

STEPHEN P. KATZ
KEVIN J. O'CONNOR

Sweeping Changes to New Jersey's LLC Law Could Dramatically Impact Your Business and Any Potential Inter-Member Disputes

In September 2012, New Jersey enacted the Revised Uniform Limited Liability Company Act (the "Revised LLC Act"), which will replace the current statute governing New Jersey limited liability companies ("LLCs"). The bill was created in an attempt to fill gaps in New Jersey law regarding the operation of LLCs, as well as to update the outdated existing law. The bill contains a number of very important changes from the existing law. Members of New Jersey LLCs and those wishing to form LLCs in New Jersey will need to fully understand the impact of the changes to the LLC law and consider how best to address them.

The Revised LLC Act will go into effect in February 2013 for all new companies formed after that date, and, in February 2014, it will apply to all LLCs, whenever formed.

Members of companies that are currently operating in the form of an LLC should take notice of significant changes in the law that could have a material effect on the way an LLC operates and how inter-member disputes are adjudicated. While we generally view the Revised LLC Act favorably as a business-friendly modern regulatory scheme for the creation and operation of LLCs, the bill has mandated significant changes that could be a trap for the unwary, including:

[Permissible Form of Operating Agreement](#)

The prior law defined an operating agreement among members as one that is in writing. The Revised LLC Act now permits an operating agreement to be proven even where it is oral or implied based on the way the LLC was actually operated. In practice, a dispute between members could be detrimental where no written agreement is in place and where one member claims the existence of an oral or implied agreement. A claim of an oral or implied agreement could possibly cause protracted and expensive litigation without the ability for early resolution through motion practice. For clients operating New Jersey LLCs without written operating agreements, we encourage them to consider having written operating agreements prepared that contain provisions indicating that the written operating agreement is the entire agreement between the members and cannot be modified unless it is in writing.

Please Contact

Stephen P. Katz
at skatz@pecklaw.com
201.343.3434

Kevin J. O'Connor
at koconnor@pecklaw.com
201.343.3434

Disassociation of a Member

Provisions of the Revised LLC Act would eliminate a major pitfall concerning the resignation or disassociation of a member of an LLC. Under the old statute, when a member resigns from an LLC, in the absence of an agreement to the contrary, that member would be entitled to receive the fair value of his or her LLC interest as of the date of resignation. Under the Revised LLC Act, upon resignation, the resigning member is disassociated as a member and has only the rights of an economic interest holder and will forfeit any voting rights.

Management

The Revised LLC Act, by default, will provide each member with equal rights in management regardless of how much capital the members contribute. Any difference arising among the members as to matters in the ordinary course of business may be decided by majority of the members (not percentage of ownership interests). However, the Revised LLC Act differentiates between ordinary course and outside the ordinary course, and requires that acts outside the ordinary course can only be undertaken with the consent of all members. If members of an LLC have different ownership percentage interests and desire to have voting in accordance with ownership percentages, provisions can be made for that in the LLC operating agreement. Otherwise, each member will have an equal vote.

Fiduciary Duties

The Revised LLC Act codifies the concepts of fiduciary duty of care and loyalty, and the obligation of good faith and fair dealing on the part of management of an LLC. It also provides that the operating agreement can eliminate or restrict elements of fiduciary duties only if elimination or restriction of fiduciary duties is “not manifestly unreasonable.”

Remedies for Deadlock and Oppression

The Revised LLC Act extends many of the traditional remedies available at common law or pursuant to statute to LLCs. It allows a member to seek a court order dissolving the company on the grounds that the managers or those members in control of the company have acted in manner that is oppressive and was, is, or will be directly harmful to the member. It also permits a less drastic method to resolve deadlock in the form of an appointed custodian.

Allocations of Profits, Losses and Distributions

Under the Revised LLC Act, unless otherwise agreed upon, allocations of profits and losses and distributions are made to members on a per capita basis NOT on the basis of capital contributed. This is another reason to put your agreement in writing.

Indemnification

Unlike the old law under which indemnification of members, managers, officers and directors is discretionary, the Revised LLC Act makes it mandatory that LLCs indemnify and hold harmless members, managers, officers and directors under certain specified circumstances except to the extent such indemnification is permitted to be limited in an operating agreement.

The new LLC law highlights the importance of drafting a written operating agreement for any business to avoid prolonged and expensive litigation in the event of member discord and management issues. Our corporate and commercial litigation practice groups are available to counsel your business in these areas, whether it be to help you adopt a written operating agreement or to provide counsel with respect to any inter-member disputes or litigation.