

Top Ten Changes Physician LLC Members Should be Concerned About Regarding New LLC Law in New Jersey

On March 1, 2014 the New Jersey Revised Uniform Limited Liability Company Act (RULLCA) became effective, and the New Jersey Limited Liability Company Act (the Old Act) was repealed. RULLCA has made a number of important changes in New Jersey limited liability company (LLC) law. This article will examine the top ten changes in LLC law under RULLCA that physician members of LLCs should be concerned about with respect to their participation in a New Jersey LLC. As a result of the changes under RULLCA, it is more important than ever for physician LLC members to ensure that they have a written operating agreement in place to govern their LLCs.

Distributions. Under the Old Act, unless otherwise specified in the operating agreement of the LLC, each member was entitled to share profits or losses of the LLC based on the agreed value of each member's capital contribution to the LLC. However, under RULLCA, each member of an LLC is entitled to an equal share of the profits or losses, regardless of capital contributions or ownership percentages, unless the LLC's operating agreement provides otherwise.

Voting. Under the Old Act, unless otherwise provided in the LLC's operating agreement, most matters, including mergers and consolidations and sales of assets, were decided by a majority of the members' current profit percentages. Under RULLCA, unless otherwise provided in the LLC's operating agreement, ordinary matters are decided by a majority of the members, with each member having one vote, regardless of the member's profit percentage interest in the LLC. Under RULLCA, unless otherwise provided in the operating agreement, extraordinary matters such as mergers, consolidations and sale of all or substantially all of the LLC's assets, are decided by the unanimous vote of the members (including in LLCs that are manager-managed). However, the ability to alter the default rule in the operating agreement is qualified by some special rules relating to approval of certain merger, conversion and domestication transactions in which a member will have personal liability.

Fiduciary Duty of Loyalty. Under the Old Act, no specific fiduciary duties were imposed on managers or LLC members. Under RULLCA, in a member-managed LLC, members now have a fiduciary duty of loyalty and in manager-managed LLCs, managers now have a fiduciary duty of loyalty. This new duty of loyalty requires the persons managing the LLC to account to the LLC and to hold as trustee for it any property, profit or benefit derived (1) in conducting, or winding up, of the LLC's activities, (2) from the use of the LLC's property, and (3) from misappropriation of any business opportunities of the LLC. Persons managing the LLC are now also required to refrain from competing with the LLC and refrain from engaging in interested transactions with the LLC, such as lending money to the LLC or leasing property to the LLC. However, there are certain limited defenses to the duty of loyalty which are available to LLC members.

RULLCA provides that an operating agreement of an LLC may eliminate or restrict the duty of loyalty specified under RULLCA, so long as doing so is not determined to be manifestly unreasonable (discussed in further detail below). For example, an operating agreement may identify specific types or categories of activities that do not violate the duty of loyalty (such as members of an LLC that owns a surgery center agreeing that members of the LLC may have other interests in other surgery centers located in other counties). Additionally, in lieu of the default requirement for all members to approve an interested transaction involving a managing person, an operating agreement may require a super-majority or majority of disinterested members to authorize or ratify an interested transaction violating the duty of loyalty after a full disclosure of material facts.

Whether an elimination or restriction of fiduciary duties is manifestly unreasonable is an issue of law to be decided by the court based on the circumstances as of the time the provision was added to the operating agreement of the LLC. The court can invalidate the limiting provision if it is readily apparent in light of the purposes and activities of the LLC, that the objective of the term is unreasonable or the term is an unreasonable means to achieve the term's objective.

Fiduciary Duty of Care. The Old Act did not impose any duty of care on managers or members in the operation of an LLC. Under RULLCA, in a member-managed LLC, each member owes a duty of care to the other members and in a manager-managed LLC, each manager owes a duty of care to the members (but members do not have a duty of care in a manager-managed LLC). Under RULLCA, the duty of care requires a managing person to refrain from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law. Unlike the fiduciary duty of loyalty, an operating agreement of an LLC cannot eliminate the duty of care (regardless of whether the elimination could be found to be not manifestly unreasonable). However, the operating agreement of an LLC may alter the duty of care (if not manifestly unreasonable), except to authorize intentional misconduct or knowing violation of law.

