Rel: August 26, 2022

SUPREME COURT OF ALABAMA

SPECIAL TERM, 2022

1210116

Doyle Sadler

v.

Players Recreation Group, LLC, Jason L. McCarty, and Felix McCarty

Appeal from Jefferson Circuit Court
(CV-15-902552)

SELLERS, Justice.

This case involves a dispute among Players Recreation Group, LLC, an Alabama limited-liability company ("the LLC"); three of its members,

Jason L. McCarty ("Jason"), Felix McCarty ("Felix"), and Doyle Sadler; and S&M Associates, Inc. ("S&M"), a company owned by Sadler. On appeal, Sadler asserts that the trial court erred insofar as it entered a judgment against him on the counterclaims asserted against him by the LLC, Jason, and Felix.[1] We reverse and remand.

I. Facts

The LLC, which was established in 1999, presently owns and operates a bowling alley known as "the Super Bowl." In 2002, the LLC's certificate of formation was amended to reflect the membership interests in the LLC at that time, which were as follows: Jason (40%), Felix and Judy McCarty ("Judy") (25%), Sadler (25%), and Scott Montgomery (10%).[2] The LLC has no written limited-liability-company agreement ("LLC agreement"), formerly known as an operating agreement. In 2003, S&M, a company owned by Sadler, loaned the LLC $150,000, which is

[1]Although both S&M and Sadler were listed on the notice of appeal, the issues raised on appeal involve only the propriety of the trial court's judgment regarding the counterclaims asserted against Sadler. We have therefore amended the style of the appeal accordingly.

[2]Neither Montgomery nor Judy are parties to this appeal. According to the parties, Montgomery "abandoned" the LLC in 2006 and Judy died in 2019.

evidenced by a promissory note; there is no dispute that the note is valid, binding, and enforceable. In 2006, the Super Bowl began incurring substantial losses, and the LLC ultimately defaulted on the promissory note payable to S&M. In July 2015, S&M and Sadler, in his capacity as a member of the LLC and as a designated agent for S&M, sued the LLC and the other members of the LLC, asserting a breach-of-contract claim and a claim seeking an accounting.[3] In August 2015, the LLC, Jason, and Felix filed an answer and a counterclaim, alleging that Sadler had breached his duty of loyalty and his duty of care to the LLC.

The case proceeded to a bench trial. The parties initially stipulated that the LLC owed S&M a total of $310,139.66 on the promissory note; the trial court ultimately entered a judgment against the LLC for that amount based on the parties' stipulation. The case was then tried solely on the counterclaims asserted against Sadler by the LLC, Jason, and Felix ("the counterclaimants"), which alleged that Sadler had breached his duty of loyalty and his duty of care to the LLC because, the

[3]The claim for an accounting was ultimately dismissed. The breach-of-contract claim was asserted against the LLC and Jason, in his alleged capacity as the managing member of the LLC; ultimately, that claim was dismissed as to Jason.

counterclaimants asserted, when the Super Bowl began incurring substantial debt, Sadler had refused to work there on a full-time basis and had also failed to make a contribution to the LLC for his share of that debt. During the trial, the counterclaimants also asserted for the first time that Sadler had breached the implied covenant of good faith and fair dealing.

As previously indicated, the LLC did not have a written LLC agreement. According to Jason, the members had orally agreed upon the LLC's fundamental operating terms. Specifically, Jason testified that all the members of the LLC were self-employed but that they had each agreed to perform work for the Super Bowl: Jason, who was a certified public accountant, agreed to be the general manager of the Super Bowl and to handle the LLC's taxes and other financial matters; Felix, who owned a window shop, agreed to be in charge of handling mechanical and maintenance issues arising at the Super Bowl; Sadler, who was an electrical contractor, also agreed to be in charge of handling mechanical and maintenance issues arising at the Super Bowl; Montgomery, who was a meter reader, agreed to help in the kitchen and to be in charge of the vending machines; and Judy, who was a licensed real-estate agent,

agreed to be the bar manager and office assistant. Jason, Felix, and Judy were the only members who had ever received salaries from the LLC. As for Sadler, Jason conceded that Sadler's job as an electrical contractor required him to travel out of town. However, Jason stated that Sadler had agreed that, when he was in town, he would perform work for the Super Bowl. Sadler did, in fact, perform work for the Super Bowl, presumably until he commenced this case. According to Jason, beginning in 2006 and continuing thereafter, the Super Bowl incurred significant losses because of, among other things, new competition in the area, the economic recession of 2008, and the closing of other businesses adjacent to the Super Bowl. Jason stated that, at some point in either 2007 or 2008, Sadler's electrical-contracting business experienced "a slowdown" and that he had "petitioned" Sadler to work at the Super Bowl on a "regular" basis. Jason stated that Sadler had repeatedly told him that he could not afford to work at the Super Bowl on a regular basis because he was looking for "odd jobs" in the area. Jason testified that, in 2010, the LLC stopped making payments to S&M under the promissory note so that the LLC could continue to pay its debt secured by a mortgage on the Super Bowl. Jason also testified that, from 2006 until 2020, the LCC

