THE STATE OF SOUTH CAROLINA
In the Supreme Court

RECEIVED
JUL 24 2017
S.C. SUPREME COURT

APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

James Randall Davis, Special Master/Referee

Opinion No. 2016-5402 (S.C. Ct. App. filed May 4, 2016)
Appellate Case No. 2016-001531

Palmetto Mortuary Transport, Inc.,..Petitioner,

v.

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

RESPONDENTS' BRIEF

James Edward Bradley, SC Bar # 66130
Moore Taylor Law Firm, P.A.
P.O. Box 5709
West Columbia, SC 29171
(803) 796-9160
ward@mttlaw.com

Attorney for Respondents

Other Counsel of Record:
John J. Pringle, Jr., S.C. Bar # 11208
Lyndey Ritz Zwingleberg, S.C. Bar # 100804
Adams and Reese, LLP
1501 Main Street, Fifth Floor
Columbia, SC 29201
803-254-4190
Attorneys for Petitioner

TABLE OF CONTENTS

Table of Authorities iii

Statement of Issues on Appeal 1

Statement of the Case 1

1. Sale of Assets 1
2. Palmetto Mortuary's Breach of Contract 3
3. Lawsuit And Trial Before Special Master 4
4. Appeal 5

Argument 6

I. THE COURT OF APPEALS CORRECTLY FOUND THE TEN-YEAR, ONE HUNDRED FIFTY MILE COVENANT NOT TO COMPETE ACCOMPANYING THE SALE OF ASSETS OF KNIGHT'S LEXINGTON COUNTY-BASED BUSINESS UNENFORCEABLE AND NOT LIMITED TO PROTECTING THE LEGITIMATE INTERESTS OF PALMETTO MORTUARY 6

A. The 150 mile restriction is unreasonable because it far exceeds the customer base Palmetto Mortuary purchased. 6
   1. A covenant imposing geographic restrictions on free market competition can be no larger than reasonably necessary to protect the existing client base of a purchased business 7
   2. The ten-year, statewide restriction far exceeds the customer base of Knight or Palmetto Mortuary 12

B. This Court should not rewrite the defective restraint on trade 12

C. The agreement requiring Palmetto Mortuary to buy body bags from Knight cannot save the unreasonable restraint on competition 13

II. AS AN ADDITIONAL SUSTAINING GROUND, THE NON COMPETITION COVENANT RESTRICTS COMPETITIVE BIDDING FOR A PUBLIC CONTRACT. THUS IT IS VOID AS AGAINST PUBLIC POLICY 15

III. AS AN ADDITIONAL SUSTAINING GROUND, PALMETTO MORTUARY FIRST BREACHED THE ASSET PURCHASE AGREEMENT. AS A RESULT, IT CANNOT ENFORCE THE COVENANT NOT TO COMPETE 18

Conclusion 24

Table of Authorities

Cases

Atlantic Coast Builders and Contractors, LLC v. Lewis,
398 S.C. 323, 730 S.E.2d 282 (2012) 16

Beverage Systems of the Carolinas, LLC, v. Associated Beverage Repair, LLC,
762 S.E.2d 316 (N.C. App. 2014).. 7, 8

Borden v. Ellis, 44 A.2d 530 (Pa. 1945) 16

Brazell v. Windsor, 384 S.C. 512, 682 S.E.2d 824 (2009) 19, 20

Cafe Associates, Ltd., v. Gerngross, 305 S.C. 6, 406 S.E.2d 162 (1991)..................6, 7

City Nat. Bank of Corpus Christi v. City of Corpus Christi,
233 S.W. 375 (Tx. 1921) 18

Conway v. Garden City Paving & Post Co., 190 Ill. 89 (1901) 18

Dexter v. Brake, 269 P.3d 846, 856 (Kan. 2012).. 23

Eastern Business Forms, Inc. v. Kistler, 258 S.C. 429, 189 S.E.2d 22 (1979).......... 12

Ebert v. Ebert, 320 S.C. 331, 465 S.E.2d 121 (Ct. App. 1995)........................... 23, 24

Faces Boutique, LTD v. Gibbs, 318 S.C. 39, 455 S.E.2d 707 (Ct. App. 1995).... 11, 12

