Big Changes in NJ LLC Law

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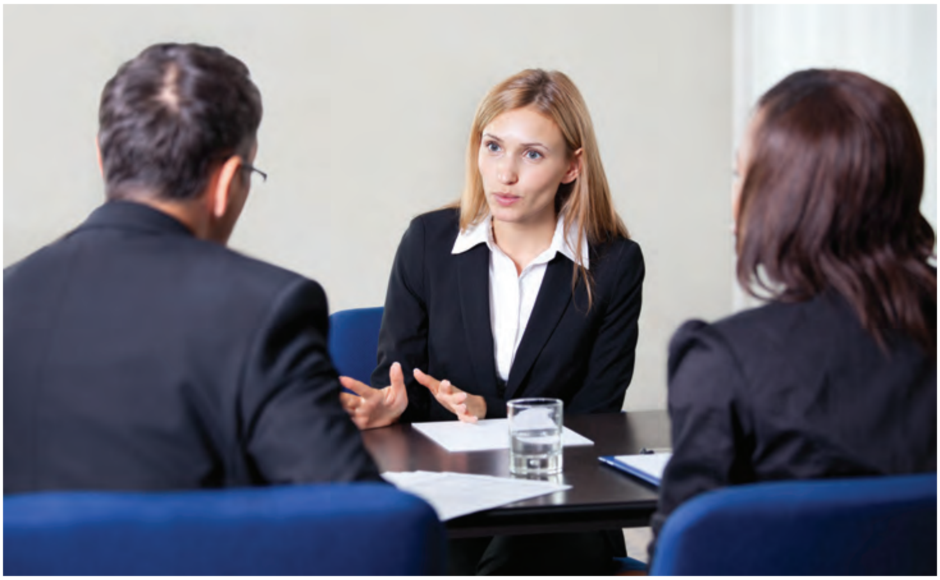

New Jersey's new LLC law – the New Jersey Revised Uniform Limited Liability Company Act (RULLCA) – already applies to any LLC formed on or after March 18, 2013, and will apply to all LLCs, both new and old, on March 1, 2014. The following are some key changes to this law:

Distributions

Assume owner A contributes $90,000 and owner B contributes $10,000 to an LLC. They may expect to share profits on a 90/10 basis, which was the case under the old law. However, under the new law, they share profits on a 50/50 basis.

Voting

Assume owner C joins the LLC by contributing $10,000. Owner A, contributing nearly 82 percent of the capital, may think that he or she makes all of the decisions for the LLC, which was true under the old law. However, under the new law each owner has an equal vote, and decisions are made by the majority of the owners. As a result, owners B and C can outvote owner A, 2-1, although they own only 18 percent of the LLC. Also, any major decisions, such as a merger of the LLC or sale of the LLC's assets, require a unanimous vote.

Resignation

Assume owner A is disillusioned and resigns from the LLC. By resigning, he or she loses the right to vote and manage the LLC, but continues to own an economic interest entitling him or her to receive any distributions from the LLC. By contrast, under the old law, owner A would have his or her equity interest purchased by the LLC for fair value.

Fiduciary Duty of Loyalty

Assume owner A forms another LLC to engage in the same business – for example, an LLC to acquire and hold real estate. Owner A would be surprised to learn that he or she has breached his or her fiduciary duty of loyalty to owners B and C by starting a competing business. Further assume owner A lends money to the LLC at an interest rate higher than one available from a bank. Unless owners B and C agree, owner A has breached his or her duty of loyalty since the terms of the loan are not fair to the LLC. Under the old law, there was no fiduciary duty of loyalty specified in the statute and nothing definitive in the case law.

Oppression

Assume owner A mistreats owners B and C by, for example, reducing their compensation or withholding information. They can file a lawsuit and, depending on the nature and extent of the oppressive conduct, the court may appoint a custodian to run the business or force owner A to purchase the equity interests of owners B and C, among other things. Minority owners did not have such rights or remedies under the old law, since oppression was not addressed in the statute and the case law was inconsistent.

Operating Agreement

There were legitimate reasons for the changes in the law. Among them, the statute protects minority owners of an LLC by, for example, treating all owners equally. Fortunately, the first four changes are default statutory provisions that will apply only if the LLC does not have an operating agreement. In fact, in drafting the statute, it was assumed that where owners make different capital contributions or have unique economic arrangements, the LLC would have an attorney prepare an operating agreement to change these default provisions.

These changes in the law can lead to surprising results if CPAs and their clients do not prepare for them. As such, it pays to have a written operating agreement so that the owners do not have to go to court to prove the terms of an oral or implied agreement. Every LLC should have a written agreement, and existing agreements should be reviewed in light of changes in the law.

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