THE STATE OF SOUTH CAROLINA

In The Supreme Court

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SC SUPREME COURT

APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

James Randall Davis, Special Master/Referee

Case No. 2016-001531

Palmetto Mortuary Transport, Inc., ...Petitioner,

v.

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

RETURN TO PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF ISSUE ON APPEAL

I. Whether the South Carolina Court of Appeals erred by finding that a covenant not to compete, ancillary to the sale of a Lexington County based business and with a 150-mile wide territorial restriction, was unreasonable, violative of South Carolina Supreme Court precedence, and not limited to protecting the legitimate interests of the business purchaser.

ARGUMENT

The South Carolina Supreme Court should not grant certiorari in this case because the South Carolina Court of Appeals decision in this case correctly applies prior decisions issued by this Court. The Petition for Certiorari fails to cite any authority from the South Carolina Supreme Court which would uphold a covenant not to compete's 150-mile wide territorial restriction for a midlands South Carolina based business.

The Petition for Certiorari claims, for the first time in this litigation, that the Covenant Not to Compete should be upheld because a provision of the mortuary transportation business' Asset Purchase Agreement also contained an "Exclusivity" provision, requiring Petitioner to purchase body bags from Respondent's separate body bag manufacturing business. Petitioner argues that the Exclusivity provision was a mutual benefit to both Parties and that, as Petitioner expanded its business throughout the 150-mile wide territorial restriction, Respondent's body bag manufacturing business would also benefit. *See*, Petition for Certiorari, p. 10. Supposedly, as the Petition for Certiorari argues, this mutual benefit evidences an intent by both Parties to have the extremely broad territorial restriction. Petitioner's neoteric entanglement of the

Covenant Not to Compete with the Exclusivity provision of the Asset Purchase Agreement fails for several reasons.

First, the Asset Purchase Agreement's provision requiring Petitioner to purchase body bags from Respondent's separate business was related to Petitioner's right to purchase Respondent's body bag manufacturing business in the event that Respondent decided to sell that business. (R. p. 375, ¶ 3.4.8 "Seller's Related Business"). Petitioner's "right of first refusal" to purchase the body bag manufacturing business, at the same price and terms as any other offer to Respondent, has no relation to the Covenant's non-competition territorial restriction, which covers the State of South Carolina and even extends into North Carolina and Georgia. There is absolutely no evidence or testimony in the Record indicating that Petitioner's mortuary transportation business was taking any action to expand its operations beyond the area of operation at the time Respondent's business was purchased.[1] Thus, there is no evidence in the Record supporting Petitioner's argument that Respondent's body bag business would benefit from Petitioner's vague future expansion plans during the term of the Exclusivity provision or Covenant Not to Compete.

Second, Petitioner successfully argued before the Special Referee that Respondent's interpretation of the Exclusivity provision, as requiring Petitioner to purchase **all** of its body bags from Respondent's related business, was erroneous. The Special Referee held that the Petitioner was only required to purchase the four specific

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[1] Petitioner's owner, Mr. Don Lintel, testified at trial that, at the time of the asset purchase, there were no plans to expand the business to other parts of the State. (R. pp. 208-210). On the topic of future expansion, Lintel testified as follows: "We didn't know where the business was actually going to -- what we were going to do -- if we were going to try to expand it at different locations. We wanted to keep our options opened if it was doable, I guess." (R. p. 208, lines 22-25, p. 209, lines 1-2). If Petitioner was uncertain of future expansion plans of its own business, it is difficult to fathom how Respondent was relying on profits from Petitioner's statewide expansion as consideration for the Non-compete agreement.

types of bags listed in Paragraph 3.4.8 of the Asset Purchase Agreement, and no other types of bags that might be used or purchased by Petitioner. (R. pp. 18-22). Additionally, the Special Referee's Order inexplicably rewrote the contractual obligations of the Parties and held that the Petitioner was no longer required to purchase any body bags from the Respondent for the remainder of the non-compete term. (R. p. 32-33). Petitioner did not object to or appeal the Special Referee's finding that the "Non-Compete Agreement was a separately executed contract which is supported by adequate consideration. Plaintiff is only seeking specific performance of the parties' Non-Compete Agreement and no one is seeking specific performance of the entire APA." *Id.* Thus, Petitioner wrongfully argues that the Court of Appeals should have considered the import of the Exclusivity provision where the Special Referee found that Petitioner's action was not even seeking specific enforcement of that provision.

