

**To: New Jersey Law Revision Commission**  
**From: Susan Thatch**  
**Re: *IE Test, L.L.C. v. Carroll***  
**Date: September 6, 2016**

## MEMORANDUM

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This Memorandum is intended to alert the Commission to a potential project relating to the New Jersey Supreme Court's opinion in *IE Test L.L.C. v. Carroll*, which interprets New Jersey's limited liability company act and provides guidance regarding when courts may order the expulsion of an LLC member.<sup>1</sup> This recently decided case has been considered noteworthy as one of the first cases interpreting New Jersey's Revised Limited Liability Company Act.<sup>2</sup>

### Background

Kenneth Carroll and Patrick Cupo had worked together since the 1990's and in 2004, they jointly founded the predecessor of the plaintiff entity, Instrumentation Engineering, LLC. ("Instrumentation Engineering"); Defendant Carroll held a fifty-one percent ownership interest in Instrumentation Engineering while Cupo maintained ownership of the remaining forty-nine percent.<sup>3</sup> By 2009, Instrumentation Engineering's business prospects had sharply declined and the operation carried significant debt (including approximately \$2.5 million owed to defendant Carroll and his other companies).<sup>4</sup> As a result, Instrumentation Engineering filed for Chapter 7 bankruptcy and ceased operations as a going concern.<sup>5</sup>

Shortly before the bankruptcy filing, Cupo formed the new entity, IE Test, L.L.C. ("IE Test"), pursuant to New Jersey's limited liability company act.<sup>6</sup> Though Cupo was originally listed as the sole member of IE Test, a subsequent agreement stated that "the Members of the Company and their LLC Percentage Interests have been and are: Kenneth Carroll (33%), Pat Cupo (34%) [and] Byron James (33%)."<sup>7</sup> The three members were in conflict almost immediately as they unsuccessfully attempted to negotiate certain provisions of the formal operating agreement<sup>8</sup> and no agreement was ever executed.<sup>9</sup>

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<sup>1</sup> 226 N.J. 166 (2016).

<sup>2</sup> *Court Offered Needed Guidance on Shifting LLC Law*, N.J. Law Journal (August 29, 2016), available at <http://www.njlawjournal.com/id=1202766322369/Court-Offered-Needed-Guidance-on-Shifting-LLC-Law?slreturn=20160805171457>.

<sup>3</sup> *IE Test*, 226 N.J. at 171.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 172. Byron James had served as a Business Development Manager and Vice-President at Instrumentation Engineering and was brought into the ownership structure of IE Test by Patrick Cupo. *IE Test, L.L.C. v. Carroll*, 2014 WL 8132907 at \*2 (App. Div. 2015).

<sup>8</sup> *IE Test*, 2014 WL 8132907 at \*2.

<sup>9</sup> *IE Test*, 226 N.J. at 174.

Less than four months following this dispute, the plaintiff-entity filed an action seeking Carroll's expulsion from IE Test pursuant to N.J.S. 42:2B-24(b)(3)(a) ("(b)(3)(a)"), or alternatively, N.J.S. 42:2B-24(b)(3)(c) ("(b)(3)(c)"). The trial court found that defendant did not engage in the type of "wrongful conduct" required to order expulsion pursuant to (b)(3)(a), but held that it would not be "reasonably practical" to continue IE Test's business with Carroll as a member and granted a partial summary judgment for his expulsion pursuant to (b)(3)(c).<sup>10</sup> On defendant's appeal, the Appellate Division evaluated some factors that may be considered in ordering judicial expulsion pursuant to (b)(3)(c), but ultimately concluded that the record supported the trial court's determination that it would not be "reasonably practicable" to operate IE Test with defendant's continued involvement, and affirmed the trial court's determination.

