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THE STATE OF SOUTH CAROLINA

In The Court of Appeals

APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

James Randall Davis, Special Master/Referee

Appellate Case No. 2014-001819

Palmetto Mortuary Transport, Inc.,.....Respondent,

v.

Knight Systems, Inc., and Robert L. Knight,.....Appellants.

RESPONDENT'S PETITION FOR REHEARING

Pursuant to Rules 221(a) and 240 of the *South Carolina Rules of Appellate Procedure*, Respondent Palmetto Mortuary Transport, Inc. ("Respondent") respectfully files this Petition for Rehearing of the Court's decision filed May 4, 2016 (Op. No. 5402) (the "Opinion"). For the reasons stated herein, no public policy of the State of South Carolina supports the Court's conclusion that a sophisticated business and its owner ("Appellants") could

1. advertise and actively pursue the sale of their mortuary transport business, including three five-year cycle contracts for services (R. p. 268, lines 2-9; p. 268, lines 17-24; p. 269, lines 3-13);

2. negotiate a complex asset purchase agreement ("Agreement") (including a covenant not to compete) while represented by an attorney and financial advisors

(R. p. 239, line 11 – p. 240, line 15; p. 244, line 4 – p. 245, line 14; p. 302, lines 5-9; p. 349, line 20 – p. 353, line 19);

3. bargain for the ability to retain their body bag manufacturing business and continue use of their business' trade name (R. pp. 372-407);

4. negotiate a requirement that the purchaser of their mortuary transport business ("Respondent") purchase body bags exclusively from Appellants in order to sustain Appellants' ongoing manufacturing business (R. p. 375 at § 3.4.8);

5. receive $590,000.00 from the above-referenced transaction (R. p. 372-407); and later

6. bid on (and win) one of the five-year cycle mortuary transport contracts transferred to Respondent as a part of the Agreement by breaching its agreement to sell body bags to Respondent (R. p. 394 at Exhibit 3.2.6; p. 344, line 22 – p. 345, line 11; R. p. 166, line 6 – p. 168, line 13; p. 241, lines 14-24; p. 346, line 14 – p. 347, line 25), and

7. actively seek to regain the two other five-year cycle contracts transferred to Respondent as a part of the Agreement (R. p. 355, lines 19-21).

See Reeves v. Sargeant, 200 S.C. 494, 21 S.E.2d 184 (1942) ("Certainly it is not going too far to say that there can be no sound public policy which operates to give countenance to the open disregard and violation of personal contracts entered into in good faith and upon valid consideration.").

STANDARD OF REVIEW

Rule 221(a), SCACR, authorizes a party who believes the Court overlooked or misapprehended points of law and/or fact to petition for rehearing. *Arnold v. Carolina Power & Light Co.*, 168 S.C. 163, 167 S.E. 234 (1933). A properly drawn petition for rehearing must state "the points supposed to have been overlooked or misapprehended by the court." *See Kennedy v. South Carolina Retirement System*, 349 S.C. 531, 564 S.E.2d 322 (2001). "The purpose of such a petition is to aid the court in deciding correctly a case heard by it." *Arnold*, 168 S.C. 163, 167 S.E. at 238.

ARGUMENTS

I. THIS COURT MISAPPLIED APPLICABLE LAW AND OVERLOOKED EVIDENCE IN THE RECORD DEMONSTRATING THE COVENANT NOT TO COMPETE ("COVENANT") WAS REASONABLE.

In South Carolina, the presumption is that covenants not to compete arising out of the sale of a business "will, in conformity with the just and equitable principles of the common law, be generally upheld and enforced." *Metts v. Weinberg*, 158 S.C. 411, 155 S.E. 734 (1930). This is consistent with the state's deep and robust public policy of enforcing private contractual agreements. *See American Bankers Life Assur. Co. of Florida v. Frederick*, 315 S.C. 97, 101, 431 S.E.2d 636, 639 (Ct. App. 1993) ("The duty of this Court is limited to the interpretation of the contract made by the parties, regardless of its wisdom or folly, apparent unreasonableness, or failure of the parties to guard their rights carefully.").[1]

Our appellate courts have routinely recognized the fundamental right of private parties to contract as they choose, by upholding the validity of contractual provisions limiting one party's liability to another, *see e.g., Huckaby v. Confederate Motor Speedway, Inc.*, 276 S.C. 629, 281 S.E.2d 223 (1981), and selecting a forum for dispute resolution, *see, e.g., Minorplanet Sys. USA Limited v. American Aire, Inc.*, 368 S.C. 146, 628 S.E.2d 43 (2006).[2] These types of private contractual provisions have as equally

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[1] As set forth herein, Respondent does not suggest that the Agreement is any way "unreasonable" to Appellants. In fact, as the record demonstrates, Appellants undoubtedly "guarded their rights carefully" throughout.