had incurred $2,713,230.33 in debt; he claimed that the debt was based on unpaid compensation, loans, reimbursements, expenses, and purchases that were allegedly owed by the LLC to Jason, Felix, and Judy. The obligation to S&M under the promissory note was not included in the $2,713,230.33 debt amount. Finally, Jason stated that he had orally requested that Sadler contribute to the LLC's debt. However, there was no evidence indicating that Sadler had agreed to make any contribution to the LLC for its debt.

At the close of the counterclaimants' evidence, Sadler filed a motion for a judgment on partial findings, which the trial court denied. See Rule 52(c), Ala. R. Civ. P. After the trial resumed, Sadler testified regarding his understanding of the agreement among the members of the LLC. Sadler stated that, to "save money," all the members had decided "to pitch in" and perform work at the Super Bowl relative to his or her trade. Sadler testified at length regarding the work, including electrical work, that he had performed at the Super Bowl without compensation. Sadler further explained that, in 2010, his electrical-contracting business had "slacked" and that he had approached Jason about working at the Super Bowl on a regular basis. He testified that he had told Jason that he did

not want to get paid but, rather, that he wanted to work solely for health-insurance benefits. According to Sadler, Jason said that he would get back with him but never did.

After hearing all the evidence, the trial court entered a judgment against the LLC in the amount of $310,139.66, based on the parties' stipulation that the LLC owed that amount on the promissory note payable to S&M. The trial court then entered a judgment against Sadler on the counterclaims, based on its findings that Sadler had breached not only a duty of loyalty and a duty of care to the LLC, but also the implied covenant of good faith and fair dealing owed to the LLC. The trial court assessed damages against Sadler in the amount of $368,167.92. Specifically, the trial court concluded that the LLC had incurred $2,713,230.33 in debt related to the management and operation of the Super Bowl and that Sadler's 25% share of that debt was $678,307.58. As a set off, the trial court deducted the amount that the LLC owed on the promissory note to S&M from the amount Sadler allegedly owed the LLC for its debt, leaving a balance of $368,167.92 to be paid by Sadler. The trial court indicated that Sadler could satisfy the judgment against him by tendering his membership interest in the LLC and by holding the

LLC harmless for any additional sums owed to S&M on the promissory note. This appeal followed.

II. Standard of Review

Because the trial court conducted a bench trial at which oral testimony was given, the ore tenus standard of review applies:

> "The ore tenus rule affords a presumption of correctness to a trial court's findings of fact based on ore tenus evidence, and the judgment based on those findings will not be disturbed unless those findings are clearly erroneous and against the great weight of the evidence. Reed v. Board of Trs. for Alabama State Univ., 778 So. 2d 791, 795 (Ala. 2000). It is grounded upon the principle that when a trial court hears oral testimony it has an opportunity to evaluate the demeanor and credibility of the witnesses. Hall v. Mazzone, 486 So. 2d 408, 410 (Ala. 1986). The ore tenus rule does not cloak a trial court's conclusions of law or the application of the law to the facts with a presumption of correctness. Kennedy v. Boles Invs., Inc., 53 So. 3d 60 (Ala. 2010)."

Allsop v. Bolding, 86 So. 3d 952, 958 (Ala. 2011). We review the trial court's conclusions of law and its application of the law to the underlying facts de novo. Id. at 959.

III. Discussion

A. Breach of Duty of Loyalty and Duty of Care

Initially, we note that in 2014 the legislature enacted the Alabama Limited Liability Company Law ("the LLC Law"), § 10A-5A-1.01 et seq.,

Ala. Code 1975, which at the time it was enacted governed all limited-liability companies created on or after January 1, 2015. See § 10A-5A-12.01(a)(1), Ala. Code 1975. However, effective January 1, 2017, the LLC Law governs all limited-liability companies regardless of when they were formed. See § 10A-5A-12.01(b). The purpose of the LLC Law is "to give maximum effect to the principles of freedom of contract and to the enforceability of limited liability company agreements." § 10A-5A-1.06(a), Ala. Code 1975.[4] One of the more significant differences between the LLC Law and its predecessor is that under the LLC Law an LLC agreement is not required to be written; rather it can be oral or implied. It is undisputed that, in this case, the LLC has no written LLC agreement and that, during the proceedings below, the counterclaimants represented to the trial court that, when the LLC was established in 1999, there was no requirement for a written LLC agreement; however, no authority was offered to support that representation. The parties also