Finley Method Co. v. Standard Asphalt Co. of Fla., 139 So. 795 (1932)................. 16

Hagemeyer North America, Inc., v. Thompson, 2006 WL 516733
(D.S.C. 2006) 11

Hartman v. W.H. Odell and Associates, Inc., 450 S.E.2d. 912 (N.C. 1994) 11

Heid Bros. v. Riesto, 281 S.W. 638 (Tx. 1926) 17

In re Hawker Beechcraft, Inc., 486 B.R. 264 (S.D.N.Y 2013)................................ 22

Kimball Elevator Co., Inc. v. Elevator Supplies Co., Inc., 272 P.2d 583
(Utah 1954) 18

Manpower of Guilford County, Inc., v. Hedgecock, 257 S.E.2d 109 (N.C. 1979).... 11

Milliken & Co. v. Morin, 399 S.C. 23, 731 S.E.2d 288, 291 (2012) 16

Moser v. Gosnell, 334 S.C. 425, 513 S.E.2d 123 (Ct. App. 1999) 6

Philadelphia Storage Battery Co. v. Mutual Tire Stores,
161 S.C. 487, 159 S.E. 825 (1931) 21, 22

Poynter Invs., Inc. v. Century Builders of Piedmont, Inc.,
387 S.C. 583, 694 S.E.2d 15 (2010) 12

Premier Electrical Const. Co. v. Miller-Davis Co., 291 F. Supp. 295
(N.D. Ill. 1968) 18

Pyle v. Kernan, 36 P.2d 580 (Or. 1934) 16

Re Salmon, 145 Fed. 649 (D.C. 1906) 18

Reeves v. Sargeant, 200 S.C. 494, 21 S.E.2d 184 (1942) 10

Richmond Co., Inc. v. Rock-A-Way, Inc., 404 So.2d 121 (Fla. 1981) 17

Sloan v. School District of Greenville County, 342 S.C. 515,
537 S.E.2d 299 (2000) 16, 17

Somerset v. Reyner, 233 S.C. 324, 104 S.E.2d 344
(1958) 7, 8, 9, 10, 11, 13

South Carolina Finance Corp. of Anderson v. Westside Finance Co.,
236 S.C. 109, 113 S.E.2d 329 (1960) 6

Spokane Sav. & Loan Soc. v. Park Vista Imp. Co., 294 P. 1028 (Wa. 1930) 17

Stringer v. Herron, 309 S.C. 529, 424 S.E.2d 547 (Ct. App. 1992) 10

Team IA, Inc. v. Lucas, 395 S.C. 237, 717 S.E.2d 103 (2011) 13

Tricat Industries, Inc. v. Harper, 748 A.2d 48 (Md. 2000) 22

Vlasin v. Len Johnson & Co., Inc., 455 N.W.2d 772 (Neb. 1990) 11

Other

18 S.C. Jur. Monopolies § 9 7

12 Ill. Law and Prac. Contracts § 107 15

17A C.J.S. Contracts § 300 15

23 Williston on Contracts, § 63:3 19

5 Sandra M. Stevenson, Antieau on Local Government Law § 73.04
(2d ed. 1999) 17

Anticipating Litigation In Contract Design, 115 Yale L.J. 814 (Jan. 2006)............. 21

STATEMENT OF ISSUES ON APPEAL

1. THE COURT OF APPEALS CORRECTLY FOUND THE TEN-YEAR, ONE HUNDRED FIFTY MILE COVENANT NOT TO COMPETE ACCOMPANYING THE SALE OF ASSETS OF KNIGHT'S LEXINGTON COUNTY-BASED BUSINESS UNENFORCEABLE AND NOT LIMITED TO PROTECTING THE LEGITIMATE INTERESTS OF PALMETTO MORTUARY.

2. AS AN ADDITIONAL SUSTAINING GROUND, THE COVENANT NOT TO COMPETE IS VOID BECAUSE IT RESTRICTS COMPETITIVE BIDDING FOR PUBLIC CONTRACTS.

3. AS AN ADDITIONAL SUSTAINING GROUND, THE COVENANT NOT TO COMPETE IS VOID BECAUSE PALMETTO MORTUARY BREACHED THE CONTRACT BY PURCHASING BODY BAGS FROM KNIGHT'S COMPETITORS.

