
FTC Proposed Rulemaking Banning Covenants Not to Compete

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On January 5, 2023, the Federal Trade Commission (FTC) announced a proposed rule that would prohibit employers from entering into or attempting to enter into covenants not to compete, from maintaining existing covenants not to compete, or from, under certain circumstances, representing to an employee that the employee is bound by a covenant not to compete. The full text of the proposed rule can be found [here](#).

This article will explore what the proposed rule means for North Carolina employers and will offer some guidance about how to prepare in the event that the proposed rule becomes law.

What is a Covenant Not to Compete?

A covenant not to compete is a contractual agreement between an employer and an employee that generally prohibits the employee from competing with the employer after the employee's termination. Non-compete agreements typically will restrict the employee from working for (or becoming) a competing employer in a certain territory and/or certain industry in that territory for a certain time period. Employers across all kinds of industries use agreements of this kind to protect their legitimate business interests and investment in their employees. Agreements of this kind are particularly common in specialized technological or professional fields, where these interests and the employers' corresponding investment is more costly. The FTC estimates that about one in five U.S. employees (approximately 30 million people) are bound by non-compete agreements of some form or another.

Although covenants not to compete are enforceable under North Carolina law, courts generally disfavor them. These are not one-size-fits-all, boilerplate clauses. Under North Carolina law, non-compete clauses must be in writing, must be incorporated into an employment contract and be supported by separate consideration (other than continued employment), must only impose reasonable restrictions on time and territory of future employment, and must be designed to protect the legitimate business interest of the employer. These last two factors may vary depending on the type of business, position of the employee, and the market at issue.

What Would The Proposed FTC Rule Do?

The proposed rule would require all employers with non-compete clauses to rescind the clauses within 180 days from the date that the rule takes effect and provide notice to employees of the rescission.

The rule would also prohibit employers from entering into or attempting to enter into agreements of this kind in the future and would void any existing non-compete clause except for non-compete clauses associated with the sale of a business.

The proposed rule would expressly preempt any state law (including court decisions) inconsistent with the rule but would not preempt any state law that is more restrictive than the rule.

Why is This a Federal Issue?

For decades, the law regarding the enforceability of covenants not to compete was left largely up to states through statutes and common law. Under existing law, an employer and an employee would generally look to the state that had the controlling law in their employment relationship (which could be set out in the employment agreement) for determining their rights and responsibilities as it relates to a covenant not to compete.

But federal law can supersede state law under certain circumstances. The FTC is one of the federal agencies generally in charge of regulating unfair methods of competition. In the FTC's view, this rule is aimed toward that end. The FTC believes that it has the authority to issue this rule which would supersede all contrary state laws. This proposed rulemaking is the first time that the FTC has claimed that covenants not to compete are unfair methods of competition under the FTC Act.

What Can North Carolina Employers Do About It?

Under the notice-and-comment rulemaking procedures applicable to federal agencies, the FTC is required to review and consider feedback from the public before issuing a final rule. Concerned businesses may submit public comments to the FTC directly by following this link. The comment period is open through April 19, 2023.

On the more immediate side, North Carolina employers can still act to protect their business interests by including covenants not to compete in their employment agreements (that are currently enforceable under North Carolina law), and by reviewing and potentially revising other portions of their employment agreements, including clauses prohibiting solicitation of employees and customers or provisions protecting their confidential information and trade secrets. See the discussion below about whether the proposed rule will become law.

Will the Proposed Rule Become Law?

Time will tell. It is likely that there will be several significant legal challenges to the rule before the time that it would take effect. One FTC commissioner actually dissented from the proposed rulemaking in a statement issued January 5, 2023. The dissenting commissioner's statement pointed out several grounds that will likely be used to challenge the rule, including arguments about the FTC's authority to issue a rule like this one, and whether the proposed rule would violate current United States Supreme Court precedent regarding the "major questions" doctrine, which generally overrides the deference that courts will give to federal agencies in their interpretation of statutes when those interpretation involve significant political or economic issues, and the "non-delegation" doctrine, which generally limits the scope of what legal determinations Congress can delegate to federal agencies. Those challenging the rule will seek an order staying its enforcement until after challenge is heard.

CONTACT US

Phone: 919-782-6860

Fax: 919-782-6753

OFFICE

Young Moore and Henderson, P.A.

3101 Glenwood Ave. Suite 200

Raleigh, N.C. 27612

MAILING ADDRESS

Young Moore and Henderson, P.A.

P.O. Box 31627

Raleigh, N.C. 27622-1627