[2] *See also Calhoun v. WHA Medical Clinic, PLLC*, 632 S.E.2d 563 (N.C. App. 2006): "Since the right of private contract is no small part of the liberty of the citizen, the usual and most important function of courts is to enforce and maintain contracts rather than to enable parties to escape their obligations." *Id.* at 573 (citation omitted).

strong public policy considerations as do those involved in the enforcement of a covenant not to compete, including the Covenant presently before this Court.

In order to be enforceable, a non-compete agreement must be "(1) supported by a valuable consideration, (2) . . . reasonably limited as to time, and (3) . . . reasonably restricted as to the place of the territory." *Somerset v. Reyner*, 233 S.C. 324, 329 104 S.E.2d 344, 346 (1958) (citations omitted). "Of course in all cases it is essential that the restrictive covenant be incidental to another lawful contract of sale involving some interest requiring the protection of the restraint." *Reeves*, 200 S.C. 494, 21 S.E.2d at 188.

"[T]he restraint must be reasonable, not oppressive, or out of proportion to the benefits which the vendee may in reason expect to follow from the restrictive features of the contract, and not injurious to the interests of the public." *Reeves*, 200 S.C. 494, 21 S.E.2d at 187 (citations omitted). Each case is necessarily decided on its own facts and circumstances. *Id.* at 501, 21 S.E.2d at 188. Case law requires the Court to examine several factors, including (1) the whole subject matter of the contract, (2) the kind and character of the business, (3) location, (4) the purpose to be accomplished by the restriction, and (5) all circumstances which show the intentions of the parties and which must have entered into the making of the contract. *Id.*

In this case, the Court misapprehended applicable law and erred in its application of the facts by solely relying upon *Somerset v. Reyner*, 233 S.C. 324, 104 S.E.2d 344 (1958), and failing to apply all of the considerations compelled by *Reeves*. Through these shortcomings, the Court unwittingly contravened public policy by reversing the lower court's order enforcing the parties' private contract (R. pp. 372-407) (the "Agreement"), including the Covenant (*id.* at p. 394 at Exhibit 3.2.6).

Rather than upholding the intentions of the parties at the time of contracting, the Court applied a rigid public policy analysis that fails to consider the specific aspects of this particular business transaction between sophisticated parties and the actions of the parties to the Agreement. "[T]he use of public policy to void written contracts is dangerous because public policy is often a two-edged sword." *Westvaco Corp. v. United Paperworkers Intern. Union, AFL-CIO ex rel. Local Union 676*, 171 F.3d 971 (4th Cir. 1999). In doing so, the Court rewarded a wrongdoer, providing a windfall to a bad actor, and created precedent which hurts business interests in this State.

A. Application of the factors in *Reeves* to evidence in the record leads to a compelling conclusion that the Covenant is reasonable and enforceable.

Reeves v. Sargeant, 200 S.C. 494, 21 S.E.2d 184, requires the Court to examine several factors, including (1) the whole subject matter of the contract, (2) the kind and character of the business, (3) location, (4) the purpose to be accomplished by the restriction, and (5) all circumstances which show the intentions of the parties and which must have entered into the making of the contract. *Id.* at 494, 21 S.E.2d at 188. The Court failed to consider all five factors in this case, narrowly focusing on the existing location of the business at the time of contracting. *See* Opinion.

As stated in *Metts v. Weinberg*, 158 S.C. 411, 155 S.E. 734 (1930), "[a] geographic restriction in a covenant not to compete ancillary to the sale of a business" should be upheld so long as "it is 'reasonably restricted as to the place of territory' and is no 'more enlarged than essential for a reasonable protection of the rights of the purchasing party.'" *Id.* at 415, 155 S.E. at 735. Undisputedly, the location of the business at the time of execution of the non-compete agreement is one factor to consider;

however, it is not the only one. *Reeves* at 494, 21 S.E.2d at 188 (listing "location" as one of five factors to be applied). This Court erred in narrowly limiting its review of the Covenant to the existing location of Appellants' business at the time of contracting as the other four factors support enforcement of the Covenant.