Last, Petitioner claims that there was a "symbiotic relationship" between the Covenant and the Exclusivity provision which guaranteed Respondent a profit in his body bag manufacturing business in exchange for the 150-mile radius territorial restriction. *See*, Petition for Certiorari, pp. 13-14. This alleged "symbiotic relationship," according to Petitioner, should have been considered by the Court of Appeals in determining the reasonableness of the territorial restriction imposed by the Covenant. *Id.* at p. 14. In sum, the Petitioner argues that the Exclusivity provision was additional and distinct compensation to Respondent for the extreme territorial restriction in the Covenant. Problematically for the Petitioner is the fact that Petitioner specifically took the position at trial that the only compensation paid for the Covenant was the One

Thousand Dollars ($1000.00) set forth in the Asset Purchase Agreement. (R. pp. 9-10, ¶¶ 16-18).

During the trial of this case, Mr. Don Lintel, owner of Palmetto Mortuary, testified that he was unaware of any other compensation paid for the Non-compete other than the purchase price for Respondent's business and the $1000.00. (R. pp. 228-239). Mrs. Ellen Lintel, an officer of Palmetto Mortuary, testified at trial that, other than the purchase price of the assets, Petitioner never offered any additional compensation or consideration for the Non-compete. (R. p. 262, lines 13-25, p. 263, line 1). In fact, Mrs. Lintel testified that during the closing of the asset purchase, she discussed with her husband and attorney whether the $1000.00 was adequate consideration for the Non-compete. (R. pp. 266-67). At no time during the trial, or appeal before the Court of Appeals, did Petitioner ever assert that the Exclusivity provision was additional compensation to Respondent for the Covenant and its statewide territorial restriction.[2] Thus, the Court of Appeals correctly did not consider the Exclusivity provision as any factor determining the reasonableness of the 150-mile territorial restriction.

Despite Petitioner's newly invented consideration for the Covenant Not to Compete, in the form of the Exclusivity provision, the Court of Appeals correctly applied prior precedent in finding that the 150-mile territorial restriction was unreasonable and invalid. Initially, it should be noted that in South Carolina, covenants not to compete are generally disfavored and should be critically examined by courts. *See e.g.*, 18 S.C. Jur. Monopolies § 9. "As a general rule, such covenants are given greater deference in the

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[2] Mr. Lintel was specifically cross examined about whether the Exclusivity provision was additional consideration for the Non-compete agreement and he repeatedly declined to state that the provision was consideration for the Covenant Not to Compete. (R. pp. 228-239).

context of a sale of business than in the employment context." *Hagemeyer North America Inc. v. Thompson*, 2006 WL 516733 (D.S.C. 2006). Nonetheless, even a restrictive covenant not to compete, which is ancillary to the sale of a business, will be upheld only if it is supported by a valuable consideration; is reasonably limited as to time; and if it is reasonably restricted as to the place of territory, "that is, where the time is not more extended or the territory more enlarged than essential for a reasonable protection of the rights of the purchasing party." *Somerset v. Reyner*, 233 S.C. 324, 104 S.E.2d 344, 346 (1958). *See also, Cafe Associates, Ltd. v. Gerngross*, 305 S.C. 6, 406 S.E.2d 162, 164 (1991) (upholding covenant not to compete as part of business sale because the territorial restriction "was no more restrictive than reasonably necessary to protect [purchaser's] legitimate interest").

