

Non-Waivable Provisions Under the New Jersey Revised Uniform Limited Liability Company Act

by Gianfranco A. Pietrafesa

Almost all of the default provisions in the New Jersey Revised Uniform Limited Liability Company Act (NJ-RULLCA)¹ may be altered, except as otherwise provided in Section 11 of the statute.² Indeed, NJ-RULLCA provides that it “is to be liberally construed to give the maximum effect to the principle of freedom of contract and to the enforceability of operating agreements.”³ This article identifies and explains the statutory default provisions that may not be altered under Section 11 of the statute, the so-called ‘non-waivable’ provisions.

Litigation

A limited liability company (LLC) has the capacity to sue and be sued in its own name.⁴ An operating agreement may not vary an LLC’s right to engage in litigation.⁵

The Uniform Law Commission (ULC) August 19, 2015 Comments (2015 Comments) to its Revised Uniform Limited Liability Company Act (RULLCA) state that an LLC is an entity distinct from its members and that its members lack the power to alter that characteristic.⁶ This provision is likely a carryover from the ULC’s general partnership act, which provides that a partnership is distinct from its partners. It is not a controversial provision.

Applicable Law

NJ-RULLCA provides that New Jersey law governs: 1) the internal affairs of a New Jersey LLC, and 2) the liability of a member as member and a manager as manager for the debts, obligations, or other liabilities of an LLC.⁷ An operating agreement may not vary this applicable law.⁸

The ULC 2015 comments state that an operating agreement may lawfully incorporate by reference the provisions of another state’s LLC statute.⁹ For example, an operating agreement of a New Jersey LLC may incorporate by reference Delaware’s LLC statute. New Jersey law would still govern the agreement, but Delaware’s LLC statute and

the operating agreement would govern the members of the LLC to the extent not prohibited by NJ-RULLCA. As noted in the ULC 2015 comments, this approach raises complex drafting issues and is rarely, if ever, a good idea.

Court Power

A court has the power to enter orders regarding the signing and filing of records.¹⁰ An operating agreement cannot interfere with the court’s power in this regard.¹¹

Fiduciary Duties

Members of a member-managed LLC and managers of a manager-managed LLC have fiduciary duties of loyalty and care.¹² Although NJ-RULLCA provides that an operating agreement may not eliminate the duty of loyalty, the duty of care, or any other fiduciary duty,¹³ it further provides that, if not manifestly unreasonable,¹⁴ an operating agreement may restrict or eliminate the duty of loyalty,¹⁵ alter (but not eliminate) the duty of care,¹⁶ and alter or eliminate any other fiduciary duties, meaning fiduciary duties under the common law.¹⁷

Good Faith and Fair Dealing

The members and, if applicable, the managers must discharge their duties and exercise their rights under the operating agreement and NJ-RULLCA consistent with the contractual obligation of good faith and fair dealing.¹⁸ An operating agreement may not eliminate this obligation,¹⁹ but, if not manifestly unreasonable, it may prescribe standards by which to measure the performance of the obligation.²⁰

Information Rights

Members, managers and even dissociated members have certain rights to receive information about the LLC.²¹ An operating agreement may restrict such rights, or the duties to provide such information, but may not do so unreasonably.²² In addition to restrictions or conditions in an operating agreement, an LLC may

impose reasonable restrictions and conditions on access to and use of records and information, including designating information as confidential and imposing nondisclosure and safeguarding obligations on the recipient.²³

The ULC 2015 comments note that in determining whether a restriction is reasonable, a court might consider: 1) the danger or other problem the restriction seeks to avoid, 2) the purpose for which the information is sought, and 3) whether, in light of both the problem and the purpose, the restriction is reasonably tailored.²⁴

Judicial Dissolution

A court has the power and authority to dissolve an LLC on various statutory grounds.²⁵ An operating agreement may not vary the court's power to judicially dissolve a New Jersey LLC under these statutory grounds.²⁶ However, an operating agreement can limit the remedies the court has the power to impose to dissolution only; for example, it can provide that a court cannot enter an order for the sale and purchase of LLC interests.²⁷

Winding Up a Dissolved LLC

An LLC in dissolution must wind up its business as provided in NJ-RULLCA.²⁸ An operating agreement may not vary this requirement.²⁹ For example, an LLC cannot continue its business indefinitely and cannot make distributions to members in lieu of payments to creditors.

Direct or Derivative Action

NJ-RULLCA provides members with the right to maintain direct and derivative actions.³⁰ An operating agreement may not unreasonably restrict such rights.³¹ The ULC 2015 comments note that reasonable provisions in an operating agreement include forum selection, mediation prior to litigation, arbitration of direct and derivative claims, waiver of jury trial and a demand in all derivative cases. By contrast, the ULC 2015 comments note that it would be unreasonable, by way of example, for an operating agreement to require a would-be derivative plaintiff to make demand regardless of futility.³²

Approval of Extraordinary Action

NJ-RULLCA requires the members to unanimously approve extraordinary action, such as a merger, conversion or domestication.³³ Nothing in the statute prevents an operating agreement from altering this unanimity requirement to a simple majority or supermajority requirement.