The "whole subject matter" of the parties' Agreement (R. pp. 372-407) supports enforcement of the Covenant. The restriction on Appellants' future ability to provide mortuary transport services arose in connection with the sale of Appellants' business to Respondent for a purchase price of $590,000.00. (R. pp. 372-407; R. p. 128, lines 8-12.) Thus, this is not a case of a non-compete agreement arising within the scope of an employment relationship and the more rigorous standard in evaluating the reasonableness of covenants not to compete contained in the employment context is not applicable. *See Hagemeyer North America, Inc. v. Thompson*, 2:05-3425, 2006 WL 516733, *4 (D.S.C. Mar. 1, 2006) ("As a general rule, such covenants are given greater deference in the context of a sale of business than in the employment context.") (citation omitted); *American Hot Rod Ass'n, Inc. v. Carrier*, 500 F.2d 1269, 1277 (4th Cir. 1974) (holding "restrictive covenants not to compete in employment contracts ... are scrutinized more rigorously than similar covenants incident to a sale of business").

In exchange for the Covenant, Appellants not only received a generous payment of money from Respondent, but the right to continue to operate their existing body bag manufacturing business without any limitation whatsoever. Appellants specifically negotiated an exclusivity provision compelling a ten-year commitment from Respondent to purchase body bags from Appellants for use in conjunction with Respondent's transport business. (R. p. 375 at § 3.4.8) ("Exclusivity Provision"). It was reasonably

foreseeable to Appellants at the time of contracting that Respondent would be required to purchase a substantial portion of its body bags from Appellants given Appellants' years of prior experience in the business.

The Exclusivity Provision guaranteed sizable future profits to Appellants and their continued manufacturing enterprise. In fact, Respondent paid Appellants more than $45,000.00 for body bags between the time of the contracting, in January 2007, and initiation of the subject litigation, in October 2011. (R. p. 160, lines 10-20; pp. 408-448.) The ten-year period of the parties' Exclusivity Provision was not coincidental; it paralleled language in the corresponding Covenant. (R. p. 394 at Exhibit 3.2.6.) As such, while the Agreement placed limitations on Appellants' ability to perform mortuary transport services for a period of ten years, the same contract allowed, and moreover enhanced, Appellants' ancillary body bag manufacturing business during the exact time period of time.

The kind and character of the parties' business interests including the potential for future expansion of Respondent's business location further supports enforcement of the Covenant. The Court unreasonably focused on the location of Appellants' existing business at the time of the sale—characterizing the purchased business as "a small business located in Lexington County at the time of sale" and "only engaged in the mortuary transport business in Richland and Lexington counties." *See* Opinion. The Court refused to give weight to Respondent's "desire to expand its business throughout the state," requiring Respondent to submit "more evidence of definitive planning, acquisitions, or other overt acts" in support of its *Id.* In so ruling, the Court unfairly created a new standard for enforcement of non-compete agreements in this State,

compelling purchasers of businesses to take active or overt steps toward expanding the business prior to purchase, in order to justify a territorial non-compete area beyond the existing customer base. There are no South Carolina case decisions supporting such an expanded test.

Moreover, the Court failed to acknowledge that evidence of Respondent's active or overt steps to expand actually exists in the Record. Appellant Knight confirmed that he provided Respondent with the "contact names of funeral homes that I did business for." (R. p. 304, lines.13-15.) This evidence, combined with Don Lintal's testimony of Respondent's intention to expand the mortuary transport business throughout the state (R. p. 208, line 12 – p. 209, line 13; p. 209, line 25 – p. 210, line 10), justified a larger territorial restriction in this case.[3]

Moreover, Appellant Knight stated a clear intention to get out of the mortuary transport business (R. p. 308, lines 7-8), rendering the Covenant reasonable. This Court's Opinion states "[a]s suggested in *Somerset*, we do not believe Appellants' intention of not returning to the mortuary transport business is a relevant factor for analyzing whether a territorial restriction is reasonable." However, as *Reeves* makes clear, such an intention must be reviewed under the applicable factors, including the "purpose to be accomplished by the restriction." *Id.* at 494, 21 S.E.2d at 188. The combined evidence of Respondent's intention to expand Appellants' prior mortuary transport business throughout the state and Appellant Knight's intention to get out of the mortuary transport business, supports enforcement of the Non-Compete Agreement. Knight's admission that he read and understood the Exclusivity Provision and Covenant and did not object to either provision

[3] In fact, evidence in the record shows Respondent has added customers that Appellants did not serve and that Respondent does business outside the area encompassed by the contracts purchased from Appellants. (R. p. 551, line 16 – p. 552, line 10.).

before signing reflects his willingness to be bound by the provisions' terms. (R. p. 353, line 16 – p. 354, line 13; p. 349, lines 9-19.)

