THE STATE OF SOUTH CAROLINA
In the Supreme Court

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APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

James Randall Davis, Special Master/Referee

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S.C. SUPREME COURT

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Opinion No. 2016-5402 (S.C. Ct. App. Filed May 4, 2016)

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

v.

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

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# REPLY TO RESPONDENTS' RETURN TO PETITION FOR WRIT OF CERTIORARI

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## ARGUMENT AND CITATION OF AUTHORITY

**I. PETITIONER'S ARGUMENT THAT THE EXCLUSIVITY PROVISION EVIDENCES THE PARTIES INTENTIONS AND REASONABLY SUPPORTS A 150-MILE TERRITORIAL RESTRICTION IN THE COVENANT NOT TO COMPETE IS NOT NEW, AND THE RESPONDENTS' ARGUMENTS TO THE CONTRARY CONTRADICT THE POSITION THEY HAVE TAKEN THROUGHOUT THIS LITIGATION.**

The Court of Appeals' decision is in conflict with prior decisions of this Court, *Reeves v. Sargeant*, 200 S.C. 494, 21 S.E.2d 184, 188 (1942), in that the Court of Appeals failed to consider all factors in evaluating the reasonableness of a non-compete agreement. Instead of applying all factors compelled by *Reeves*, the Court of Appeals narrowly focused only on the existing location of the business at the time of contracting, *Palmetto Mortuary*, -- S.C. --, 786 S.E.2d 588, 591-92, an analysis which necessarily ignored other facts and negotiated provisions of the parties' Asset Purchase Agreement ("Agreement")—including the Exclusivity Provision (R. p. 375 at Section 3.4.8), requiring Petitioner to purchase certain bags from Respondents for the duration of the parties' Non-Compete Agreement (R. p. 394 at Exhibit 3.2.6). The facts and circumstances ignored by the Court of Appeals demonstrate the 150-mile geographic restriction placed on Respondents' ability to compete against Petitioner protected the rights of the Petitioner in a reasonable manner.

**A. Petitioners are not making any argument "for the first time."**

Respondents do not address the merits of Petitioner's argument—that the Exclusivity Provision of the Agreement supports the 150-mile territorial restriction in the Non-Compete Agreement. Instead, Respondents claim Petitioner's argument is new and

made for the first time to this Court. To the contrary, Petitioner specifically argued to the Court of Appeals:

> Knight received a financial benefit of $590,000.00 as a result of entering into the APA and the Non-Compete Agreement, retained the specific right to continue to conduct his body bag business, and through the Exclusivity Provision required Respondent to purchase certain bags from Knight for the 10-year term of the Non-Compete Agreement.
>
> . . .
>
> Knight negotiated the Exclusivity Provision requiring Palmetto Mortuary to purchase body bags from Knight for ten years—the duration of the Non-Compete Agreement. (R. p. 375 at § 3.4.8.) (The ongoing business relationship between Palmetto Mortuary and Knight is in sharp contrast to the facts in *Somerset*, 233 S.C. 324, 104 S.E.2d 344, where the plaintiff was discharged as manager of the defendant's business following the sale of plaintiff's business to defendant after merely three months on the job. *Id.* at 329, 104 S.E.2d at 346.) The Exclusivity Provision (R. p. 375 at § 3.4.8) conferred a significant financial benefit upon Knight. Prior to Knight's breach of the Non-Compete Agreement and the Exclusivity Provision, Palmetto Mortuary paid Knight more than $45,000 for body bags purchased pursuant to the Exclusivity Provision. (R. p. 160, lines 10-20; R. pp. 408-448.) As such, while the APA placed reasonable limitations on Knight's ability to perform mortuary transport services, the same APA allowed and enhanced Knight's ancillary body bag business.

Respondent's Brief at pp. 18, 23. Therefore, Respondents' argument that Petitioner's position is made "for the first time in this litigation" and "neoteric," *see* Respondents' Return to Petition for Certiorari at p. 2, should be ignored.

### B. The language of the Agreement demonstrate the interplay between the Non-Compete and Exclusivity Agreements.

It is clear from the language of the Agreement itself that the Non-Compete Agreement and Exclusivity Provision were intended by the parties to work in tandem following closing. (*See* R. p. 394 at Exhibit 3.2.6; R. p. 375 at Section 3.4.8.) In fact, the Exclusivity Provision specifically references the Non-Compete Agreement:

> [Respondent Knight], through his related body bag business (the "Related Business") shall provide to [Petitioner] body bags at a discounted rate and

> [Petitioner] shall **for the term of the non-compete agreement** buy all their body bags from the Seller.

(R. p. 375 at Section 3.4.8 (emphasis added).)

The language could not be plainer: as long as the Non-Compete Agreement applied to Respondents, Petitioner had the obligation to buy bags from Respondents. There is no geographic restriction in the Exclusivity Provision limiting Petitioner's obligation to purchase body bags based upon any territory whatsoever. On the contrary, the Exclusivity Provision guarantees profit for Respondents' body bag manufacturing enterprise based on *any* territory in which Petitioner provides mortuary transport services during its term. As such, Respondents' claim that "there is no evidence in the record" Respondents' body bag business would benefit from any expansion of Petitioner's mortuary transport business (Return to Petition for Writ of Certiorari at p. 3) is simply wrong. The evidence is found in the plain language of the Agreement negotiated by the parties.