[4]Under the LLC Law, with regard to a limited-liability company formed before January 1, 2015, its "formation document, whether articles of organization or certificate of formation, is deemed to be the … certificate of formation," and its "operating agreement is deemed to be the … limited liability company agreement." § 10A-5A-12.01(c)(1) and (2), Ala. Code 1975.

disagreed as to whether the LLC Law or its predecessor, which was in effect at the time when the LLC was established in 1999, controlled Sadler's duties to the LLC. For purposes of this appeal, this Court will apply the LLC Law, which focuses on the contractual nature of an LLC; however, the outcome of this appeal would be the same regardless of whether we apply the LLC Law or its predecessor.

An LLC agreement is the essential mechanism that governs the relations among the members of an LLC and the obligations of the members to the LLC itself. § 10A-5A-1.08(a)(1), Ala. Code 1975. If there is no LLC agreement defining those matters, the provisions of the LLC Law govern. § 10A-5A-1.08(a)(2). Although an LLC agreement may be "written, oral or implied," § 10A-5A-1.02(l), Ala. Code 1975, to the extent that a member has duties, including fiduciary duties, to the LLC or to the other members, those duties may be "expanded or restricted or eliminated" only by a written LLC agreement. § 10A-5A-1.08(b)(1). However, the implied covenant of good faith and fair dealing may not be eliminated from an LLC agreement. Id. In this case, because there is no written LLC agreement defining Sadler's duty of loyalty and duty of care to the LLC, the provisions of § 10A-5A-4.08, Ala. Code 1975, govern.

Pursuant to § 10A-5A-4.08(a)(1), a person who has "the authority to direct and oversee the activities and affairs of a limited liability company owes to the limited liability company and to the members … the duty of loyalty and the duty of care." The duty of loyalty includes each of the following:

> "(1) To account to the limited liability company and to hold as trustee for it any property, profit, or benefit derived by that person in the conduct or winding up of the limited liability company's activities and affairs or derived from a use by that person of the limited liability company's property, including the appropriation of the limited liability company's opportunity.
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> "(2) To refrain from dealing with the limited liability company in the conduct or winding up of the limited liability company's activities and affairs as or on behalf of a party having an interest adverse to the limited liability company.
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> "(3) To refrain from competing with the limited liability company in the conduct of the limited liability company's activities and affairs before the dissolution of the limited liability company."

§ 10A-5A-4.08(b)(1)-(3). The duty of care includes "refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of the law." § 10A-5A-4.08(d)(1).[5] In

[5]The former Alabama Limited Liability Company Act (the predecessor to the LLC Law), which was in effect when the LLC was established, recited substantially the same duty of loyalty and duty of

contrast, a person who does not have the authority to direct and oversee the activities and affairs of an LLC owes to the LLC or to the LLC's other members only a duty "to not disclose or otherwise use information of the limited liability company to the detriment of the limited liability company or the other members." § 10A-5A-4.08(g)(1).

In this case, the trial court found that the LLC was member-managed, meaning that Sadler had authority to direct and oversee the activities and affairs of the LLC. Based on that finding, the trial court concluded that Sadler had breached both the duty of loyalty and the duty of care to the LLC, presumably by failing to work for the Super Bowl on a full-time basis and by failing to make a contribution toward the LLC's debt, as the counterclaimants had alleged. Assuming, without deciding, that Sadler had any authority to oversee the activities and affairs of the LLC, the only obligations Sadler owed to the LLC under the duty of loyalty were (1) to account to the LLC and hold as trustee for it any property, profit, or benefit derived by Sadler in the conduct and winding up of the activities of the LLC; (2) to refrain from dealing with the LLC

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care as the LLC Law. See Ala. Code 1975, former § 10-12-21(f)(1)-(3) and former § 10-12-21(g).

as a person having an interest adverse to the LLC; and (3) to refrain from competing with the LLC. § 10A-5A-4.08(b)(1)-(3). There is no evidence indicating that Sadler breached any of those enumerated duties of loyalty to the LLC. Simply put, any alleged duties on the part of Sadler to work for the Super Bowl on a full-time basis or to contribute to the LLC's debt would be duties that fall outside the provisions of § 10A-5A-4.08(b)(1)-(3), and, therefore, to be enforceable, they were required to be in writing. See § 10A-5A-1.08(b)(1); see also § 10A-5A-4.04(c), Ala. Code 1975 ("A promise by a member to make a contribution to a limited liability company … is not enforceable unless set forth in a writing signed by the member.").[6] There is also no evidence indicating that Sadler breached the duty of care to the LLC because there was no evidence indicating that he had engaged in "grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of the law." § 10A-5A-4.08(d)(1).