The intentions of the parties at the time of entering into the Agreement were clear: Appellants intended to cede their mortuary transport service business to Respondents for a sizable profit ($590,000.00) and a guaranteed future revenue stream—their body bag business—spurred by Respondent's promise to purchase certain body bags solely from Appellants. This exchange assured Appellants a substantial future revenue stream which justified the limitations on Appellants' ability to provide mortuary transport services in the State. In return, Respondent received assurance that Appellants would not compete for ten years and obtained a ten-year fixed price for the purchase of certain body bags, enabling Respondent to predict future costs in light of anticipated statewide business growth. The symbiotic relationship between the Covenant and the Exclusivity Provision could not be more clear.

For these reasons, the subject case is not similar to those where concerns regarding a person's future livelihood override private contractual arrangements. *See, e.g., Milliken & Co. v. Morin*, 399 S.C. 23, 731 S.E.2d 288 (2012) (stating a non-compete agreement should be "no greater than necessary to protect the employer's legitimate interests" and "not unduly harsh in that it curtails the employee's ability to earn a living"). The Covenant, in light of the Exclusivity Provision, should have been enforced because it protected both parties' legitimate business interests and did not curtail Appellants' ability to earn a living. In fact, enforcement of both the Covenant and Exclusivity Provision would have financially benefitted both parties. Accordingly, this

Court should reconsider the purported public policy considerations on which its Opinion is based in light of the facts of this case, and conclude the Opinion was in error.

B. A comparison of the facts in this case with those in *Somerset* reveals that the result in *Somerset* is not dispositive here.

The facts of this case demonstrate the reasonableness of the Covenant. The Court's narrow focus and short-sighted application of the facts in *Somerset*, without reflecting upon other considerations from *Reeves*, reflects the Court's misunderstanding of the facts and misapplication of the law.

Here, the Agreement executed by the parties involved a complicated transaction between sophisticated business entities, both represented by competent counsel and financial advisors. (R. p. 239, line 11 – p. 240, line 15; p. 244, line 4 – p. 245, line 14; p. 302, lines 5-9; p. 349, line 20 – p. 353, line 19.) The transaction occurred after months of Appellants' intentional advertising of the mortuary transport business, solicitations of sophisticated business purchasers, and negotiations between the parties directly and, later, between their legal representatives. (*Id.*; *see also* R. p. 260, lines 9-12; p. 268, lines 2-9; p. 268, lines 17-24; p. 269, lines 3-13.)

In particular, and unlike the plaintiff in *Somerset*, 233 S.C. at 329, 104 S.E.2d at 346, both Respondent and Appellants were represented by attorneys in the negotiation and drafting of the Agreement, including specifically the Covenant. (*See id.*) Appellants' attorney was present at the closing that took place on January 5, 2007. (R. p. 268, lines 13-16, p. 306, lines 4-20; p. 354, lines 1-13.) Appellants also received advice from their accountant at the closing with respect to financial implications of executing the Agreement and Covenant. (R. p. 266, line 20 – p. 267, line 2; p. 305, lines 6-15.) These

circumstances are substantially different from *Somerset*, in which (1) the plaintiff was never represented by counsel, (2) the defendant was at all times represented by counsel, and (3) the defendant's counsel drafted all the transaction documents. *Id.*, 233 S.C. at 329, 104 S.E.2d at 346.

Moreover, as the Court's Opinion notes, in *Somerset*, "[f]ollowing the sale[,] the purchaser briefly employed the seller as the manager of the shop but soon terminated his employment after about three months." *See* Opinion (citing *Somerset* at 233 S.C. at 329, 104 S.E.2d at 346). The fact that the plaintiff was purportedly promised an ongoing employment relationship with the defendant but was fired shortly after the transaction sets quite a different tone than the facts of the subject case. Such action in *Somerset* reveals the defendant's bad faith which was particularly harsh in light of the twenty-year non-compete agreement signed by the plaintiff in that case. *Id.* at 328, 104 S.E.2d at 346. No such facts exist here.