STATEMENT OF THE CASE

1. Sale of Assets

On January 5, 2007, Knight sold Palmetto Mortuary the assets of his body removal business. *See*, App. pp. 386-402. Don and Ellen Lintal own Palmetto Mortuary. As part of the sale, Palmetto Mortuary agreed to "to buy all of their body bags from" Knight's related body bag manufacturing business. *See*, App. p. 389 (Section 3.4.8 Seller's Related Business). In addition, Palmetto Mortuary bought all Knight's furniture, fixtures, equipment, and customer lists. Palmetto Mortuary took assignment of Knight's contracts with Lexington County, Richland County, and the University of South Carolina School of Medicine. *See*, App. p. 402 (Exhibit 2.3 Purchase Price Allocations attached to Asset Purchase Agreement); *see also*, App. p. 217, p. 218, lines 1-10; p. 276, lines 3-13; p. 320, lines 19-22.

Knight received $1,000.00 for agreeing to a covenant not to compete. The covenant prohibits Knight from competing with Palmetto Mortuary within 150 miles of Knight's

location for 10 years. App. p. 410. It also states that "[n]otwithstanding anything herein to the contrary, a breach by [Palmetto Mortuary] of the Purchase Agreement or such other documents ancillary thereto, shall constitute a breach of this [covenant not to compete] and shall release [Knight] from any and all restrictions hereunder." App. p. 411 (Section G).

Knight primarily provided mortuary transportation in Lexington and Richland Counties. App. p. 223, lines 12-15; p. 312, lines 19-25. On behalf of Palmetto Mortuary, Don Lintal testified that the 150 mile radius restriction was intended to prevent Knight from competing against Palmetto Mortuary anywhere in South Carolina. App. p. 223, lines 1-11. Although Knight Systems operated in Lexington and Richland Counties, Mr. Lintal justified the statewide restriction on competition as follows:

> Just because I didn't -- why was it important? Putting a geographic distance on it would have strengthened -- I didn't -- it wasn't to go against Mr. Knight in that regard. We didn't know where the business was actually going to -- what we were going to -- 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. I mean, you know, the standard -- a standard contract – I mean, he didn't have to accept it. We put it in there. He accepted it. So, I mean, the significance of it was that not only was there a duration of time, but we defined the territory, the boundary of which this applied . . . We did not know, but we did not want to limit our options if it was available to us.

See, App. pp. 223-225. Knight's business was based primarily in Lexington and Richland Counties. The only justification offered by Palmetto Mortuary for a statewide covenant not to compete was Palmetto Mortuary might someday expand its operations into other parts of the State of South Carolina. *Id.*

The Asset Purchase Agreement also requires Palmetto Mortuary to purchase all its body bags from Knight's body bag manufacturing business. Section 3.4.8 of the Agreement addresses this issue as follows:

> Knight, through his related body bag business (the "Related Business"), shall provide to Buyer body bags at a discounted rate and buyer shall for the term of the non-compete agreement buy all of their body bags from the Seller. Below are the current charges for different types of body bags. The prices cited below shall not be increased by more than ten percent (10%) in any calendar year.
>
> | | |
> |---|---|
> | Heavy Duty body bags: | $20.00 |
> | Lightweight body bags: | $8.00 |
> | Odor-Proof body bags: | $50.00 |
> | Water-Retrieval body bags: | $30.00 |

2. Palmetto Mortuary's Breach of Contract

Although the agreement obligated Palmetto Mortuary to buy body bags only from Knight, it purchased bags from Southland Medical Corporation. App. p. 164, lines 22-25; p. 168, lines 14-16. It also purchased body bags from Evident Crime Scene Products and Medical Products Limited. App. p. 467 (Evident Crime Scene); p. 171, lines 2-11; p. 172, line 25 – p. 173, line 17 (Medical Products Limited). When Knight confronted Don Lintal about Palmetto Mortuary's breach, Lintal lied. He told Knight he had purchased only infant body bags from another vendor when he knew he had purchased other bags from other vendors. App. p. 348, lines 2-3.

