Federal Trade Commission Votes to Ban Employment-Based Noncompetes

by Michael B. Kent, Jr.

On April 23, 2024, the Federal Trade Commission voted 3-2 to approve a final rule banning most noncompete provisions in the employment context. The rule has nationwide applicability and preempts inconsistent state and local laws. Additionally, the rule requires that employers notify employees subject to a prohibited noncompete that such provisions will not be enforced. If allowed to stand, the rule will change the landscape of employment law by overturning decades of state law precedents governing the validity and enforcement of noncompete agreements.

What is prohibited?

The rule deems each of the following acts to be “an unfair method of competition” and, thus, prohibited under federal law:

• To enter into a noncompete clause (or attempt to do so);
• To enforce a noncompete clause (or attempt to do so); and
• To represent that a worker is subject to a noncompete clause.

The rule defines “noncompete clause” broadly to include any term or condition of employment that prohibits, penalizes, or functions to prevent a worker from seeking or accepting work or operating a business in the United States. The rule prohibits only noncompete clauses that apply after the conclusion of employment, however. Restrictions imposed during the worker’s employment remain untouched.

The rule also contains a broad definition of “worker,” which encompasses not only traditional employees but also independent contractors, interns, apprentices, and volunteers.

Is the rule retroactive?

Not only does the rule prohibit an employer from entering into new noncompete clauses, but it also invalidates existing noncompetes. The rule does not apply, however, to causes of action related to a noncompete that accrued before the rule becomes effective.

What notices must an employer provide?

Employers must notify workers subject to existing noncompete clauses that enforcing the noncompete is now an unfair method of competition and that the clause cannot (and will not) be enforced against them. The notice can be hand-delivered, mailed, emailed, or texted to the worker, but it must be sent no later than the date on which the rule becomes effective. The rule contains model language for providing this notice, and employers who use the model language are deemed to have complied with the notice requirement.

Are there exceptions?

Aside from existing causes of action, the rule contains three exceptions:

• *Senior executives*. Noncompetes entered into with senior executives prior to the rule's effective date are not invalidated. New noncompetes may not be imposed after that date, however, even for senior executives. The rule defines "senior executive" as a worker who occupies a policy-making position and earns at least $151,164 in annual compensation.

• *Bona fide sale of business*. The rule does not apply to noncompete clauses entered into as part of a bona fide sale of a business entity, of an ownership interest in a business entity, or of all or substantially all of a business entity's operating assets. The rule defines "business entity" to include a partnership, corporation, association, limited liability company, or other legal entity, as well as divisions or subsidiaries of the foregoing.

• *Good faith*. It is not a violation of the rule to enforce, attempt to enforce, or make representations about a noncompete clause where a good-faith basis exists to believe the rule does not apply to the noncompete in question.

When does the rule take effect?

By its terms, the rule becomes effective 120 days after its publication in the Federal Register. The FTC published the rule on May 7, 2024, meaning it becomes effective on September 4, 2024.

Is the rule legal?

To date, at least three legal challenges have been brought against the rule in federal courts. These lawsuits—two in Texas and one in Pennsylvania—allege several reasons for invalidating the rule, including a lack of authority on the part of the FTC, violations of separation of powers principles, and the irrationality of the rule's economic impact and retroactive application. It remains to be seen whether these arguments will prove successful in delaying implementation of the rule or in striking it down altogether.

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Envisage attorneys assist both individuals and businesses with employment-related matters, and we are available to help you understand the new FTC rule and how it might affect you or your business. If you have questions about this alert or think we might be of assistance to you, you may contact us at (919) 755-1317.

Court Rules That COVID-19 Orders Violated

Constitution

by Michael B. Kent, Jr.

The North Carolina Court of Appeals recently issued an important decision addressing one of Governor Cooper's COVID-19 "lockdown" orders. In **North Carolina Bar & Tavern Association v. Cooper**, the Court ruled that the order violated the North Carolina Constitution by allowing some businesses to reopen while forcing others to remain closed.

The case involved a challenge to Executive Order No. 141, which permitted certain drinking establishments—such as restaurant and hotel bars—to resume operations so long as they utilized certain safety precautions. The order required private bars to remain closed, however, stating that "by their very nature," such businesses "present greater risks of the spread of COVID-19." Owners of the shuttered bars sued, alleging that the order effected a taking of their businesses and violated their constitutional rights.

