust Division is of the opinion that these types of agreements amount to *per se* violations of Section 1 of the Sherman Act (because the restraint affects supply and price of labor in the U.S. market). Whether that assertion is correct or not (or whether the rule of reason applies), caution must be exercised in drafting restrictive covenants in the employment context when: (1) the parties to the agreement are horizontally related to one another (direct competitors) and the agreement affects (a) the free flow of the supply of labor (in a particular market) or (b) price or price-setting mechanisms of the labor (in a particular market).

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² *U.S. v. Lucasfilm Ltd*, Case No. 1:10-cv-02220, U.S. District Court, District of Columbia, Hon. Reggie B. Walton. Along with the Complaint, the parties also contemporaneously filed: (i) a Competitive Impact Statement, (ii) a Stipulation, (iii) a Proposed Final Judgment, and (iv) an Explanation of the Consent Decree. See <http://www.justice.gov/atr/cases/f265300/265395.htm> (Complaint); <http://www.justice.gov/atr/cases/f265400/265409.htm> (Stipulation); <http://www.justice.gov/atr/cases/f265300/265397.htm> (Competitive Impact Statement); <http://www.justice.gov/atr/cases/f265400/265405.htm> (Proposed Final Judgment).

³ 15 U.S.C. §1 (The Sherman Act prohibits “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States.”).

⁴ Both companies are digital animators headquartered in California and are alleged to be direct competitors of one another for digital animator employees. While both companies were alleged to have violated Section 1 of the Sherman Act, only Lucasfilm Ltd. was made a defendant in this case. As the Antitrust Division explained, Pixar was not made a defendant because the relief obtained by the DOJ from Pixar in the *U.S. v. Adobe Systems, Inc.* case was sufficient to prevent Pixar from entering into these types of restrictive agreements. See http://www.justice.gov/atr/public/press_releases/2010/265387.htm.

⁵ The Antitrust Division separately published an announcement of its settlement with Lucasfilm Ltd. http://www.justice.gov/atr/public/press_releases/2010/265387.htm.

⁶ *U.S. v. Adobe Systems, Inc. et al*, Case No. 1:10-cv-01629-CKK, U.S. District Court, District of Columbia, Hon. Colleen Kollar-Kotelly.

⁷ Compl. at ¶16.

⁸ *Id.* at ¶¶17-18.

⁹ *Id.* ¶¶18-20.

¹⁰ The Complaint characterized Lucasfilm as a "direct competitor" of Pixar for the hiring of highly skilled digital animators in the United States and do so on the basis of salaries, benefits, and career opportunities. *Id.* at ¶¶1, 4, 12-15, 22.

¹¹ *Id.* at ¶¶3, 22-23.

¹² See e.g., Colorado Revised Statute, §8-2-113(2); *Atmel Corp. v. Vitesse Semiconductor Corp.*, 30 P.3d 789, 794 (Colo. App. 2001), *abrogated in part on other grounds*, *Ingold v. AIMCO/Bluffs, L.L.C.*, 159 P.3d 116 (Colo. 2007); *Golder Associates, Inc. v. Edge Environmental, Inc.*, 2007 WL 987458 at *4 (D. Colo. 2007). In the typical case, employment restrictive covenants are two-party agreements between an employer and employee, whereby the employer seeks to restrain the post-employment conduct of the employee. The protocol agreement in *Lucasfilm*, by contrast, was a two-party agreement between competing employers, whereby each sought to restrain the other from poaching current digital animator employees without their knowledge or consent. See Compl. at ¶¶18, 22, 25, 28, 31.

¹³ The Antitrust Division characterized the relationship between the employers as direct competitors, not because they competed with one another as *sellers* of products (a down-stream restraint), but rather as *buyers* for employees within the digital animator labor market (an up-stream restraint). Compl. at ¶¶1, 4, 12-15, 22.

¹⁴ Supreme Court cases discussing the *per se* treatment under Section 1 of the Sherman Act include: *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 886 (2007); *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 210 (1940). The applicability of a *per se* treatment, instead of the rule of reason, to the agreements in *Lucasfilm* and *Adobe Systems* was uncontested as both cases settled.