Lintal testified that after this discussion he was concerned Knight knew he had violated the Agreement by purchasing body bags from other sources. Lintal believed that Knight might bid on the Richland County request for proposals. App. p. 191, lines 1-12. Lintal testified that Knight told him Palmetto Mortuary broke the contract. "I don't believe it was -- the terminology was breached. It might have been it broke my agreement. But in effect, yes, it was the same inference." *Id.* at lines 13-20. Lintal testified that following his conversation with Knight, he went home and told his wife that he was "quite confident" that Knight would bid on the Richland County contract. App. p. 192, lines 12-23. Ellen

Lintal testified that Don Lintal was concerned Knight would bid on the Richland County contract because Knight knew Palmetto Mortuary breached the Agreement. App. p. 289, lines 14-22. She further testified that neither she nor her husband spoke with Knight later about the breach or tried to resolve the issue. App. p. 290, lines 2-14.

As a result of Palmetto Mortuary's breach of the agreement and Don Lintal's lies about its scope, Knight submitted a bid on the Richland County contract for body removal. Richland County awarded Knight the contract, and Palmetto Mortuary sued.

3. Lawsuit And Trial Before Special Master.

On October 20, 2011, Palmetto Mortuary sued Knight alleging that he breached the covenant not to compete executed when Palmetto Mortuary purchased the business. Knight counterclaimed alleging that Palmetto Mortuary first breached the terms of the Agreement.

Palmetto Mortuary alleged that Knight breached the Agreement by submitting a bid to provide body removal and transportation services to Richland County. It also alleged Knight breached Section 3.4.8 of the Agreement by removing Knight's odor-proof bags from the open market, thereby preventing Palmetto Mortuary from meeting a requirement of the Richland County Request for Proposals. App. p. 181, line 10-24; p. 182, lines 10-12; p. 308, lines 6-22.

Palmetto Mortuary was not guaranteed the Richland County contract, regardless of what Knight did. *Id.* at lines 19-22. Mrs. Lintal testified that Palmetto Mortuary's damages claimed are speculative because Palmetto Mortuary could not be assured it would receive the Richland County contract. App. p. 305, lines 14-23; p. 306, lines 8-21.

Randy Davis was appointed Special Referee. He tried the case on December 18, 2013. Mr. Davis found the covenant not to compete enforceable, supported by valuable consideration, and reasonably limited in time and scope. He also held that Palmetto Mortuary breached the Asset Purchase Agreement by purchasing body bags from a source other than Knight. He ruled this breach was not material. Mr. Davis also found that Knight breached the covenant not to compete by bidding on the Richland County Contract.

In his July 22, 2014 Order, Mr. Davis awarded Palmetto Mortuary damages of $373,264.54, as lost profits arising from Knight's wrongful competition in Richland County. Mr. Davis also ordered Knight to pay $72,077.38 to Palmetto Mortuary for attorney's fees and litigation costs. He issued an injunction requiring Knight to abide by the terms of the covenant not to compete for five years and seven months beginning from the date of his Order. Lastly, Mr. Davis ordered Palmetto Mortuary to pay $478.50 to Knight as damages for its breach of the Asset Purchase Agreement's requirement that Palmetto Mortuary purchase body bags exclusively from Knight.

4. Appeal.

Knight filed his Notice of Appeal on August 22, 2014, and on May 4, 2016, the Court of Appeals filed Opinion No. 5402 reversing and remanding the matter. The Court of Appeals found the 150 mile territorial restriction unreasonable.

ARGUMENT

I. THE COURT OF APPEALS CORRECTLY FOUND THE TEN-YEAR, ONE HUNDRED FIFTY MILE COVENANT NOT TO COMPETE ACCOMPANYING THE SALE OF ASSETS OF KNIGHT'S LEXINGTON COUNTY-BASED BUSINESS UNENFORCEABLE AND NOT LIMITED TO PROTECTING THE LEGITIMATE INTERESTS OF PALMETTO MORTUARY.

"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.*, 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 when accompanying the sale of a business, "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).

