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New Jersey Revised Uniform Limited Liability Act Takes Effect March 18, 2013

The New Jersey Revised Limited Liability Act, enacted September 19, 2012 and codified at N.J.S.A. 42:2C-1, *et seq.*, takes effect March 18, 2013 for all New Jersey LLCs formed after that date and any existing LLCs that elect to be subject to the Revised Act by amendment to the LLC's operating agreement. The Revised Act will apply to all New Jersey LLCs beginning April 1, 2014 regardless of election. Important changes include:

- **Form of Operation Agreement:** Permits operating agreements to be oral, written or implied.
- **Perpetual duration:** Eliminates the default for the LLC having a limited life, and instead provides for perpetual duration, like corporations.
- **Statement of Authority:** Confirms that a "member is not an agent of a limited liability company solely by reason of being a member," and permits the LLC to file a "statement of authority" with the NJ Office of Commercial Recording authorizing certain individuals or entities to bind the LLC.
- **Fiduciary Duty of Care & Loyalty:** Unlike the current Act, the Revised Act expressly provides for a fiduciary duty of care and loyalty upon members of a member-managed LLC, or upon managers if a manager-managed LLC. It also allows for the operating agreement to eliminate or restrict certain aspects of these duties so long as the result is not "manifestly unreasonable."
- **Indemnification:** Requires an LLC to indemnify and hold harmless any member or manager against debts and liabilities incurred in the course of activities on behalf of the LLC, but permits the operating agreement to limit or eliminate these indemnification obligations.
- **Voting Rights of Members:** Provides for members to have equal voting rights regardless of each member's ownership interest in the LLC, and that a majority vote of members shall be controlling for ordinary matters. Equal voting rights can be altered by provision of the operating agreement calling for some other method, such as based on ownership interest percentage.
- **Limitation on Distributions:** Prohibits generally the LLC from making distributions to a member if the LLC's liabilities exceed the fair value of its assets after giving effect to the distributions, and provides that distributions are made to members on a per capita basis, unless otherwise agreed.
- **Resignation Rights:** Provides that a resigning LLC member is no longer entitled to receive the fair value of the member's

LLC interest as of the resignation date, but rather the resigning member disassociates himself as a member and will have only rights as an economic interest holder - i.e., retain an equity interest but forfeit voting rights.

- **Remedies for Deadlock or Member Oppression:** Provides for certain remedies for minority members similar to the NJ Business Corporation Act, including the right to seek dissolution by the Superior Court on grounds that the controlling members have acted in an oppressive or harmful manner, and permits more flexible means for resolving deadlock by appointment of a custodian.

NJ Legislature Passes Bill Putting Strict Limits on Shareholder's Derivative Suits

The New Jersey Senate and Assembly have passed legislation that would put strict limitations on derivative suits by corporate shareholders involving New Jersey corporations. The proposed law, S-2326 / A-3123, which won unanimous approval of the Senate Commerce Committee, passed the Assembly on December 17, 2012,and the Senate on February 7, 2013. The measures are part of a three-bill package designed to make New Jersey more business friendly and more in line with certain neighboring states. The legislation, which is now on the Governor's desk for signing, would mandate that a complaining shareholder remain a shareholder for the duration of the proceedings and "fairly and adequately" represent the corporation's interest. If enacted, it will amend the statute governing New Jersey shareholder actions, N.J.S.A. 14A:3-6, imposing measures that could significantly curtail derivative actions in New Jersey. Among other notable changes, it would allow for dismissal of suit based on a determination that "maintenance of the derivative proceeding is not in the best interests of the corporation," which determination could be made by an "independent director," a majority of independent directors, a board-appointed committee or a court-appointed panel. It also would require that any plaintiff holding less than 5% of shares, or shares with a market value less than $250,000, post security for reasonable expenses, at the corporation's request.

