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## ► Can I Judicially Expel My Fellow LLC Member If We Can't Get Along?

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### Can I Judicially Expel My Fellow LLC Member If We Can't Get Along?



By: Michael L. Rich, Esq.

What options do members of a limited liability company (LLC) have if they cannot get along with a fellow member? What if the LLC's operating agreement provides little or no guidance for resolution? Is judicial expulsion a viable option and, if so, must the complaining members show that the member sought to be expelled acted wrongfully and materially harmed the LLC, or will some lesser standard be sufficient to expel?

The New Jersey appellate court answered some of these questions when it recently tackled, for the first time, the standard for obtaining judicial expulsion of an LLC member for engaging in conduct making it "not reasonably practicable to carry on the business with the person as a member." In *IE Test, LLC v. Kenneth Carroll* (N.J. Appellate Division, Docket No. A-6159-12T4, decided March 17, 2015), the Court closely examined two related subsections of the former New Jersey Limited Liability Act concerning judicial expulsion. While that Act now has been replaced in New Jersey by the Revised Uniform Limited Liability Company Act (RULLCA), the two subsections regarding judicial ouster remain essentially unchanged in the RULLCA.

The factual backdrop in *IE Test, LLC* was not all that uncommon from many other closely held business relationships resulting in business divorce. Carroll and Cupo co-owned Instrumentation Engineering, LLC (IE), with Carroll holding a 51% interest. James served as IE's business development manager, and eventually its president. By early 2009, IE was in steep financial difficulties, such that only a complete restructuring might save the company from failure. Thus, IE retained a consulting firm to evaluate IE, who recommended that IE file for bankruptcy, which it did. IE's total liabilities included over \$2.5 million in debt owed to Carroll personally, or to entities he wholly owned.

That same month, Cupo formed the plaintiff-LLC. While the certificate of formation indicated Cupo was its sole member, in September 2009, Carroll, Cupo and James signed an agreement stating that, while they intend to negotiate and sign a formal operating agreement, they agree that their percentage interests in plaintiff-LLC from inception are 33% Carroll, 34% Cupo, and 33% James. The parties' relationship began to deteriorate within weeks of formation. Cupo and James attributed this to Carroll's "demand" during an October 2009 meeting that the LLC's operating agreement include a provision for repayment of IE's debt to Carroll, and that Cupo and James be personally responsible. As compensation to him for the prior IE debt, Carroll proposed that either the new LLC give him equal distribution of profits plus some premium, or he receive a salary and equal distribution of profits but no premium on the IE debt, even though all anticipated that Carroll's day-to-day role in the LLC would be quite limited. Cupo and James declined. Not long thereafter, Cupo told Carroll that he no longer wanted him in the business.

Carroll complained that Cupo and James were reluctant to recognize his ownership interest in plaintiff-LLC and simply refused to enter into an operating agreement. Carroll further asserted that Cupo and James stopped sharing data with him, and neglected to include him in the "sales pipelines." For their part, James and Cupo maintained that it was clear that "the three of us can't work together and probably will never work together in the future." They further asserted that plaintiff-LLC was harmed by the members' inability to come to an operating agreement and thereby govern the company.

Cupo and James caused the LLC to file suit against Carroll in January 2010, seeking Carroll's expulsion. Carroll counterclaimed and filed a third party complaint against Cupo and James, alleging a prior agreement that plaintiff-LLC and its members would compensate him for \$2.5 million of IE's prior indebtedness. Carroll ultimately stipulated to dismissal of his counterclaim and third party complaint, but persisted with his defenses to the expulsion claim.

Plaintiff-LLC eventually moved for summary judgment on the judicial expulsion claim under alternative provisions in the LLC statute. Plaintiff contended that Carroll's demand for repayment of IE's debt amounted to wrongful conduct, warranting expulsion under N.J.S.A. 42:2B-24(b)(3)(a). Alternatively, plaintiff argued that Carroll's conduct and the parties' inability to consummate an operating agreement made it not "reasonably practicable" for the relationship to continue, warranting expulsion under N.J.S.A. 42:2B-24(b)(3)(c). Carroll, in turn, argued there was no evidence supporting the contention that he interfered with the business, claiming it turned a profit (which plaintiff disputed). He further argued that, since Cupo and James agreed to his limited role in the day-to-day operations of plaintiff, Carroll's continued status as a member would not detrimentally affect the operations of the company. He also contended that the inability to reach consensus on the operating agreement was not per se grounds for his expulsion, and that plaintiff failed to demonstrate that the lack of an operating agreement prevented it from obtaining financing.