Contractual Obligation of Good Faith and Fair Dealing. Under the Old Act, there was no statutory covenant of good faith and fair dealing. Under RULLCA, members and managers of an LLC are required to exercise their rights and perform their duties under both RULLCA and the LLC's operating agreement under a standard of good faith and fair dealing. Under RULLCA, the contractual obligation of good faith and fair dealing cannot be eliminated in an LLC's operating agreement, but it may prescribe standards by which to measure whether a member or manager has complied with the obligation.



Oppression. Under the Old Act, there were no rights or remedies available to oppressed members of an LLC such as those available to minority shareholders of New Jersey corporations. Under RULLCA, a court can dissolve an LLC or appoint a custodian or provisional manager on grounds that the managers or controlling members (a) have acted, are acting, or will act in an illegal or fraudulent manner or (b) have acted or are acting in an oppressive manner that was, is or will be directly harmful to a member. Under RULLCA, the rights and remedies available to oppressed members of an LLC may not be eliminated or altered in the LLC's operating agreement.

Resignations. Under the Old Act, a resigning member was entitled to receive fair value from the LLC for the member's equity interest as of the date of resignation, less all applicable discounts (such as minority or marketability discounts), unless otherwise provided in the LLC's operating agreement. Under RULLCA, a member who resigns or withdraws from an LLC is not entitled to fair value for that member's equity interest or any other distribution from the LLC, but instead simply becomes a disassociated member who continues to be entitled to distributions and a liquidating distribution on dissolution, without a right to vote or participate in the management of the LLC. However, the LLC's operating agreement can include provisions which address buyouts on resignations or withdrawals so as to avoid this issue.

Member Retention of Rights, Duties and Obligations After Transfer of the Member's LLC Interest. Under RULLCA, unless otherwise provided in the LLC's operating agreement, when a member transfers a transferable interest of the member (the right to receive distributions), the transferring member retains the rights of a member other than the interest in distributions transferred and retains all duties and obligations of a member of the LLC. Under RULLCA, there is an exception under which a transferring member does not retain the rights of a member, but that exception requires the transferring member to be disassociated as a member of the LLC by being expelled by the unanimous consent of the other members of the LLC upon the transfer of all of the person's transferable interest in the LLC. Therefore, unless otherwise provided in an LLC's operating agreement, a transferring member of an LLC will continue to be a member of the LLC with all rights and duties, except the right to receive distributions, unless affirmatively expelled by the other members in accordance with RULLCA (in which case the expelled person would have no management rights but would remain liable for any liabilities and obligations incurred while a member of the LLC). Though a transferring member and the LLC could try to negotiate this issue at the time of transfer (to allow the transferee to obtain all member rights), it is in the interest of LLC members to have this issue resolved in their operating agreement so that no last minute negotiations of this issue will be necessary.

Oral and Implied Operating Agreements Permitted. Under the Old Act, an LLC was not affirmatively required to have an operating agreement, but if it had one, it had to be in writing to be enforceable. Under RULLCA, oral and implied operating agreements are permitted. If an LLC does not have a written operating agreement which addresses the concerns described above or otherwise modifies the default rules under RULLCA, physician LLC members may be faced with the very difficult task of proving their oral or implied agreements regarding the LLC in court in lengthy and expensive litigation.

Dissolution. Under RULLCA, dissolution of an LLC is now a two-step process under which the LLC must first file a certificate of dissolution with the New Jersey Division of Revenue, wind up the LLC and then file a certificate of termination upon the completion of the wind up of the LLC. RULLCA also contains detailed provisions regarding LLC dissolution procedures. Under RULLCA, unless otherwise provided in the LLC's operating agreement, any remaining funds of the LLC after payment of creditors and distribution of unreturned capital contributions is to be distributed equally to members and dissociated members (i.e., per capita). Under the Old Act, such liquidating distributions were to be distributed to members based on the percentages in which the members shared profit distributions, unless otherwise provided in the LLC's operating agreement.

For more information regarding the changes in New Jersey LLC law under RULLCA, please contact Patrick Convery, Esq. at (732) 219-5499 or pconvery@ghclaw.com.