**C. Respondents have themselves relied upon the interplay between the Exclusivity and the Non-Compete Agreements in this litigation.**

Similarly, Respondents' argument—that the Exclusivity Provision and Non-Compete Agreement are not related or mutually beneficial to the parties (Respondents' Return to Petition for Certiorari at p. 3)—is belied by their legal claims and positions in this litigation. From the outset of this litigation through their assertion of a counterclaim for breach of contract, Respondents have contended Petitioner's purchase of body bags from manufacturers other than Respondents was in alleged violation of the Exclusivity Provision and entitled them to abrogate the Non-Compete Agreement. *See* Appellants' Brief at pp. 36-49. In particular, Respondents' specifically alleged Petitioner's failure to

buy one or more body bags from Respondents pursuant to the Exclusivity Provision "negated all terms, conditions and responsibilities of the Defendants under the Asset Purchase Agreement *and the Non-Compete Agreement*." (R. p. 58 at ¶¶ 39-43 (Appendix) (emphasis added).)

Likewise, Respondents' belief that the Exclusivity Provision is "related to Petitioner's right to purchase Respondents body bag manufacturing business in the event that Respondent [Knight] decided to sell that business," Respondent's Return to Petition for Certiorari at p. 3, is at odds with both the clear and unambiguous language of the Exclusivity Provision, as well as Respondents' own reading of the Exclusivity Provision. As set out above, Respondents firmly believed the language of the Exclusivity Provision required Petitioner to buy bags from Respondents (as opposed to giving Petitioner some right of first refusal), as evidenced by Respondents' claim that the Petitioner's alleged failure to buy bags released Respondents from all their obligations under the Agreement, including the Exclusivity Provision and the Non-Compete Agreement. (R. p. 58 at ¶¶ 39-43 (Appendix).)

Respondents' argument that the Exclusivity Provision is somehow less enforceable because Petitioner did not seek specific performance of the Exclusivity Provision (Respondents' Return to Petition for Writ of Certiorari at p. 4 ("the "Special Referee found that Petitioner's action was not even seeking specific enforcement of that provision")), is inscrutable and in any event contrary to Respondents' position throughout this litigation. Petitioner does not dispute that specific performance of the Exclusivity Provision was not requested by *either* party. Insinuating that the Exclusivity Provision is not relevant because Petitioner did not seek specific performance of it in this litigation is

disingenuous. In fact, there is no reason for Petitioner to seek to enforce the Exclusivity Provision. Specific enforcement would have been in *Respondents'* best interest, not Petitioner's because it would have continued Petitioner's obligation to purchase bags from Respondents. Respondents not only did not seek specific performance of the Exclusivity Provision, but indeed claimed that a non-material breach of that contractual provision by Petitioner excused its obligations both under the Exclusivity Provision and the Non-Compete Agreement.

## II. CONSIDERATION FOR THE NON-COMPETE AGREEMENT IS NO LONGER AT ISSUE IN THIS APPEAL.

Respondents argue Petitioner is seeking to have this Court conclude that the Exclusivity Provision serves as additional "consideration" for the Non-Compete Agreement. *See* Respondents' Return to Petition for Certiorari at p. 4 ("In sum, the Petitioner argues that the Exclusivity provision was additional and distinct compensation to respondent for the extreme territorial restriction in the Covenant."); *id.* at p. 5 ("newly invented consideration"). Nowhere in the Petition does Petitioner argue any point of law or fact regarding "consideration." Indeed, any such argument would be irrelevant at this juncture because the lower court found that Non-Compete Agreement was adequately supported by consideration, despite Respondents' arguments to the contrary. (*See* R. pp. 3-15 at ¶¶ 1-31.) Respondents' appeal of this issue (*See* Appellants' Brief at pp. 28-31) was not addressed by the Court of Appeals.

Because consideration is not at issue in this appeal, this Court should ignore Respondents' arguments regarding consideration as a red herring.

## III. CASES CITED BY RESPONDENTS ARE DISTINGUISHABLE.

Respondents' citation to *Somerset v. Reyner*, 233 S.C. 324, 104 S.E.2d 344, 346 (1958), and cases from courts in other jurisdictions is unconvincing.

The facts underlying is Court's decision in *Somerset* are dissimilar from the facts in this case. In particular, and unlike the plaintiff in *Somerset*, 233 S.C. at 329, 104 S.E.2d at 346, both parties were represented by attorneys in the negotiation and drafting of the Agreement, including specifically the Non-Compete Agreement. Respondents' 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.) Respondents 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, 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* Court of Appeals 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 in that case. *Id.* at 328, 104 S.E.2d at 346. No such facts

painting Petitioner in even vaguely similar light as the *Somerset* defendant exist here. To the contrary, and as argued by Petitioner (Petition for Rehearing at pp. 1-2), the Respondents' actions at every turn fell well short of behavior in good faith.