However, if a merger, conversion or domestication

will result in the members having personal liability as the owners of the surviving, converted or domesticated company, then the members will have the right to unanimously approve the action.³⁴ For example, if an LLC for some reason wants to convert to a general partnership, it must receive the unanimous approval of the members since they would have unlimited personal liability as partners in the general partnership. In such situations, an operating agreement may not restrict a member's right to approve such a merger, conversion or domestication.³⁵

Rights of Third Parties

An operating agreement may restrict the rights of a member and manager,³⁶ as well as a dissociated person and transferee,³⁷ but not the rights of third parties, such as creditors.³⁸

Indemnification and Exculpation

NJ-RULLCA provides for an LLC's indemnification of members, managers and others.³⁹ However, an operating agreement may alter and even eliminate such indemnification.⁴⁰ An operating agreement may also eliminate a member or manager's personal liability to the LLC and its members for money damages.⁴¹ However, under no circumstances may an operating agreement permit indemnification or exculpation of a member or manager for certain 'bad acts,' such as breaching the duty of loyalty,⁴² receiving an improper personal benefit, making improper distributions,⁴³ intentionally inflicting harm on the LLC or a member,⁴⁴ or intentionally violating criminal law.⁴⁵

Conclusion

Section 11 provides that certain provisions of NJ-RULLCA cannot be altered—the so-called non-waivable provisions. However, as noted, many of the non-waivable provisions may, in fact, be altered as provided in NJ-RULLCA. ■

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Endnotes

1. N.J.S.A. 42:2C-1 *et seq.*
2. N.J.S.A. 42:2C-11(C), as modified by N.J.S.A. 42:2C-11(D) Through 42:2C-11(G).

3. N.J.S.A. 42:2C-11(I).
4. N.J.S.A. 42:2C-5.
5. N.J.S.A. 42:2C-11(C)(1).
6. ULC 2015 Comment to Section 105(C)(2). NJ-RULLCA is Based on the ULC's July 20, 2011 Version of RULLCA. See http://www.Uniformlaws.Org/Shared/Docs/Limited%20liability%20company/Ullca_Final_06rev.Pdf. Since then, the ULC Has Revised RULLCA and its Comments. The current version of RULLCA is dated Aug. 19, 2015. See Http://Www.Uniformlaws.Org/Shared/Docs/Limited%20liability%20company/ULLCA_Final_2014_2015aug19.Pdf. N.J.S.A. 42:2C-11 is based on Section 110 of the 2011 version, which was revised and renumbered as Section 105 in the 2015 version. A table with cross-references of N.J.S.A. 42:2C-11, 2011 RULLCA Section 110 and 2015 RULLCA Section 105 accompanies this article.
7. N.J.S.A. 42:2C-6.
8. N.J.S.A. 42:2C-11(C)(2).
9. ULC 2015 Comment to Section 104(1).
10. N.J.S.A. 42:2C-21.
11. N.J.S.A. 42:2C-11(C)(3).
12. N.J.S.A. 42:2C-39(A) & -39(I)(1). See N.J.S.A. 42:2C-39(B) (Duty of Loyalty) and N.J.S.A. 42:2C-39(C) (Duty of Care).
13. N.J.S.A. 42:2C-11(C)(4).
14. NJ-RULLCA addresses how a court is to determine whether a term in an operating agreement is manifestly unreasonable, but there is no case law explaining the term or its application. See Gianfranco A. Pietrafesa, The Manifestly Unreasonable Standard Under NJ-RULLCA, *NJSBA Business Law Section Newsletter*, Vol. 38, No. 1 (July 2014).
15. N.J.S.A. 42:2C-11(D)(1). In addition to eliminating or altering the duty of loyalty, an operating agreement may identify the specific types or categories of activities that do not violate the duty of loyalty. N.J.S.A. 42:2C-11(D)(2). For example, in a real estate holding company, the operating agreement will often provide that the ownership of other real estate by the members does not violate the aspect of the duty of loyalty prohibiting a member from competing with the LLC. See N.J.S.A. 42:2C-39(B)(3). See Also Gianfranco A. Pietrafesa, The Duty Of Loyalty Under The New Jersey Revised Uniform Limited Liability Company Act, 290 *N.J. Lawyer Mag.* 12 (Oct. 2014).
16. N.J.S.A. 42:2C-11(D)(3). Although an operating may alter the duty of care, it cannot authorize intentional misconduct or knowing violations of law, which is not surprising. *Id.*
17. N.J.S.A. 42:2C-11(D)(4). It is not clear whether there are any other fiduciary duties, but a court may conclude that a member or manager has the duty to maintain the confidentiality of the LLC's confidential information and the duty to make certain disclosures to the LLC, its managers and members.
18. N.J.S.A. 42:2C-39(D).
19. Every contract in New Jersey includes an implied covenant of good faith and fair dealing, which is identical to the contractual obligation of good faith and fair dealing; therefore, it makes sense that the contractual obligation of good faith and fair dealing cannot be eliminated. Note that the obligation includes the exercise of rights and the discharge of duties under NJ-RULLCA (in addition to those under the operating agreement), which makes sense since the statute serves as the default operating agreement in the absence of an operating agreement. See N.J.S.A. 42:2C-11(B) ("To The Extent That The Operating Agreement Does Not Otherwise Provide For A Matter Described In Subsection A. Of This Section, This Act Governs The Matter").
20. N.J.S.A. 42:2C-11(D)(5). There is no case law explaining the concept of prescribing standards to measure performance of the contractual covenant of good faith and fair dealing. See Gianfranco A. Pietrafesa, Standards To Measure Good Faith And Fair Dealing Under NJ-RULLCA, 216 *N.J.L.J.* 362 (May 5, 2014). See ULC 2015 Comment to RULLCA §105(C)(6) for examples of contract provisions purporting to create standards to measure performance of the contractual covenant of good faith and fair dealing.
21. N.J.S.A. 42:2C-40.
22. N.J.S.A. 42:2C-11(C)(6).
23. N.J.S.A. 42:2C-40(G).