### Analysis

New Jersey's predecessor Limited Liability Company Act governed IE Test's action and N.J.S. 42:2B-24(b)(3) provided for a member disassociation from an LLC in certain enumerated situations:

"[O]n application by the limited liability company or another member, the members expulsion by judicial determination because:

(a) the member engaged in wrongful conduct that adversely and materially affected the limited liability company's business;

(b) the member willfully or persistently committed a material breach of the operating agreement; or

(c) the member engaged in conduct relating to the limited liability company business **which makes it not reasonably practicable** to carry on the business with the member as a member of the limited liability company." (Emphasis added.)<sup>11</sup>

The Court noted that the Legislature did not define the phrase "not reasonably practicable."<sup>12</sup> As a result, the Court sought to determine legislative intent by comparing the language of subsection (b)(3)(a) with that of (b)(3)(c)<sup>13</sup> and identified the two main differences between the provisions: first, (b)(3)(a) requires a determination of "wrongful conduct" while (b)(3)(c) does not require a similar finding of fault, and second, (b)(3)(a) redresses past actions

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<sup>10</sup> *IE Test*, 2014 WL 8132907 at \*4.

<sup>11</sup> N.J.S. 42:2B-24(b)(3). New Jersey repealed the Limited Liability Company Act in 2012 and enacted the Revised Uniform Limited Liability Company Act ("RULLCA"). The Court noted that the language "not reasonably practicable" was retained identically in New Jersey's adoption of RULLCA and would accordingly require a similar analysis. *IE Test*, 226 N.J. at 182.

<sup>12</sup> *IE Test*, 226 N.J. at 180.

<sup>13</sup> *IE Test*, 226 N.J. at 181.

while (b)(3)(c) looks prospectively to determine the impact of a member's conduct on the ongoing business.<sup>14</sup>

The Court further opined that individuals seeking to expel a fellow LLC member "are required to clear a high bar. Neither provision authorizes a court to disassociate an LLC member merely because there is a conflict."<sup>15</sup> To further guide future determinations, the Court identified seven factors that a trial court should analyze before ordering the expulsion of an LLC member, specifically:

- The nature of the member's conduct as it relates to the business;
- Whether the LLC can continue to be managed for the purposes for which it was formed;
- Whether the members' dispute precludes working together towards the LLC's business goals;
- Whether the members are in deadlock;
- In the event of deadlock, whether the members can manage the company pursuant to the operating agreement or default statutory provisions;
- Whether the LLC remains a viable business; and
- Whether it is financially feasible to continue the LLC with the identified LLC member.<sup>16</sup>

The Court concluded that applying the identified factors to IE Test and defendant Carroll creates "genuine issues of material fact that warrant the denial of partial summary judgement." Accordingly, the Court unanimously reversed the Appellate Division's decision and remanded for further proceedings consistent with its own opinion.<sup>17</sup>

### **Conclusion**

The Supreme Court's decision in *IE Test* seeks to frame the analysis for judicial expulsion and to perhaps ensure that the lower courts' more perfunctory analysis does not inadvertently "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."<sup>18</sup>

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<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 183.

<sup>16</sup> *Id.* The Court noted that these factors were substantially derived from the Colorado appellate court decision, *Gagne v. Gagne*, 338 P.3d 1152-1159-60 (Colo. App. 2014), which similarly analyzed the phrase "not reasonably practicable" in the context of a LLC dissolution.

<sup>17</sup> *Id.* at 187.

<sup>18</sup> Michael L. Rich, *NJ Appellate Court Construes Statute Allowing Judicial Expulsion of LLC Member if "Not Reasonably Practicable" to Carry on Together*, Porzio, Bromberg & Newman, P.C. Commercial Litigation Briefs (June 2015), <http://www.pbnlaw.com/media/557222/nj-appellate-court-construes-statute-allowing-for-judicial-expulsion-of-llc-member.pdf>.

In evaluating this project, the Commission may wish to consider whether incorporating the Courts' evaluative factors into New Jersey's limited liability statute would provide additional clarity for both the New Jersey business community and for other jurisdictions that have adopted RULLCA with similar language. With the Commission's authorization, Staff will conduct additional research and propose revisions designed to clarify this area of New Jersey's limited liability company law in a manner consistent with the Court's holding.