Although the Court disagreed that the order constituted an unlawful taking, it found in favor of the bar owners on two of their other claims. First, the Court held that the order violated a provision of the state constitution guaranteeing to all North Carolinians "the enjoyment of the fruits of their own labor." Second, the Court held that the order violated the state constitution's guarantee of "the equal protection of the laws."

The order ran afoul of both provisions, the Court ruled, because it resulted in an "irrational and arbitrary" distinction between those bars that could reopen and those that could not. The Court rejected the claim that the decision was based on "data and science." Much of the government's evidence came from the Governor's "own assertions" in other executive orders or from ordinary news articles that could be found "by private citizens utilizing Internet search engines." The one scientific study the government did produce post-dated Executive Order No. 141 (and, therefore, could not have been the basis for it) and failed to "differentiate between various types of bars."

Because the evidence did not support the decision to allow some bars to reopen while forcing others to stay closed, the decision was "illogical and not rationally related" to the government's goal of slowing the spread of the virus. That rendered the executive order unconstitutional, notwithstanding the public health concerns for which it was designed. "Our Constitution," the Court explained, "applies even when a government official acts with the best stated purposes."

Envisage attorneys help individuals and businesses protect their constitutional and other legal rights amidst increasingly complex regulatory landscapes (including a previous challenge to Executive Order No. 141). If you have questions about this alert or think we might be of assistance, you may contact us at (919) 755-1317.

Short-Term Rental Regulation in North Carolina

Short-Term Rental Regulation in North Carolina

by: Michael B. Kent, Jr.

As one of the most visited states in America, North Carolina has seen a surge in short-term rentals (think Airbnb or Vrbo). This growing sector of the economy has brought both opportunities and challenges. Positive impacts have included increased revenue and financial stability for homeowners, a rise in property values, and the creation of new jobs and services. Challenges have included potential disruptions to neighborhoods, concerns about affordable housing, and the need to preserve community and quality of life.

It is not surprising, then, that both governments and property owners' associations have considered whether and how to regulate short-term rentals. Our attorneys have advised and represented clients on such matters and resulting disputes. To help understand the legal landscape, some important topics relating to short-term rental regulation are highlighted below.

State Regulations

The primary mechanism for regulating short-term rentals at the state level is the North Carolina Vacation Rental Act. Aside from some listed exemptions, the Act generally applies to any person or entity (specifically including a real estate broker) that offers, rents, or manages a "vacation rental" in the state. The Act defines "vacation rental" to mean "the rental of residential property for vacation, leisure, or recreation purposes for fewer than 90 days" if the renter has (and plans to return to) another permanent residence.

The Act requires that vacation rentals be accomplished via a written agreement that contains both a statutorily prescribed notice and several specified provisions governing the rights and obligations of the parties. Other requirements govern the handling and accounting of rents, fees, and security deposits. The Act obligates the landlord to keep the premises in a fit and habitable condition, and it requires the tenant to use the premises in a clean and safe manner. Finally, the Act establishes the grounds and processes by which a tenant may be evicted from a vacation rental.

Local Regulations

Many city and county governments in North Carolina have enacted their own short-term rental regulations. Frequent provisions include occupancy limits, parking specifications, noise restrictions, and the prohibition of short-term rentals in certain zoning districts or within a certain distance from other specified land uses. These regulations vary by locality, however, so it's important to consult each government's specific requirements carefully.

Two important judicial decisions shape the way in which short-term rentals can be regulated at the local level. The first decision, *Shroeder v. City of Wilmington* (2022), struck down a local ordinance requiring short-term rental operators to register their properties. The Court of Appeals held that such requirements ran afoul of a state statute prohibiting rental registrations and, therefore, could not be mandated by governments at the local level.

The second decision, *Frazier v. Town of Blowing Rock* (2022), held that a short-term rental operation could qualify as a valid nonconforming use. A "nonconforming use" is one that existed before the adoption of a regulation and that is allowed to continue (under certain conditions) without adhering to the new regulation's requirements. Accordingly, the use of a particular property for short-term rentals prior to the adoption of short-term rental regulations might create a "grandfathering" effect that renders the new regulations inapplicable to that property.

Neighborhood Restrictions

A number of property owners' associations have also attempted to regulate short-term rentals within their neighborhoods through the adoption of restrictive covenants. These types of restrictions arise from private agreement between landowners, and they generally are enforceable so long as they comply with the various legal standards governing such devices.