Delaware Supreme Court Upholds XTO's Bonus Plan Under the Business Judgment Rule

In *Friedman v. Adams, et al.,* No. 230, 2012 (decided January 14, 2013), the Delaware Supreme Court invoked the Business Judgment Rule to reject a shareholder's derivative complaint that challenged the decision of the XTO Energy Inc's corporate board to pay certain executive bonuses without adopting a plan that could make those bonuses tax deductible. Specifically, the shareholder maintained that compensation awarded to corporate officers in excess of $1 million per year is tax deductible only if paid pursuant to §162(m) of the Internal Revenue Code. Over a 4-year period, XTO paid executive bonuses totaling more than $130 million, and those payments were not tax deductible. The court noted that waste claims usually involve a transaction where a corporation allegedly exchanges assets for disproportionately low consideration, and that to state such a claim a stockholder must allege, with particularity, that the board authorized action that no reasonable person would consider fair.

The court found that plaintiff failed to state a claim as the complaint did not allege that any of the bonuses paid to XTO's executives actually would have been deductible under such a plan, and inasmuch as the board believed that a Section 162(m) plan would constrain the compensation committee in its determination of appropriate bonuses. The court concluded that the decision to sacrifice some tax savings in order to retain flexibility in compensation decisions is a classic exercise of business judgment. Accordingly, even if the decision was a poor one for the reasons alleged by the shareholder, it was not unconscionable or irrational, and therefore not actionable by reason of the Business Judgment Rule.

Buyout Provision Based on Net Book Value Enforceable Even Where Significant Disparity Between Book and Fair Market Value

In *Estate of Cohen v. Booth Computer*, 421 N.J. Super. 134 (App. Div. 2011), cert. denied, 208 N.J. 370, the New Jersey Appellate Division upheld a Chancery Judge's decision that a family partnership agreement providing for a buyout based on net book value may be enforced even where significant disparity exists between book value and fair market value. The partnership agreement was created and funded (except for only modest contributions by the children) by the father for the benefit of his children, but according to his terms. It was apparent on the face of the agreement that the father intended the beneficiaries to be family members, that the buyouts would require the children to provide funds to the other children, and that there would be the possibility or even probability that a surviving child would be the ultimate beneficiary of the partnership assets.

The court found the agreement, including the provision for "net book value," to be clear and unambiguous. Accordingly, the trial judge did not abuse his discretion by finding the buyout provision was not unconscionable simply because fair market value was approximately 60 times greater than book value, where the buyout provision is clear and unambiguous. The appellate court further noted the finding is consistent with the basic principle that where the terms of a contract are clear, it is not the court's function to make a better contract for either of the parties. The case illustrates the importance of careful drafting, as had the agreement been found to be unclear, the New Jersey Uniform Partnership Act might then have had to "fill the gap" resulting in a "fair value" buyout price instead of net book value.

Courts Will Not Write a New Contract for Parties by Estoppel

In *Dombroski v. J.P. Morgan Chase Bank*, N.A., 2013 U.S. App. LEXIS 2402 (3d Cir., decided February 4, 2013), the Third Circuit affirmed the district court's dismissal of plaintiff's complaint and refusal to allow leave to further amend his breach of contract claim. Dombroski contended that the contractual disclaimer in Chase's Code of Conduct is not sufficiently prominent and clear to preclude formation of a contract between Chase and him. While noting that Dombroski, no doubt, was correct that the disclaimer could have been clearer and more prominent, the panel affirmed the finding below that the language was sufficiently prominent and clear to negate the attempt to claim that the Code of Conduct was a contract that Chase breached. However, the panel found that the district Court misinterpreted its prior holding in *G-I Holdings, Inc. v. Reliance Ins. Co.*, 586 F.3d 247 (3d Cir. 2009), in holding that judicial estoppel does not apply based on Chase's unsuccessful assertion of a contradictory position in prior litigation. Nonetheless, the panel noted that while courts will "apply [judicial estoppel] to neutralize threats to judicial integrity however they may arise," judicial integrity was not threatened here by refusing to create a contract between these parties because "estoppel will not operate to create a contract that never existed [and] the court will not write a new contract for the parties by estoppel." Thus, in spite of the district court's misinterpretation of G-I Holdings, and even though Chase did appear to be taking a position inconsistent with the one it took in prior litigation, the panel found the district court was correct in refusing to create a contractual relationship between the parties, in dismissing the complaint and in concluding that Dombroski's attempt to amend the complaint would have been futile.

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