

# The New Jersey Revised Uniform Limited Liability Act: An Overview

by W. Raymond Felton

On Sept. 19, 2012, Governor Chris Christie signed legislation adopting the Revised Uniform Limited Liability Company Act in New Jersey.<sup>1</sup> The act is largely based upon the Revised Uniform Limited Liability Company Act adopted in 2006 by the National Conference of Commissioners on Uniform State Laws (NCCUSL), but with important differences.

**T**he act replaces New Jersey's original Limited Liability Company Act, which was adopted on Jan. 26, 1994, and modified minimally since then.<sup>2</sup> The act applies to all limited liability companies (LLCs) formed on or after March 18, 2013, and to LLCs formed prior to that date that elect in their operating agreements to be governed by the act.<sup>3</sup> Any LLC formed prior to March 18, 2013, that did not elect to be governed by the act, nevertheless became subject to the law on March 1, 2014. The prior LLC act has been repealed effective on March 1, 2014.<sup>4</sup> Contrast this with the New Jersey Business Corporation Act (NJBCA), which became effective on Jan. 1, 1969, yet preserved certain features of the prior corporation law unless the corporation took affirmative steps to be governed by the NJBCA.<sup>5</sup>

The following is a summary of key changes the act makes relating to New Jersey limited liability companies.

## Oral Agreements

The act abandons the previous requirement that operating agreements be written, specifically authorizing oral or implied

agreements.<sup>6</sup> While it is unlikely that one would recommend to the members that they adopt an agreement orally, a court may construe a course of dealing or similar evidence to find the existence of an oral agreement.

## Perpetual Duration

The act provides that an LLC has perpetual duration.<sup>7</sup> This changes the default rule in the prior LLC act that an LLC terminates in 30 years, absent a contrary provision in its certificate of formation.

## Formation

An LLC is formed when the certificate of formation is filed in the Division of Revenue in the Department of the Treasury unless the certificate provides for a deferred effective date, and the LLC has at least one member.<sup>8</sup> An annual report must be filed with the state, and failure to do so will result in the LLC being transferred to an inactive list. While on the inactive list, an LLC's name is available to be used as the name of another LLC. Thus, even if the inactive LLC applies to be reinstated as an active LLC, it may not be able to do so with the name it had when it became inactive.<sup>9</sup>

## Statement of Authority

The act creates a new instrument known as a statement of authority that may be filed in the Division of Revenue. This instrument provides public notice of the authority of one or more persons who may act on behalf of the LLC. The statement of authority can indicate the scope as well as the limitations on the person's authority and can refer either to a position or office, or to a person by name. For example, it may apply to the "president" or to "Sally Smith."<sup>10</sup> Note that one's status as a member of an LLC does not, in and of itself, make

one an agent of the LLC.<sup>11</sup> The act provides a mechanism for a person named in a statement of authority to deny the grant of authority by filing a statement of denial with the Division of Revenue.<sup>12</sup>

### **Purpose**

The act permits an LLC to be formed for any lawful purpose, regardless of whether for profit.<sup>13</sup> Thus, an LLC may be formed to operate as a not-for-profit organization or to own non-income-producing property.

### **Management**

The default provisions of the act indicate that an LLC is managed by its members unless the operating agreement provides for one or more managers to take that role. The act provides that each member in a member-managed LLC has equal rights in management.<sup>14</sup> Thus, a 10-percent member would have the same rights as a 90-percent member in the same LLC. This can vary by the operating agreement, however.

Since a manager-managed LLC must, by definition, have an operating agreement, care should be taken in such an agreement to establish the scope of authority of the manager(s); the process for selecting, removing and replacing the manager(s); and the compensation, if any, of the manager(s). Given the flexibility the act provides in structuring LLCs,<sup>15</sup> one may opt, for example, for a corporate model with a board of directors and designated officers. If that is used, operating agreements often include provisions typically found in corporate bylaws relating to meetings, authority and other director and officer provisions.

### **Fiduciary Duties**

The previous law did not address fiduciary duties, although many practitioners believed the managers of LLCs, whether or not they were members, had such duties. The act provides that mem-

bers in a member-managed LLC and managers have duties of loyalty and care, and further provides guidance on what those duties entail. The member or manager must exercise those duties consistently with the contractual obligation of good faith and fair dealing.<sup>16</sup> The mere fact that the actions of a member or manager further that person's own interest does not mean his or her duty or obligation has been violated.<sup>17</sup>

The act provides that, if not manifestly unreasonable, the operating agreement may alter the duty of care, except to authorize intentional misconduct or knowing violations of law, and may alter any other fiduciary duties, including particular aspects of that duty.<sup>18</sup> It remains to be seen how the term "manifestly unreasonable" will be construed by the courts, and its interpretation may hinge on the facts and circumstances of each particular case.

### **Indemnification**

Under prior law, an LLC had the power but not the obligation to indemnify and hold harmless its members, managers and others. The new act requires such indemnification but allows the operating agreement to alter or eliminate such an obligation. The act does not provide for the LLC to advance the expenses of a person subject to a claim for which indemnification applies. If that person succeeds on the merits, however, then the LLC is obligated to reimburse those expenses.<sup>19</sup> The operating agreement may, of course, alter this rule to require the LLC to advance the expenses as they are incurred.

