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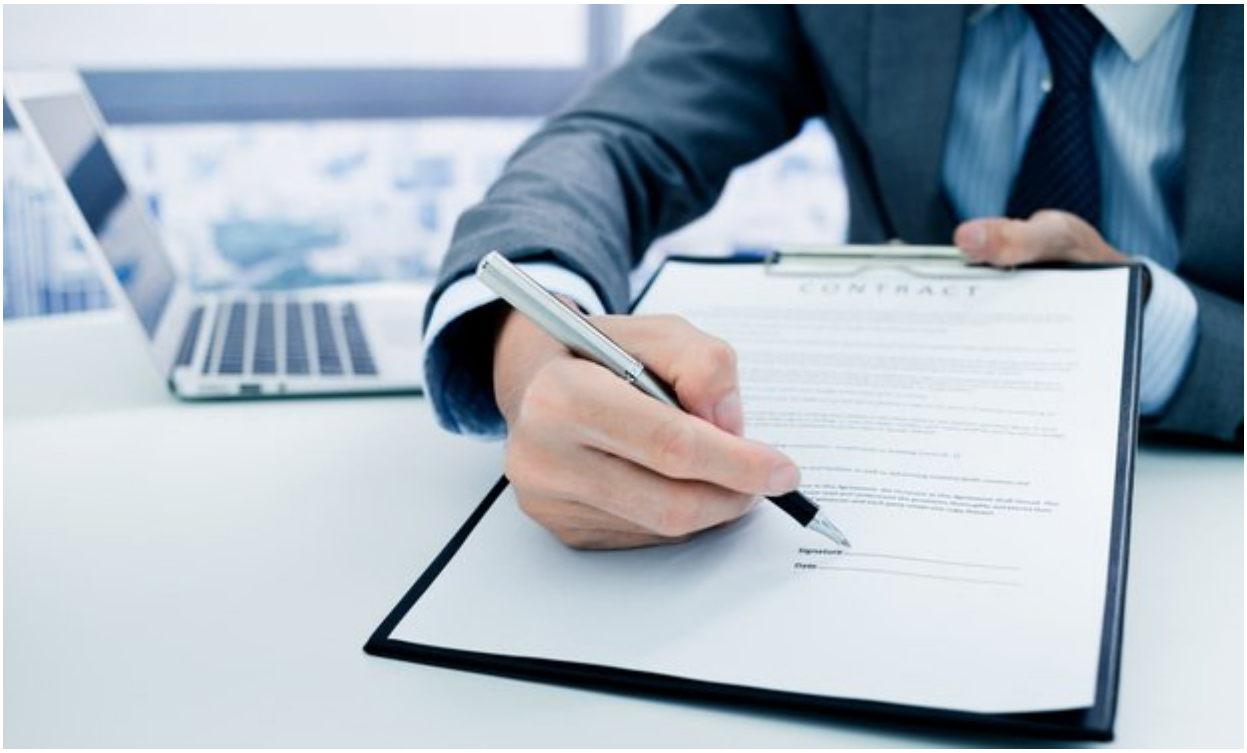
How Do I Bind Thee (to an LLC Operating Agreement)? Let Me Count the Ways

A recent appellate decision clarifies the point at which members—either existing or subsequent—may be bound by an operating agreement. But it leaves unresolved the question of how a member might consent to an operating agreement through conduct.

By **Mark J. Oberstaedt and Amy E. Pearl** | July 22, 2021



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There are many ways in which an LLC member, and even certain non-members, can be bound by the terms of a limited liability company's operating agreement, or even a draft they did not sign, under New Jersey's Revised Uniform Limited Liability Company Act (NJ-RULLCA), N.J.S.A. 42:2C-1 et. seq. In a recently published decision, *Premier Physician Network v. Maro*, No. A-1152-20, 2021 WL 2124195 (App. Div. May 26, 2021), the Appellate Division makes clear that when it comes to operating agreements, all members are not created equal. Whether and how a member (or other interested person) can become bound by an operating agreement depends, in part, on when they acquired that status.

The 'Maro' Decision

In *Maro*, six physicians, who were already colleagues in an existing medical practice, agreed to form a new entity that they hoped would allow them to earn higher profits with a number of other doctors. In August 2014, the doctors formed a new LLC by filing a certificate of formation with the New Jersey Division of Revenue, and all of them signed a letter of intent which purported to set forth the principal terms of their agreement to participate in that LLC. The letter of intent provided that, after at least four doctors signed it, the signors and organizers would initiate negotiation and preparation of an operating agreement, and they would use good faith efforts to have that operating agreement executed by Dec. 31, 2014. If the operating agreement was not finalized by that date, any of the physicians could elect not to continue.

The Dec. 31 deadline expired without a finalized operating agreement, but none of the members withdrew. Instead, the members continued to exchange drafts of the operating agreement and, eventually, many of the doctors signed a supposedly final version. An exhibit to the operating agreement that purported to list all members of the LLC did not include the two defendants. Despite not signing, the defendants continued to participate as members of the LLC from 2014 until January 2016 by, among other things, submitting billings to the entity, depositing cash, using services, having the LLC pay their office rent and malpractice insurance, executing personal guarantees for company debt, and receiving distributions and K-1s from the LLC. In other words, they fully participated as members, but had not signed the operating agreement.

