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Is newer always better?: Important changes in the New Jersey limited liability company act

Over the last decade, limited liability companies

(LLCs) have become the entity of choice for real estate investments in most



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jurisdictions. The LLC entity offers great flexibility in establishing the rights, obligations and economic terms between the owners and in structuring the management of the company. At the same time, it provides liability protection for the owners as well as favorable tax treatment. Although matters such as the rights and obligations of the members, economic terms, and management are generally contractual in nature and governed by the parties' operating agreement, the LLC is a creature of statute and drafters need to be aware of the underlying statute and its impact on the LLC, especially when that underlying statute is revised.

On September 19, 2012,

New Jersey did not merely revise its statute governing LLCs, it replaced



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it with the Revised Uniform Limited Liability Company Act, colloquially known as RULLCA. Although the new law became effective on March 18, 2013 (the "Effective Date"), it was not until March 1, 2014 that RULLCA applied to LLCs formed prior to the Effective Date. (Between the Effective Date and March 1, 2014, RULLCA applied only to LLCs formed during that period or to LLCs that voluntarily amended their operating agreements to specify that RULLCA would govern.) Therefore, it was not until March 1, 2014, when the prior act was repealed, that RULLCA applied to all NJ LLCs.

What does this mean to you? Well, whether you are a new or existing LLC, RULLCA has upgraded and modernized the rules for the formation and operation of

LLCs. The key changes can be divided into two categories: those that impact on the formation and governance of LLCs and those that affect the relationships between the members of LLCs.

The Formation and Governance of LLCs

There are four important changes regarding the formation and governance of an LLC:

(1) Under the prior act, unless specifically stated, LLCs had a limited lifespan of thirty years. RULLCA provides that LLCs, like corporations, now have a perpetual duration unless specified otherwise.

(2) RULLCA provides that an LLC's operating agreement may be written, oral or, most importantly, IMPLIED based upon the way the parties have operated the company. This is a crucial change for LLCs without a written agreement or with an incomplete one, as it allows a court to establish an operating agreement and/or its provisions through prior conduct. This can be a positive change or

a very detrimental one, depending on what side of a dispute you may be, but it definitely poses risks for everyone.

(3) LLCs can now file a Statement of Authority with the New Jersey Department of the Treasury, setting forth what individuals or entities can bind the LLC. Filing such a statement can be helpful as it puts third parties on notice as to who can contractually bind the LLC, minimizing problems with rogue employees or maintaining control among key members of the LLC.

(4) RULLCA makes it easier for an out-of-state entity to domesticate to a NJ LLC and for any entity to convert into an NJ LLC.

The Relationships between Members

As for the changes concerning the relationships between the members of LLC, there are five that can drastically affect how members interact under the new law:

(1) Distributions. Unless the operating agreement states otherwise, distributions shall be

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made on a per capita basis with each member entitled to an equal share of the profits or losses. If an LLC's current operating agreement is silent on this issue, or there is no written agreement, and the members have not been taking distributions on a per capita basis (but based on percentage of ownership interest, for example), the distributions will have to be specifically addressed or the intent of the parties may no longer be protected by the statute.

(2) Voting. Similarly, RULLCA provides that each member shall have an equal vote, regardless of percentage of ownership. It requires that ordinary business matters be decided by a majority vote of the members, with each member having one equal vote, and that matters outside the ordinary course (e.g., mergers, sale of all assets, or amendment of the operating agreement) be decided by a unanimous vote. Alternate voting schemes must be expressly addressed in the operating agreement.

(3) Fiduciary Duties of Loyalty and Care: Unlike the prior law, RULLCA imposes a duty of loyalty (which may be modified in the operating agreement) and a duty of care (which

may not be) on persons (whether members, or not) managing the LLC.

(4) Disassociation of a member. Previously, if a member elected to withdraw from the LLC, the LLC was obligated to distribute, in a reasonable time after withdrawal, the monetary value of that member's interest. With the adoption of RULLCA, a member does not have an automatic right to 'cash-out' his interest in the LLC but rather, upon withdrawal or disassociation, becomes an economic interest holder with an equity interest but no voting rights.

(5) Redress for Oppressed Minority Equity Owners. While RULLCA eliminated the right for a member to withdraw from an LLC at will, it did adopt a statutory scheme, similar to that found in the New Jersey Business Corporation Act, whereby oppressed minority equity owners can seek redress. It also expressly imposed a standard of good faith and fair dealing on the members (which may not be eliminated). So while a withdrawing member is no longer automatically entitled to the value of his, her or its interest upon withdrawal from the company, a member under RULLCA has remedies if

the managers or members in control are acting in a manner to oppress the aggrieved member, and taking actions that were, are or will be harmful to the aggrieved member's interest. The remedies include seeking dissolution of the company, appointment of a custodian, or requiring the LLC or other members to purchase the interest of the aggrieved member. This is a critical change in how disputes among members may be resolved, and it will take time for the courts to develop a body of case law related to the oppressed minority member provisions. However, the Courts will likely look to the case law developed under the Corporation Act.

The bottom line is that key changes have been made by RULLCA that impact the formation and governance of New Jersey LLCs as well as the relationships between the LLC members. If it was not the case before, it is certainly now critically important for members of LLCs in New Jersey who have not already done so to negotiate and execute a comprehensive operating agreement. Further, existing operating agreements should be reviewed with an eye to the chang-

es brought by RULLCA.

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