### **Exculpation**

The new act authorizes operating agreements to eliminate or limit a member or manager's liability to the LLC or its members for money damages, except for: 1) a breach of the duty of loyalty, 2) a financial benefit received by the mem-

ber or manager to which he or she is not entitled, 3) a wrongful distribution of money or other property to the member, 4) intentional infliction of harm on the LLC or a member, or 5) an intentional violation of criminal law.

### **Distributions**

The default rule under the act is that distributions to members are to be made in equal shares among the members, rather than *pro rata* to their capital contributions or capital accounts.<sup>20</sup> This may contradict the expectation of the members, particularly those who have made larger capital contributions than their co-members, and can be addressed differently in the operating agreement.

The act is silent regarding the allocation of profits and losses. It is important to understand the distinction between allocations of profit and loss, particularly for income tax purposes, and distributions. The allocation of profit or income to a member obligates the member to include the amount allocated in his or her taxable income but does not create a right to have that allocation, or even a portion of it, distributed to the member prior to the dissolution of the LLC. It is crucial that these matters be addressed fully in an operating agreement. Moreover, there may be a number of other tax considerations to be addressed but they are beyond the scope of this article. The foregoing assumes the LLC is taxed as a partnership, which is the most common arrangement. However, an LLC may elect to be taxed as a corporation.

### **Amendments to Operating Agreements**

An operating agreement may now specify that an amendment to the agreement requires the approval of a person that is not a party to the agreement or the satisfaction of a condition.<sup>21</sup> This provision may be useful in certain types of financing arrangements.

## Dissociation

Under prior law, a member could withdraw from an LLC and be paid the “fair value” of the member’s interest.<sup>22</sup> That provision does not apply under the new act. A member now has the power to dissociate as a member, whether rightfully or wrongfully, by withdrawing as a member.<sup>23</sup> The act specifies a number of events that may cause dissociation.<sup>24</sup> When a member dissociates, he or she retains the economic benefits of membership but loses the other incidents of an ownership interest in the LLC, such as the right to participate as a member in the conduct and management of the company’s business.<sup>25</sup> Absent an agreement to the contrary, neither the LLC nor the other members have an obligation to purchase the dissociated member’s interest.

## Charging Orders

The new act clarifies and expands the provisions relating to charging orders. A charging order in favor of a judgment creditor of a member of an LLC constitutes a lien on the judgment debtor’s interest in the LLC, and requires the LLC to pay over to the person holding the charging order any distributions from the LLC with respect to that interest. As originally adopted, the act provided that if a judgment creditor showed that distributions under the charging order will not pay the judgment debt within a reasonable time, a court could foreclose the lien and order the sale of the transferable interest. This provision was amended earlier this year to revert back to the concept that a judgment creditor of a member may obtain no more than a charging order.<sup>26</sup>

## Deadlock and Oppression

New Jersey deviated somewhat from the Revised Uniform Limited Liability Company Act in adopting provisions in the new LLC act that are to some extent based on the oppressed minority share-

holder provisions of the NJBCA.<sup>27</sup> The New Jersey Superior Court can enter an order dissolving an LLC on the grounds that its conduct is unlawful or that it is not reasonably practicable to carry on the LLC’s activities in conformity with either the certificate of formation or the operating agreement. Furthermore, upon a finding that the managers or members in control of an LLC have acted illegally or fraudulently, or in a manner that is oppressive and directly harmful to the applicant, the court will have broad powers to dissolve the company, appoint a receiver or order the sale of certain membership interests. An operating agreement may vary the power of a court to decree dissolution in an action under this provision.<sup>28</sup> In an action based on these provisions, a court has the discretion to award counsel fees and other expenses if it finds a party has acted vexatiously or otherwise not in good faith.<sup>29</sup> ☞

## Endnotes

1. The act is codified at N.J.S.A. 42:2C-1, *et seq.*
2. N.J.S.A. 42:2B-1, *et seq.* (repealed).
3. N.J.S.A. 42:2C-91.
4. P.L. 2012, Ch. 50, §95.
5. *See, e.g.* N.J.S.A. 14A:10-3 relating to the shareholder approval required for a corporate merger.
6. *See* the definition of an operating agreement in N.J.S.A. 42:2C-2.
7. N.J.S.A. 42:2C-4.
8. N.J.S.A. 42:2C-18(d).
9. N.J.S.A. 42:2C-26.
10. N.J.S.A. 42:2C-28.
11. N.J.S.A. 42:2C-27.
12. N.J.S.A. 42:2C-29.
13. N.J.S.A. 42:2C-4(b).
14. N.J.S.A. 42:2C-37(b)(2).
15. N.J.S.A. 42:2C-11(c).
16. N.J.S.A. 42:2C-39.
17. N.J.S.A. 42:2C-39(e).
18. N.J.S.A. 42:2C-11.
19. N.J.S.A. 42:2C-38.
20. N.J.S.A. 42:2C-34.

21. N.J.S.A. 42:2C-13(a).
22. N.J.S.A. 42:2B-39 (repealed).
23. N.J.S.A. 42:2C-45.
24. N.J.S.A. 42:2C-46.
25. N.J.S.A. 42:2C-47.
26. N.J.S.A. 42:2C-43. *See* P.L. 2013, Ch. 276.
27. N.J.S.A. 42:2C-48.
28. N.J.S.A. 42:2C-11(c)(7).
29. N.J.S.A. 42:2C-48(c).

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