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Purchaser of LLC Units May Enforce Non-Compete Without Employee Consent

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As ubiquitous as limited liability company interests may be these days, litigants are still arguing over whether the sale of LLC membership units is like the sale of stock. When a stock sale takes place, the new owners of the stock simply fill the shoes of the old stockholders. In a stock sale, there is no "FICA" restart – the employer identification remains the same, as does nearly everything else associated with the transaction. An asset sale, on the other hand, involves the actual transmission of tangible or intangible things to an entirely new entity. The asset transaction invariably results in a FICA restart (a new employer, a new employer identification, and everything that comes with the "newness") because a different entity (but not always a brand new one) now owns the assets.

Why is this relevant to non-compete agreements?

Many states prohibit the assignment of a non-compete agreement without an employee's consent if in fact the non-compete agreement is transferred to a new entity, such as in connection with an asset sale. This makes sense given that a new party – new employer X – is now being introduced into the equation and an employee should have the option of deciding whether to enter into a personal services contract with a new employer. But contracts are transferred by operation of law in a stock sale because it isn't the party who is changing, but the owner of the stock. Generally speaking, unless the contract provides otherwise, the employee has no say in the matter.

It would seem logical therefore that the sale of LLC units would be treated exactly the same as a stock sale – the only distinction being that the LLC entity is legally though not really functionally different from a traditional corporation. But the concept of ownership of shares and units – and the change in ownership having no impact on the operations, ownership or party affiliation – is the same.

Apparently, however, the distinction between the sale of LLC units and shares of stock is still an open question in the courts. Recently, in *Excellence Community Management LLC v. Gilmore*, (Nev. June 25, 2015), the Nevada Supreme Court closed this gap (at least in Nevada) when it confirmed that the sale of 100% of the membership interests in an LLC was functionally equivalent to a stock sale when it comes to the enforcement of an non-compete – which meant that no employee consent to the assignment of the contract was required because the same employer existed before *and* after the transaction.

It is unclear whether other courts would reach a similar result, but this case is a good reminder that the employment matters associated with a transaction may be more complex than meets the eye. One way for employers to address this gap without court intervention is to consider inserting an assignment consent clause into the non-compete agreement. If assignment provisions are enforceable in the relevant jurisdiction, this is one issue that can be checked off the transaction to-do list.

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Jennifer B. Rubin is a Mintz Member who advises clients on employment issues like wage and hour compliance. Her clients range from start-ups to Fortune 50 companies and business executives in the technology, financial services, publishing, professional services, and health care industries.