*Beverage Systems of the Carolinas. LLC v. Associated Beverage Repair, LLC*, 762 S.E.2d 316 (N.C. 2014), *rev'd on other grounds*, 784 S.E.2d 457 (2016), is also distinguishable. In that case, the North Carolina Court of Appeals, and later, Supreme Court, held a non-compete agreement was unreasonable because its geographic scope included areas beyond those "necessary to maintain plaintiff's customer relationships." 762 S.E.2d at 321; 784 S.E.2d at 461. In so holding, the Court of Appeals stated the applicable test in considering as follows:

> 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.

*Id.* at 321 (citation omitted).

As previously stated, in South Carolina, evidence of the location of a business' customers or clientele is only one factor to consider in examining the reasonableness of a restraint as to territory. *Reeves*, 200 S.C. 494, 21 S.E.2d at 188 (listing "location" as only one of five factors to be applied). In *Standard Register Co. v. Kerrigan*, 238 S.C. 54, 119 S.E.2d 533 (1961), this Court noted: "The general rule is that restraint as to territory, in order to be reasonable, must be necessary in its full extent for the *protection of some legitimate interest of the employer*." *Id.* at 66, 119 S.E.2d at 539 (emphasis added). "Stated negatively, the territorial scope renders the restraint unreasonable if it covers an area broader than necessary to protect the legitimate interest of the employer." *Id.*

In *Standard Register*, this Court listed "the most important single asset of most business[es]" as "their stock of customers," but it did not limit an employer's "legitimate business interests" to that factor alone. *Id* at 66, 119 S.E.2d at 539. Petitioner maintains that its interest in expanding the mortuary transport business is reasonable in light of the fact that Respondent Knight stated his intent to "get out of the business" entirely, maintained his body bag business as a separate business enterprise, and received a promise of future income from Petitioner pursuant to the Exclusivity Provision.

*Vlasin v. Len Johnson & Co., Inc.*, 455 N.W.2d 772 (Neb. 1990); *Hartman v. W.H. Odell and Associates, Inc.*, 450 S.E.2d 912 (N.C. 1994); and *Manpower of Guilford County, Inc.*, 257 S.E.2d 109 (N.C. 1979), all cited by Respondents (see Return to Petition for Certiorari at pp. 8-9), deal with the enforcement of a covenant not to compete *arising in the context of an employment relationship.* Case law from South Carolina and other jurisdictions is clear that a more rigorous standard applies in these contexts, as opposed to where a non-compete agreement arises in the context of a sale of a business. 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 the sale of a business than in the employment context.") (citation omitted); *Bybee v. Issac*, 178 P.3d 616, 621 (Id. 2008) ("Though this Court has said non-compete covenants are disfavored in the employment context, we have not said they are disfavored when ancillary to the sale of a business"); *American Hot Rod Ass'n, Inc. v. Carrier*, 500 F.2d 1269, 1277 (4th Cir. 1974) ("restrictive covenants not to compete in employment contracts ... are scrutinized more rigorously than similar covenants incident to the sale of a business"); *Seaboard Indus., Inc. v. Blair*, 178 S.E.2d 781, 787 (N.C. App. 1971)

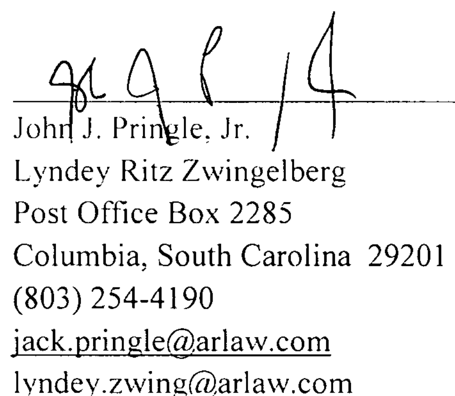
("Greater latitude is generally allowed in these covenants given by the seller in connection with the sale of a business than in covenants ancillary to an employment contract.").

**CONCLUSION**

For the foregoing reasons, the Court of Appeals failed to uphold the intentions of the parties at the time of contracting, failed to recognize the purpose of the restrictions in the Agreement, and failed to consider the substantial benefits *all* parties received as a result of the Agreement, the Non-Compete Agreement, and the Exclusivity Provision. The Court of Appeals erred in restricting the applicable factors for enforcement of non-compete agreements solely to existing business location. Certiorari should be granted by this Court on the ground that the Court of Appeals failed to apply all of the factors required in *Reeves v. Sargeant*, 200 S.C. 494, 21 S.E.2d 184, 188 (1942), in evaluating the reasonableness of a non-compete agreement.

Respectfully submitted,

ADAMS AND REESE LLP



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## PROOF OF SERVICE

I hereby certify I served the Reply to Respondents' Return to Petition for Writ of Certiorari upon Knight Systems, Inc., and Robert L. Knight, by depositing copies of the documents in the United States Mail, postage prepaid, on September 6, 2016, addressed to its attorney of record, Reginald I. Lloyd, Esquire, The Lloyd Law Firm, LLC, Post Office 1555, Camden, South Carolina 29021.

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