[6]Former § 10-12-27, Ala. Code 1975, which was in effect when the LLC was established, did not require a writing. That section stated, in relevant part, that a member was "obligated to the limited liability company to perform any promise to pay cash or convey property or to render services …." § 10-12-27(a). In this case, there was no evidence that Sadler agreed either orally or in writing to make any contributions other than his original capital contribution to the LLC.

Accordingly, the trial court's judgment, insofar as it held that Sadler had breached the duty of loyalty and the duty of care to the LLC by refusing to work at the Super Bowl on a full-time basis and by failing to contribute $678,307.58 to the LLC's debt, is not supported by the evidence and is, therefore, due to be reversed. In summary, under the LLC Law, a written LLC agreement is the only means to define the business relations among the members of an LLC and the obligations of the members to the LLC in a way that varies from the provisions of the LLC Law itself. By failing to reduce to writing the specific terms of their agreement, the parties in this case created a business relationship that was undefined and subject to misunderstanding, misinterpretation, and instability for the management of the LLC.

B. Breach of Implied Covenant of Good Faith and Fair Dealing

Finally, assuming, without deciding, that the counterclaimants' claim alleging breach of the implied covenant of good faith and fair dealing was tried by the consent of the parties, see Rule 15(b), Ala. R. Civ. P., and that their counterclaim was constructively amended to conform to the evidence, we conclude that the evidence was insufficient to support a finding that Sadler had breached that implied covenant. By

operation of law, the covenant of good faith and fair dealing is expressly implied in all contracts, Sellers v. Head, 261 Ala. 212, 217, 73 So. 2d 747, 751 (1954), and, under the LLC Law, that implied covenant cannot be waived by agreement. § 10A-5A-1.08(b)(1). The purpose of that implied covenant is to ensure that no party to a contract will do anything that will injure the right of another party to the contract to receive the benefits of the contract. Sellers, 261 Ala. at 217, 73 So. 2d at 751 ("Where a contract fails to specify all the duties and obligations intended to be assumed, the law will imply an agreement to do those things that according to reason and justice the parties should do in order to carry out the purpose for which the contract was made."). Simply put, that implied covenant mandates that the parties perform in good faith the obligations imposed by their agreement. In this case, the evidence indicates that Sadler agreed to work at the Super Bowl only when he was not working in his regular capacity as an electrical contractor. There was no evidence indicating that Sadler had agreed to work at the Super Bowl on a full-time basis without compensation merely because the Super Bowl began

incurring substantial losses for reasons unrelated to Sadler.[7] For this reason, the counterclaimants cannot rely on the implied covenant of good faith and fair dealing to alter the terms of the original agreement between Sadler and the other members of the LLC. See Cobbs, Allen & Hall, Inc. v. EPIC Holdings, Inc., 335 So. 3d 1115, 1141 (Ala. 2021) (noting that the implied covenant of good faith and fair dealing "cannot be used to alter the plain meaning of a contract"). Accordingly, the trial court's judgment, insofar as it held that Sadler had breached the implied covenant of good faith and fair dealing, is unsupported by the evidence and is, therefore, due to be reversed.

IV. Conclusion

We reverse the judgment entered against Sadler on the counterclaims asserted against him because there was no evidence to

[7]Notably, the trial court indicated in its findings of fact that Sadler had "refused to work full time at the Super Bowl as he [had] previously agreed when he became a member." However, the evidence was undisputed that Sadler never agreed to work for the Super Bowl on a full-time basis; rather, as Jason testified, Sadler had agreed to perform services at the Super Bowl only when he was not working in his full-time capacity as an electrical contractor. According to Sadler, he did offer to work full time at the Super Bowl in exchange for health-insurance coverage, but, he said, Jason never responded to that offer.

support findings that Sadler had breached the duty of loyalty and the duty of care owed to the LLC or the implied covenant of good faith and fair dealing, and we remand the case to the trial court for the entry of a judgment consistent with this opinion.

REVERSED AND REMANDED.

Parker, C.J., and Bolin, Wise, and Stewart, JJ., concur.