A. <u>The 150 mile restriction is unreasonable because it far exceeds the customer base Palmetto Mortuary purchased</u>.

The covenant not to compete extends ten years for a radius of 150 miles from Lexington County. *See*, App. pp. 408-414. This radius essentially restricts competition throughout the State of South Carolina and into some parts of Georgia. The consideration

paid for this statewide restriction is listed as $1,000.00 in the covenant – about twice what the master found the damages were for Palmetto Mortuary's initial breach he ruled not material. *See*, App. p. 402. The 150 mile radius from Lexington County as a territorial restriction is a statewide ban far exceeding the primary business area of Knight Systems and Palmetto Mortuary which was limited to Lexington and Richland Counties.

Covenants not to compete are a restraint on free trade and free markets. As a result, they are disfavored and are closely examined by courts. *See e.g.*, 18 S.C. Jur. Monopolies § 9. Covenants restraining the free market are appropriate only when they are supported by valuable consideration; reasonably limited as to time; and reasonably restricted as to territory. This Court only enforces restrictive covenants "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").

1. A covenant imposing geographic restrictions on free market competition can be no larger than reasonably necessary to protect the existing client base of a purchased business.

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 addressed the importance of limiting a restrictive covenant's territorial restriction to the customer area purchased. The buyer of a beverage dispensing business sued the seller alleging breach of a covenant not to compete. The Court held that the two state territory was unreasonable

and void. It 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 covenant not to 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.*

Like South Carolina courts, the North Carolina Court required a logical relationship between the existing customer base and the covenant not to compete's territorial restriction. It required that the covenant be limited to where customers are located. *Id.* at 321, *quoting*, *Hartman v. W.H. Odell & Associates, Inc.*, 450 S.E.2d 912, 917 (N.C. App. 1994).

In *Somerset v. Reyner*, 233 S.C. 324, 104 S.E.2d 344 (1958), this Court invalidated a covenant not to compete in similar circumstances. Somerset brought a declaratory judgment action to declare a covenant not to compete void. He signed the covenant as part of the sale of his retail jewelry business. Somerset's business was in the Five Points area 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 prohibited Somerset from engaging in the sale of jewelry, silverware, or similar items in the entire State of South Carolina for 20 years. *Id.* at 346. This Court ruled the statewide geographic restriction invalid.

This Court held that "[i]t is well settled that a restrictive covenant not to compete, ancillary to the sale of a business and its good will, will be upheld and enforced if '(1) supported by a valuable consideration, (2) if reasonably limited as to time, and (3) if

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,* 104 S.E.2d at 346 (citations omitted). It struck down the statewide covenant not to compete and noted that it "shall first determine whether the covenant under consideration is necessary in its full extent for the protection of the covenantee's business or good will. If not, the territorial scope of the restraint is unreasonable and no inquiry need be made as to the presence or absence of other necessary requirements." *Id.*, *citing*, Annotation in 46 A.L.R.2d. 119.

Palmetto Mortuary attempts to distinguish this case by arguing Somerset was not represented by a lawyer while Knight had a lawyer at the closing. It also argues that Knight never objected to the statewide ban and that Palmetto Mortuary anticipated future expansion of its business beyond the territory Knight serviced. These arguments do not distinguish Palmetto Mortuary's statewide ban from the ban in *Somerset*. The defendant in *Somerset*, much like Palmetto Mortuary, argued that the overly broad restriction on free trade should be upheld because Somerset suggested that the ban include the whole state; that Somerset stated he had no intention of going back into this business; and that the statewide restriction was necessary for the protection of the defendant's business. *See*, *Id.* at 346-47.

This Court held that it could "find no rational basis for the [statewide] extent of the territorial restraint." *Id.* at 347. "Obviously, it was unnecessary to the protection of the business sold, or that later operated . . . that plaintiff be prohibited from engaging in a similar business in Charleston, Spartanburg, Greenville or numerous other cities in South

Carolina." *Id.* at 346. As a result, the restriction was not enforceable. Likewise, Palmetto Mortuary's overly broad restriction on trade fails.

Palmetto Mortuary argues the statewide restraint on trade is not determinative. It contends the statewide restraint is only one of many factors to consider. This argument is directly opposed to the Court's holding in *Somerset*. It relies wholly on *Reeves v. Sargeant*, 200 S.C. 494, 21 S.E.2d 184 (1942), which was decided 16 years before *Somerset* and is cited in *Somerset* in support of the three-factor test *Somerset* sets forth.