As with the local regulations discussed above, some important judicial decisions address the validity of neighborhood restrictions in the short-term rental context. In *Russell v. Donaldson* (2012), the Court of Appeals rejected the argument that short-term rentals violated a covenant prohibiting any neighborhood lot from being "used for business or commercial purposes." The court found the phrase "business or commercial purposes" to be ambiguous and noted that such uncertainties must "be resolved in favor of the unrestricted use of the land." In the absence of language clearly prohibiting short-term rentals, that use did not contravene the covenants at issue.

More recently, in *Mileview LLC v. The Reserve II at Sugar Mountain Condominium Owners' Association* (2024), the Court of Appeals addressed an amendment to neighborhood covenants that would have prohibited short-term rentals explicitly. Building on the concept articulated in *Russell*—that "covenants are strictly construed in favor of the free use of land"—the court explained that its primary task was to give effect to the original covenants agreed to by the property owners. To be enforceable, "an amendment should not exceed the purpose of the original declaration," meaning later amendments had to be a reasonable extension of the initial agreement made by the neighbors. Because the original covenants expressly contemplated that rentals would occur, and the evidence showed that short-term rentals were commonplace prior to the amendment, the court held the amendment prohibiting such rentals to be unreasonable.

Finally, in *Miesch v. Ocean Dunes Homeowners Association* (1995), the Court of Appeals invalidated a special fee imposed by a condominium association on short-term renters. The court concluded that the fee selectively restricted the rights of owners who sought to rent their units on a short-term basis, while allowing other unit owners to rent long-term without being subject to the fee. Accordingly, the fee effectively created two classes of unit owners in contravention of the condominium's governing documents.

Envisage attorneys assist property owners with issues relating to short-term rentals, as well as a variety of other real estate matters involving land use regulations, restrictive covenants, and leasing. If you have questions about this alert or think we might be of assistance to you, you may contact us at (919) 755-1317.

Federal Court Upholds Property Rights Against Government Intrusion

Federal Court Upholds Property Rights Against Government Intrusion

by **Michael B. Kent, Jr.**

Last month, a federal appeals court issued an important decision curbing the government's ability to use a criminal investigation of one party to search and seize property belonging to another. In **Snitko v. United States**, the Ninth Circuit Court of Appeals held that federal agents violated the constitutional rights of several hundred citizens when they opened and attempted to seize the contents of safe deposit boxes located at a raided facility. The decision helps bolster constitutional protections for private property by keeping governmental investigations within their proper limits.

The case arose out of a criminal investigation into US Private Vaults ("USPV"), a company that rented safe deposit boxes. One of USPV's primary marketing strategies was its promise to protect the identity of its customers, which attracted a certain criminal clientele in addition to honest users. Over time, law enforcement agencies began to suspect USPV itself of criminal activity, and a federal grand jury eventually returned an indictment against the company.

Based on the indictment, federal agents secured a warrant authorizing them to search USPV's place of business and seize, among other things, the "nests" of safe deposit boxes located inside. The warrant also authorized a limited inspection of the individual boxes within the nests pursuant to the FBI's "written inventory policies," which allow agents to catalogue property for safekeeping until it can be returned to its rightful owner. The warrant expressly stated that the agents were not to conduct a criminal search of the boxes.

Prior to executing the warrant, however, the FBI created a new "written policy" entitled "Supplemental Instructions on Box Inventory," which was to govern the "inventory" searches of the USPV safe deposit boxes. This policy instructed agents to place any amount of cash over $5,000 in an evidence bag, give it a forfeiture identification number, note the manner in which it was bundled, and record any distinguishing features (like strong odors, evidence of drug residue, and whether a gun was found in the same box as the cash).

The raid resulted in the agents opening over 700 individual boxes and initiating asset forfeiture proceedings against any box containing at least $5,000 in value. Asset forfeiture allows law enforcement agencies to retain property suspected of facilitating or resulting from criminal activity. Under current law, however, forfeiture does not necessarily require judicial oversight and can occur even without a criminal conviction. Indeed, among the USPV box holders whose property was subject to forfeiture were many who undeniably used their boxes for innocent, non-criminal purposes.

After learning of the attempted forfeitures, several boxholders sued the government, seeking the return of their property and alleging that the agents violated their constitutional rights in searching and seizing the box contents. The Ninth Circuit agreed.