In late January 2016, however, the two defendants stopped using the LLC and returned to practicing on their own. The remaining members sued them and, among other things, alleged the defendants were bound by the operating agreement and owed their respective portions of the entity's debt. On summary judgment, the trial court sided with the remaining members and held that the defendants were bound by the draft operating agreement that was "drafted and circulated in or about January 2015" even though they had not executed it. In doing so, the trial court relied on N.J.S.A. 42:2C-12(b), which provides "[a] person that becomes a member of a limited liability company is deemed to assent to the operating agreement."

The Appellate Division reversed, finding that NJ-RULLCA's definition of "operating agreement" in N.J.S.A. 42:2C-2 required that all existing members of the LLC must agree to the operating agreement's terms. The court explained that "[i]f all existing members do not agree to the draft agreement when it is proposed, then the draft operating agreement remains just that—a draft agreement; it never becomes the operating agreement of the LLC." The panel found that the provision upon which the trial court based its ruling, N.J.S.A. 42:2C-12(b), only applied to future members, not the original members of the LLC.

Since the statute does not define how a member can demonstrate assent to the terms of the operating agreement, and because it allows for oral operating agreements, signatures are not required. Instead, members can demonstrate their consent in writing, verbally, or by their actions. Because the Appellate Division found that there was a material dispute as to whether the actions of the non-signors demonstrated consent to the operating agreement, the panel remanded the case back to the trial court.

LLC Members

The *Maro* decision drew a line in the sand between existing members and future members in determining whether a given member is bound by the company's operating agreement, and relied on NJ-RULLCA's statutory language to tease out that distinction.

- *Existing Members*

As interpreted by the Appellate Division, NJ-RULLCA requires all existing members of an LLC to demonstrate their acceptance of the terms of a draft operating agreement before it becomes "the" operating agreement. This is hardly surprising since NJ-RULLCA defines an operating agreement, in relevant part, as "the

agreement … of all the members of a limited liability company." N.J.S.A. 42:2C-2. In other words, there is no operating agreement unless and until all members agree to its terms.

But, as the *Maro* court points out, parties can assent to the terms of a contract in writing, verbally, or through their conduct. The easy case is written assent. Typically, the existing member(s) of an LLC execute an operating agreement at or near the formation of the entity, which leaves no doubt as to their consent. Verbal assent, if uncontested, is easy to establish too. While *Maro* recognized members can consent to a draft operating agreement through their conduct, it left unanswered what conduct would be sufficient to constitute that consent when the member has not otherwise assented. Potentially probative of an intent to be bound might be carrying oneself as a member of the LLC by accepting distributions, exercising voting rights, or executing personal guarantees on behalf of the company.

Notably, the original members of the LLC do not need to wait until after the entity is formed to agree to the terms of the operating agreement. The statute specifically allows the members to enter into an agreement before they form the entity "providing that upon formation of the company the agreement will become the operating agreement." N.J.S.A. 42:2C-12(c).

• *Subsequent Members*

Although the initial members of the LLC must affirmatively agree to the terms of the operating agreement in one form or another, that is not the case for members who join the LLC after the existing member(s) have adopted the operating agreement. Under NJ-RULLCA "[a] person that becomes a member of a limited liability company is deemed to assent to the operating agreement." N.J.S.A. 42:2C-12(b). Interpreting that statutory language, the *Maro* court recognized that after the initial members consent to the operating agreement, "any subsequent members are bound by the already-existing operating agreement."

• *Non-Members*

Even non-members may be bound by the terms of the LLC's operating agreement if the circumstances warrant. NJ-RULLCA provides the "limited liability company is bound by and may enforce the operating agreement, whether or not the company has itself manifested assent to the operating agreement." N.J.S.A. 42:2C-12(a). The statute also allows operating agreements to govern the rights and obligations of managers, who may or may not be members of the LLC. N.J.S.A. 42:2C-11(a)(2).

These provisions are consistent with traditional common law principles regarding third-party beneficiaries, who can be bound by contractual provisions they did not sign or otherwise accept. *See, e.g.*, *Jansen v. Salomon Smith Barney*, 342 N.J. Super. 254, 260-61 (App. Div. 2001) (non-signatories bound to an arbitration clause because they were the intended successors to the decedent's interest under his retirement account); *Allgor v. Travelers Insurance Co.*, 280 N.J. Super. 254, 261-62 (App. Div. 1995) ("A third-party beneficiary may accept the benefits of the contract, but is also bound by any burdens or restrictions created by it.").

Conclusion

Maro clarifies the point at which members—either existing or subsequent—may be bound by an operating agreement. At the same time, it leaves unresolved the question of how a member might consent to an operating agreement through conduct. Following *Maro*, it may now be easier at the summary judgment stage to bind later-added members or non-members to the operating agreement, even where they clearly did not consent, than it would be to bind original members whose actions were consistent with consent. While that may seem anomalous, it is consistent with NJ-RULLCA's statutory language and long-held common law principles.

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