In this case, the Agreement provided specifically that Appellants were allowed to keep their existing body bag business and the Exclusivity Provision guaranteed Appellants a revenue stream from Respondent for a period of ten years. (R. pp. 372-407; p. 375 at § 3.4.8.) As evidence in the Record shows, Respondent not only paid Appellants $590,000.00 for Appellants' mortuary transport business, but also Respondent provided Appellants at least $45,000.00 from its purchases of body bags within a period of less than five years following the parties' execution of the Agreement. (R. p. 160, lines 10-20; pp. 408-448.)

The Court's narrow reliance on *Somerset* to overturn enforcement of the parties' Covenant was error and should be reconsidered.

II. THE COURT FAILED TO CONSIDER THAT APPELLANTS' BREACH OF THE EXCLUSIVITY PROVISION OF THE AGREEMENT PROVIDES SEPARATE AND INDEPENDENT GROUNDS FOR AFFIRMING THE SPECIAL REFEREE.

The Court only disposed of one issue on appeal, enforcement of the Covenant. *See* Opinion. After concluding the Covenant was invalid because of an unreasonable territorial restriction, the Court "decline[d] to address the remaining issues on appeal." *Id.* In doing so, the Court refused to consider Respondent's argument that even if the non-compete agreement was invalid, Appellants are liable for their separate and independent violation of the Exclusivity Provision which required Appellants to make certain body bags available to Respondent for purchase for a period of ten years. (R. p. 375 at § 3.4.8.)

The Court ignored evidence that in 2011, in conjunction with their submission of a competing bid for mortuary transport services to Richland County, Appellants informed the Richland County procurement office that they were "withdrawing odor proof body bags from the market." (R. p. 166, line 6 – p. 168, line 13; p. 241, lines 14-24; p. 346, line 14 – p. 347, line 25.) Appellants' affirmative statement that it was a sole provider of odor proof body bags, and intended consequence of knocking Respondent out of the bid, was in direct violation of Appellants' contractual obligation to provide odor proof body bags to Respondent for a period of ten years. (R. p. 375 at § 3.4.8; p. 241, lines 2.5.)

Even if Appellants were permitted to compete against Respondent, i.e., if Covenant were not enforceable, and are therefore not liable for submitting a competing bid for mortuary transport services, Appellants' act of withdrawing odor proof body bags from the market was the only reason Appellants won the Richland County five-year mortuary transport contract, not because they were the lowest bidder. (R. p. 225, lines 1-

14; p. 168, lines 14-25; p. 241, lines 2-25.) As evidence in the record shows, Appellants' breach of the Exclusivity Provision damaged Respondent in the same way as Appellants' breach of the Covenant and this breach separately supports an affirmance of the lower court's order.

In reversing and remanding the lower court's order in favor of Respondent and failing to address Respondent's claim that Appellants breached the parties' Agreement by withdrawing odor proof body bags from the market, the Court overlooked or misapprehended issues on appeal and failed to consider record evidence which would support an affirmance.

CONCLUSION

This Court overlooked or misapprehended the issues on appeal because it has failed to appropriately apply all factors for considering the validity of a non-compete agreement ancillary to the sale of a business and in wholly failing to acknowledge Appellants' breach of the exclusivity provision of the parties' agreement which provides a separate basis for affirming the lower court. For the reasons stated above, this Court should grant Respondent's Petition for Rehearing.

Respectfully submitted,

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May 19, 2016.

THE STATE OF SOUTH CAROLINA
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APPEAL FROM LEXINGTON COUNTY
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James Randall Davis, Special Master/Referee

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PROOF OF SERVICE

I hereby certify I served Respondent's Petition for Rehearing upon Appellants, by depositing a copy of the document in the United States Mail, postage prepaid, on May 19, 2016, addressed to its attorney of record:

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VIA Hand Delivery:
The Honorable Jenny Abbott Kitchings
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Re: *Palmetto Mortuary Transport, Inc. v. Knight Systems, Inc. and Robert L. Knight*
Appellate Case No. 2014-001819
A&R File No. 052173-011885

Dear Ms. Kitchings:

Enclosed for filing in the above-referenced matter are the original and seven (7) copies of Respondent's Petition for Rehearing together with our firm's check in the amount of $25.00 to cover the filing fee. Please file the original and six (6) copies pursuant to Rule 240, SCACR, and return the extra copy to me via our courier.

By copy of this letter, I am serving all counsel of record with the Petition as set forth in the enclosed Proof of Service. Thank you for your attention to this matter.

Sincerely,

/JJP

John J. Pringle, Jr.

JJP/vhm

cc: Reginald I. Lloyd, Esquire