As an initial matter, the court held that the "Supplemental Instructions" could not be viewed as falling within the warrant's reference to "written inventory policies." Under prior precedent, that reference could only mean the "standardized instructions" that the FBI applied consistently in all cases, not customized instructions designed especially for a single case. "[T]he fact that the Supplemental Instructions were created specifically for the USPV search," explained the court, "takes this case out of the realm of a standardized 'inventory' procedure," and made the purported inventorying of the boxes little more than a "ruse for a general rummaging in order to find incriminating evidence."

Additionally, the court held that the agents exceeded the scope of the warrant by using the purported "inventory search" as a pretext for a criminal search of the boxes, which the warrant expressly prohibited. "A look at the record, and the Supplemental Instructions in particular, confirms that the search was criminal in nature," the court concluded, and "any doubt is put to rest by the fact that the government has already used some of the information from inside the boxes to obtain additional warrants to further its investigation [of USPV] and begin new ones [against others]."

In short, the court found the government's conduct to resemble the "limitless searches of an individual's personal belongings … that led to the adoption of the Fourth Amendment in the first place." For that reason, the searches violated the Constitution, the property had to be returned, and all records of the searches had to be destroyed.

Envisage attorneys help individuals protect their property and other legal rights through a variety of services, including disputes with government agencies. If you have questions about this alert or think we might be of assistance to you, you may contact us at (919) 755-1317.

The Corporate Transparency Act Goes Into Effect

The Corporate Transparency Act Goes Into Effect

By **Tara Seidel**

The Corporate Transparency Act (31 U.S.C. § 5336 and regulations at 31 C.F.R. 1010.380), goes into effect in January 2024 and may impact your small business by requiring you to report information about your business ownership to the federal government. Failure to comply with these reporting requirements could result in the imposition of civil and criminal penalties.

Congress enacted the CTA in order to address corruption and other financial misconduct, such as money laundering and the use of illicit shell corporations. The legislation states that it is necessary to protect national security interests as well as interstate and foreign commerce. As part of the government's efforts, the CTA will require certain business entities to report information about themselves and their "Beneficial Owners." Such information shall be stored by the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) in a secure and confidential database, protected at the "highest security level," while the information is available to national security, intelligence and law enforcement agencies.

The CTA's reporting requirements are imposed on "Reporting Companies," which includes corporations, LLCs or other similar entities that have been created by a filing with a secretary of state (North Carolina or other), whether under the law of the United States or a foreign country, so long as it is registered to do business in the U.S. The CTA does include a limited number of statutory exemptions for some business entities, such as tax-exempt organizations, larger entities (with at least twenty full-time employees and gross receipts or sales of more than $5,000,000, among other requirements) and certain entities in the financial industry (e.g., banks, credit unions and accounting firms).

In general, the CTA requires each Reporting Company to submit to FinCEN the following company information:

- The full legal name of the company;
- Any trade name or d/b/a/ name of the company;
- The current address of the company; and
- the company's EIN.

The CTA also requires information about the Reporting Company's Beneficial Owners. In general, a Beneficial Owner is an individual who either (1) owns or controls at least 25% of the interests of the Reporting Company, or (2) exercises substantial control over the Reporting Company. Who is or is not a Beneficial Owner of your entity should be subject to close analysis under the language of the CTA – it may include a senior officer of the company or a Board member.

Additionally, for entities created on or after January 1, 2024, the CTA requires the same information be submitted about the "Company Applicant" – the individual who directly files the document that creates the entity. This will have implications for legal representatives who file applications with the secretary of state on behalf of their clients. In a scenario where an attorney oversees the filing of creation documents by a paralegal, both the attorney and the paralegal may be considered a Company Applicant and therefore subject to the CTA. Reporting is not required for Company Applicants for businesses that were in existence prior to 2024.

The following information about each Beneficial Owner and Company Applicant must be reported:

- Full legal name;
- Date of birth;
- Current residential or business street address; and
- The ID number from an acceptable identification document (such as a nonexpired passport or driver's license) or a unique FinCEN identifier (which can be obtained upon application by an individual providing FinCEN with certain identifying documents).

Any changes to previously submitted information regarding a Beneficial Owner or a Reporting Company must be filed with FinCEN in an updated report within thirty (30) days after the date of such change to the information. Such changes include registering a new business name, a change in Beneficial Owners (such as a new CEO), or any change to a Beneficial Owner's name, address or unique ID. The CTA does not require changes to the Company Applicants' information to be updated.