In *Beverage Systems of the Carolinas, LLC v. Associated Beverage Repair, LLC*, 762 S.E.2d 316 (N.C. App. 2014), the North Carolina Court of Appeals, applying principles of analysis similar to South Carolina cases, described the importance of examining a non-compete's territorial restriction in relation to the customer or clientele area actually purchased in a business sales transaction. *Beverage Systems of the Carolinas* involved a suit brought by the buyer of a beverage dispensing business alleging, inter alia, breach of a non-compete agreement by the seller. Holding that the subject two state non-compete was unreasonable, and therefore void, the North Carolina Court of Appeals noted that the areas serviced by the purchased business "extended from Wake County to Morgantown in North Carolina. In South Carolina . . . business only reached as deep as Rock Hill and Spartanburg and as far west as Gaffney." *Id.* at 321. "Consequently, the geographic area covered by the non-compete

[the entire states of North and South Carolina] was not limited to places where [the business sellers] had former customers and included areas not necessary to maintain plaintiff's customer relationships; thus, it was unreasonable." *Id.*[3]

Explaining the logical relationship between the connection of an existing or established customer base and a non-compete's territorial restriction, the North Carolina Court of Appeals applied an analysis parallel to that utilized by South Carolina courts. "With regard to the reasonableness of the territory [in a non-compete], this Court has noted that

> to prove that a geographic restriction in a covenant not to compete is reasonable, an employer must first show where its customers are located and that the geographic scope of the covenant is necessary to maintain those customer relationships. A restriction as to territory is reasonable only to the extent it protects the legitimate interests of the employer in *maintaining* its customers. The employer must show that the territory embraced by the covenant is no greater than necessary to secure the protection of its business or good will."

Id. at 321, *quoting, Hartman v. W.H. Odell & Associates, Inc.*, 450 S.E.2d 912, 917 (N.C. App. 1994) (internal citations omitted).

Generally, in South Carolina, "[a] covenant not to compete is enforceable if it is not detrimental to the public interest, is ancillary to the sale of a business or profession, is reasonably limited as to time and territory, and is supported by valuable consideration." *South Carolina Finance Corp. of Anderson v. Westside Finance Co.*,

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[3] The North Carolina Court of Appeals also "noted that any area in which plaintiff itself had former or existing customers would also be reasonable to include in the non-compete." *Id.* at 321, n. 2. However, because there was no pleading or proof offered that plaintiff had ever operated in North or South Carolina prior to the purchase of defendants' business or that plaintiff had existing customers not acquired by the business purchase, "for purposes of reasonableness, only former customers of [the defendants] will determine the scope of the territory." *Id.* Likewise, in the case before this Court, Respondents did not have any existing customers prior to the purchase of Knight's mortuary transportation business, and certainly offered no proof or evidence of customers throughout South Carolina and into parts of Georgia and North Carolina.

236 S.C. 109, 113 S.E.2d 329 (1960), *citing*, 36 Am.Jur., Monopolies, Combinations, and Restraints of Trade, Sections 52, 53, 54, 55, 56; *Metts v. Wenberg*, 158 S.C. 411, 155 S.E. 734 (1930); *Reeves v. Sargeant*, 200 S.C. 494, 21 S.E.2d 184 (1942); *Somerset v. Reyner*, 233 S.C. 324, 104 S.E.2d 344 (1958). Nonetheless, such covenants not to compete, even in association with the sale of a business or profession, "are looked upon with disfavor, examined critically, and strictly construed." *Moser v. Gosnell*, 334 S.C. 425, 513 S.E.2d 123, 125 (Ct. App. 1999) (review of covenant where purchasers sued sellers of construction company for breach). *See also*, *Cafe Associates, Ltd. v. Gerngross*, 305 S.C. 6, 406 S.E.2d 162, 164 (1991) (holding restrictive covenant not to compete contained in restaurant asset purchase agreement is viewed with disfavor and examined critically).