The Chancery Judge hearing the case found that plaintiff failed to establish that Carroll engaged in wrongful conduct that adversely and materially harmed plaintiff, and consequently dismissed the claim brought pursuant to subpart (a) of N.J.S.A. 42:2B-24(b)(3). The Chancery Judge concluded, however, that pursuant to subpart (c) of N.J.S.A. 42:2B-24(b)(3), "it was not reasonably practicable to continue the business with Carroll as a member." She thus granted partial summary judgment to plaintiff-LLC, judicially expelling Carroll from membership. She observed that subsection (c) was "more liberal and much broader" than subsection (a) and "does not require ... that there ha[ve] been any adverse or material effect on the company's business." Following trial, she granted final judgment awarding Carroll 33% of the value of plaintiff, \$227,497, plus interest. Carroll appealed, not challenging the valuation of the LLC or his respective share, but rather limiting his appeal only to whether his expulsion was proper.

Carroll argued that plaintiff's proofs were insufficient because the statute does not permit expulsion of a member based upon speculative "future disagreements or

disputes between members." Cupo, James and the LLC countered that (i) the Judge's findings and conclusions were amply supported by the record; and (ii) the statute does not prohibit consideration of the potential for future conflict once a finding of existent conduct has been made.

The N.J. Appellate Division affirmed the trial court's decision. The Court first observed that the only terms that define the nature and quality of conduct by a member that justifies judicial expulsion under the operative subsection are found in the statutory language itself. The member's conduct must "relat[e] to the limited liability company business," and it must "make[] it not reasonably practicable to carry on the business with the member as a member." N.J.S.A. 42:2B-24(b)(3)(c). The Court further noted that "the distinctions between subsection (a) and (c) are obvious, and those differences provide an overarching framework that guides our interpretation." A member could be expelled under subsection (a) of N.J.S.A. 42:2B-24(b)(3) only if his conduct was "wrongful" and actually harmed the LLC in an adverse and material manner. In contrast, subsection (c) does not require proof that the member committed any wrongful conduct or actually harmed the LLC in any adverse and material way. Instead, subsection (c) "is forward-looking and requires only proof that the member's conduct makes it 'not reasonably practicable to carry on the business' if the member remains." The Court thus found that, "[i]n order to reach a 'judicial determination' under subsection (c), the judge must engage in predictive reasoning." The Court observed: "The judge must decide if the current conduct of the member and the circumstances that resulted therefrom will make continued operation of the business reasonably impractical." The Court further observed that "the statute does not require a finding of complete impracticality." Rather, "it only requires that the continued operation of the LLC with the member as a member be 'not reasonably practicable.' "

The Court noted that its research uncovered no reported decision interpreting this provision from New Jersey, or from any sister state that adopted verbatim the language of the uniform acts. It, however, found the analysis in the Colorado court's decision in *Gagne v. Gagne*, 38 P.3d 1152 (Colo. Ct. App. 2014) to be persuasive. That case construed for the first time Colorado's LLC Act, which (similar to the RULLCA) permits judicial dissolution "if it is established that it is not reasonably practicable to carry on the business of the limited liability company in conformity with the operating agreement of said company." The Colorado court set forth a number of factors to be considered in reaching such a determination, which the IE Test, LLC Court quoted and found that, as applied to the facts of this case, the lower court correctly granted plaintiff-LLC partial summary judgment.

The Court further observed that the record demonstrated that discord among the members arose immediately after the company's formation, that no operating agreement was ever circulated, and that Carroll was at odds for a protracted period over whether he was due compensation by reason of a certain alleged debt. The Court found telling that, although Carroll at one time asserted Cupo and James agreed to the repayment and were legally bound to do so, Carroll subsequently admitted that he possessed no legally enforceable right to seek repayment. The Court observed that "[e]ven if the genesis of the disagreement arose from hard-edged negotiations, it is undisputed that the relationship between Cupo, James and Carroll never recovered from the initial exchange." Under the circumstances, the Court concluded that the record supported the decision that the continued operation of the limited liability company with Carroll as a member was "not reasonably practicable" under N.J.S.A. 42B-24(b)(3)(c) and, therefore, he was subject to judicial expulsion.

The case illustrates the N.J. Court's power to judicially expel an LLC member without showing any wrongful conduct, or any past event that caused adverse material harm to the LLC. Plaintiff need not show complete impracticality, but rather only that continued operation of the LLC with that person as a member will not be "reasonably practicable." Given the relatively low showing required under this subsection, this decision is likely to increase the number of actions for judicial expulsion when members do not get along, particularly where the parties cannot agree on an operating agreement or such agreement is inadequate for resolving fundamental issues. At bottom, this decision seems to have turned on both the Chancery Judge's

and Appellate Division's aversion to the hard-edged negotiation tactics employed by the member who ultimately was judicially expelled. It remains to be seen whether trial judges will exercise with caution, or not, the power to judicially expel on the basis of it being "not reasonably practicable" to carry on together.

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