Timing of the Reporting Obligations:

If the Reporting Company was created prior to 2024, it will have one (1) year in which to file its initial report with FinCEN (to be submitted no later than January 1, 2025).

If the Reporting Company is created in 2024, it is required to file its initial report with FinCEN within thirty (90) days following the company's formation.

For a Reporting Company created on or after January 1, 2025, it shall be required to file its initial report with FinCEN within thirty (30) days following the company's formation.

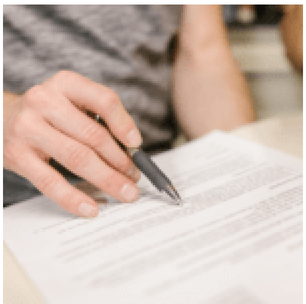
If an entity experiences a change with respect to who is a Beneficial Owner, or with respect to the information of a particular Beneficial Owner, the Reporting Company must file an updated report within thirty (30) days of the occurrence of such change.

Reports can be filed online at **https://www.fincen.gov/boi** beginning January 1, 2024.

At this time, at least one national organization has challenged the constitutionality of the CTA. In November 2022, the National Small Business Association filed a lawsuit against the U.S. Department of the Treasury alleging that the CTA violates the U.S. Constitution, and this case is slowly working its way through the federal court system. It will be interesting to see whether such challenges to Congress's authority to require small, in-state companies to disclose their private information regarding ownership to the federal government will be successful.

Envisage attorneys are available to help you understand the CTA and the requirements it may impose upon you and your business. If you have questions about this alert or think we might be of assistance to you, you may contact us at (919) 755-1317.

The Importance of Recording Leases, Options, and Other Interests in Real Estate



The Importance of Recording Leases, Options, and Other Interests in Real Estate

by **Michael B. Kent, Jr.**

Do leases, options, and similar "non-ownership" interests in real estate need to be recorded with the register of deeds? The North Carolina Court of Appeals addressed this issue earlier this year in ***Greaseoutlet.com, LLC v. MK South II, LLC***. The decision reinforces the importance of promptly recording real estate interests, including "non-ownership" interests like leases, options, and preemptive rights. A failure to do so can effectively result in the loss of such interests where subsequent third parties take rights in the same parcel. The decision potentially affects any buyer, seller, lessor, lessee, or lender of real estate.

The case involved a tenant who entered into a five-year agreement to lease industrial property for its business in 2016. A memorandum of lease, specifying the five-year term, was recorded in the county registry. A few months later, the tenant and its landlord amended the lease to grant the tenant an option to renew at the expiration of the lease's original term. Neither party recorded a new memorandum evidencing this amendment, however. In 2019, the landlord sold the property, and the new owner informed the tenant that it would need to vacate the premises when the original term expired in 2021. When the tenant attempted to exercise its option to renew the lease, the new owner refused. Although it admitted to knowing about the option before it purchased the property, the new owner argued that it was not bound by the amendment.

The Court of Appeals agreed. Because the deed transferring the property made no mention of the lease, the new owner was not obligated by the express terms of conveyance. As a result, the lease could bind the new owner only to the extent provided by North Carolina's recording statute, known as the "Connor Act."

Originally enacted in 1885, the Connor Act requires certain interests in land to be recorded if they are to bind subsequent lien creditors or purchasers for value. These interests include not only actual conveyances but also options, rights of first refusal or first offer, and leases lasting more than three years. Significantly, as the Court of Appeals reaffirmed, "only actual prior recordation of an interest" will satisfy the statute. Even actual knowledge of an unregistered interest, "however full and formal" it may be, is typically insufficient to bind a subsequent purchaser who records his or her own interest in the parcel.

Applying these rules, the court determined that the new owner was subject to the original five-year lease because a memorandum evidencing that lease had been recorded prior to the new owner's purchase of the property. The new owner was not subject to the amendment creating the renewal option, however, because no memorandum or other instrument in the chain-of-title indicated its existence. The fact that the new owner was aware of the amendment was irrelevant, as was the new owner's acceptance of rent (which it later returned) for part of the renewal period. Additionally, the court rejected the tenant's argument that language in the recorded memorandum making generic reference to future lease amendments was sufficient to provide legal notice of the particular amendment in dispute.

Envisage attorneys assist clients with a variety of real estate matters, including the negotiation, documentation, recordation, and enforcement of commercial leases. If you have questions about this alert or think we might be of assistance to you, you may contact us at (919) 755-1317.