In *Hagermeyer*, the South Carolina District Court observed that "South Carolina Courts have struck down statewide restrictive covenants, but not for that reason alone; a particular geographic scope is 'generally reasonable if the area covered by the restraint is limited to the territory in which the employee was able, during the term of his employment, to establish contact with his employer's customers.'" *Hagermeyer*, *supra* at p. 5, *quoting*, *Rental Uniform Service of Florence, Inc. v. Dudley*, 278 S.C. 674, 301 S.E.2d 142, 144 (1983). Non-compete agreements should be limited in geographic or territorial scope to only the area necessary to protect an employer's or business purchaser's legitimate interest in the current client or customer base. *See e.g.*, *Vlasin v. Len Johnson & Co., Inc.*, 455 N.W.2d 772 (Neb. 1990) (striking 50 mile restrictive covenant as not reasonably necessary to protect employer's legitimate interest in existing customer goodwill); *Hartman v. W.H. Odell and Associates, Inc.*, 450 S.E.2d

912 (N.C. 1994) (to prove that a geographic area in a non-compete is reasonable, an employer must show where its customers are located and that the geographic scope of the covenant is necessary to maintain those customer relationships); *see also*, *Manpower of Guilford County, Inc. v. Hedgecock*, 257 S.E.2d 109 (N.C. 1979) (employer must show that the territory in covenant is no greater than necessary to secure the protection of its business).

In *Somerset, supra*, the South Carolina Supreme Court considered a covenant not to compete which arose in circumstances very similar to the present case between Petitioner and Respondent. The Respondent in *Somerset* brought a declaratory judgment action to declare a covenant not to compete, executed as part of Respondent's sale of his retail silver and jewelry business. Respondent's business was located in the Five Points area of the City of Columbia and nearly 95% of his sales were in the greater Columbia area. *Somerset*, 104 S.E.2d at 345. However, the covenant not to compete, signed by the parties in *Somerset*, prohibited Respondent from engaging in the sale of jewelry, silverware, or similar items in the entire State of South Carolina for 20 years. *Id.* at 346.

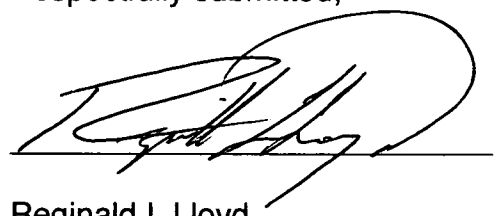
The Supreme Court, in *Somerset*, cited long-standing authority for the rule that restrictive covenants, ancillary to the sale of a business, must be reasonably tailored to the customer area served by the purchased business. *Id.* at 346. "The [Respondent's] trade came almost entirely from the area of Greater Columbia. Sales to customers living elsewhere, with the exception of four or five florists, were described in the testimony as being very 'spotty.'" *Id.* "Obviously, it was unnecessary to the protection of the business sold, or that later operated by [purchaser] that Respondent be prohibited

from engaging in a similar business in Charleston, Spartanburg, Greenville or numerous other cities in South Carolina. *Id.* Finding "no rational basis for the extent of the territorial restraint," the South Carolina Supreme Court ruled that the covenant not to compete was "clearly invalid.". *Id.* at 347. Like the covenant not to compete in *Somerset*, the non-competition covenant in this litigation between Petitioner and Respondent was not narrowly drawn to protect any legitimate interests of Palmetto Mortuary.

CONCLUSION

For the reasons set forth herein, the Court of Appeals ruled correctly that the Covenant Not to Compete in this case contained an invalid territorial restriction and this Court should deny the Petition for Certiorari.

Respectfully submitted,

By: 

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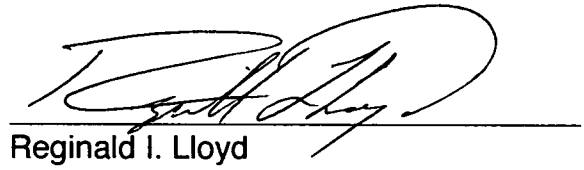
PROOF OF SERVICE

I hereby certify that I served the Respondent's RETURN TO PETITION FOR WRIT OF CERTIORARI upon Palmetto Mortuary Transport, Inc., Petitioner, by depositing a copy of the same in the United States Mail, postage prepaid, on August 24, 2016, addressed to its attorney of record, John J. Pringle, Jr., Esquire, Adams and Reese LLP, 1501 Main Street, Fifth Floor, Columbia, South Carolina 29201.



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