24. ULC 2015 Comment to RULLCA 105(C)(8).
25. N.J.S.A. 42:2C-48(A)(4) & (5). These statutory grounds include, but are not limited to, it being not reasonably practicable to carry on the LLC's business in conformity with the operating agreement, N.J.S.A. 42:2C-48(A)(4)(B), and oppression of one or more members by the managers or controlling members, N.J.S.A. 42:2C-48(A)(5)(B).
26. N.J.S.A. 42:2C-11(C)(7).
27. ULC 2015 Comment to RULLCA 701(B) (“...[N.J.S.A. 42:2C-48(B)] Can Be Overridden By The Operating Agreement. Thus, The Members May Agree To Restrict Or Eliminate A Court’s Power To Craft A Lesser Remedy, Even To The Extent Of Confining The Court (And Themselves) To The All-Or-Nothing Remedy Of Dissolution.”).
28. N.J.S.A. 42:2C-49(A) & -49(B)(1).
29. N.J.S.A. 42:2C 11(C)(8).
30. N.J.S.A. 42:2C-67 through -72.
31. N.J.S.A. 42:2C-11(C)(9).
32. See ULC 2015 Comments to Section 105(C)(11).
33. N.J.S.A. 42:2C-75(A), -79(A) & -83(A)(1).
34. N.J.S.A. 42:2C-86(A).
35. N.J.S.A. 42:2C-11(C)(10). An operating agreement cannot sidestep such a unanimous vote requirement through a provision allowing an amendment of the agreement with less than the unanimous consent of the members. See N.J.S.A. 42:2C-86(B).
36. N.J.S.A. 42:2C-11(C)(11).
37. *Id.*; N.J.S.A. 42:2C-13(B). For example, an operating agreement may restrict a transferee of a transferable interest from becoming a member unless the transferee satisfies certain conditions, such as agreeing to be bound to the terms of the operating agreement.
38. N.J.S.A. 42:2C-11(C)(11). As noted, an operating agreement may limit the power of a court to dissolution of an LLC as opposed to the grant of lesser remedies for oppression. See *Supra* N.27.
39. N.J.S.A. 42:2C-38.
40. N.J.S.A. 42:2C-11(G).
41. *Id.*
42. However, As Noted, An Operating Agreement May Eliminate The Duty Of Loyalty. *Supra* N.15.
43. See N.J.S.A. 42:2C-36.
44. This prohibition against indemnifying or exculpating a member or manager for intentionally inflicting harm on a member includes oppressive conduct.
45. N.J.S.A. 42:2C-11(G).

Table of Applicable Provisions under
NJ-RULLCA v. 2011 RULLCA and 2015 RULLCA

| NJ-RULLCA | RULLCA (7-20-11) <i>NJ law based on this version</i> | RULLCA (8-19-15) <i>Current version</i> |
|-----------------|---|--|
| 42:2C-11(c)(1) | 110(c)(1) | 105(c)(2) |
| 42:2C-11(c)(2) | 110(c)(2) | 105(c)(1) |
| 42:2C-11(c)(3) | 110(c)(3) | 105(c)(4) |
| 42:2C-11(c)(4) | 110(c)(4) | 105(c)(5) |
| 42:2C-11(c)(5) | 110(c)(5) | 105(c)(6) |
| 42:2C-11(c)(6) | 110(c)(6) | 105(c)(8) |
| 42:2C-11(c)(7) | 110(c)(7) | 105(c)(9) |
| 42:2C-11(c)(8) | 110(c)(8) | 105(c)(10) |
| 42:2C-11(c)(9) | 110(c)(9) | 105(c)(11) |
| 42:2C-11(c)(10) | 110(c)(10) | 105(c)(13) |
| 42:2C-11(c)(11) | 110(c)(11) | 105(c)(15) |
| 42:2C-11(g) | 110(g) | 105(c)(7) |