The Court of Appeals relied on *Somerset* to hold that when a covenant not to compete's territorial provision is facially invalid, the covenant is unenforceable. In *Stringer v. Herron*, 309 S.C. 529, 424 S.E.2d 547 (Ct. App. 1992), the Court of Appeals held that a territorial restriction of fifteen miles surrounding three veterinarian practice locations in Anderson County had the practical affect of proscribing the competition of a former employee in "nearly all of Anderson County, parts of Abbeville, Greenville, Pickens, and Oconee Counties, and indeed a small part of Georgia." The territory extended beyond that which the employee had served, and the Court found it invalid.

Citing *Somerset*, the Court of Appeals in *Stringer* held that its "focus here need only be upon the question of whether, as a matter of law, the covenant in issue is reasonably limited in its operation with respect to place." *Stringer*, 424 S.E.2d at 548. Like in *Somerset*, the Court noted no other factors to consider once it found the territorial restriction on free trade unreasonable. *Id.*, *citing*, *Somerset*, 104 S.E.2d at 346 ("If . . . the territorial scope of the restraint is unreasonable . . . no inquiry need be made as to the presence or absence of other necessary requirements.") "If a covenant not to compete is defective in one of the [required elements], the covenant is totally defective and cannot be

saved." *Faces Boutique, LTD v. Gibbs*, 318 S.C. 39, 455 S.E.2d 707, 709 (Ct. App. 1995), *citing, Eastern Business Forms, Inc. v. Kistler*, 258 S.C. 429, 189 S.E.2d 22, 24 (1972) (The court "cannot make a new agreement for the parties into which they did not voluntarily enter. We must uphold the covenant as written or not at all, it must stand or fall integrally."); *Somerset*, 104 S.E.2d at 346.

In *Somerset*, this Court followed long-standing authority that covenants in restraint of trade must be reasonably tailored to the customer area served by the purchased business. *Id.* at 346. Like the covenant not to compete in *Somerset*, Palmetto Mortuary's covenant is not narrowly drawn to protect its legitimate business interest.

In *Hagemeyer North America v. Thompson*, 2006 WL 516733 (D.S.C. 2006) (Norton, J.), the District Court observed that "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.'" *Id.* quoting, *Rental Uniform Service of Florence, Inc., v. Dudley*, 278 S.C. 674, 301 S.E.2d 142, 144 (1983). Covenants not to compete 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 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 restrictive covenant 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).

2. The ten-year, statewide restriction far exceeds the customer base of Knight or Palmetto Mortuary.

Palmetto Mortuary's covenant not to compete contains a statewide, ten-year ban on Knight participating in the free market although Knight's operating territory at the time of Palmetto Mortuary's purchase consisted of Lexington and Richland Counties. *See*, App. p. 223, line 1 - p. 224, line 15. Thus, the geographical restriction is overbroad, unrelated to a reasonable, legitimate business interest, and not reasonably related to protecting the good will purchased by Palmetto Mortuary. The explicitly overbroad geographic restriction imposed by the covenant in restraint of free trade "must stand or fall on [its] own terms." *Poynter Invs., Inc., v. Century Builders of Piedmont, Inc.*, 387 S.C. 583, 694 S.E.2d 15, 18 (2010) (holding that trial court could not "blue pencil" contract by replacing an unreasonable seventy-five (75) mile territorial restriction with one of its own). A strict construction of the covenant not to compete requires a finding that it is not reasonably restricted in time and territory.

B. This Court should not rewrite the defective restraint on trade.

Unenforceable covenants not to compete cannot be saved by a court imposing terms not negotiated by the parties or by "blue pencilling" the non-compete. "If a covenant not to compete is defective . . . it is totally defective and cannot be saved." *Faces Boutique, Ltd. v. Gibbs*, 455 S.E.2d 707, 708-09 (S.C. Ct. App. 1995) (citations omitted); *see also*, *Eastern Business Forms, Inc. v. Kistler*, 258 S.C. 429, 189 S.E.2d 22 (1979) (a court cannot make a new agreement or reform a covenant not to compete into one which the parties did

not voluntarily enter, and, instead, the court must uphold the covenant as written or not at all).

Palmetto Mortuary's covenant in restraint of trade contains a statewide restriction even though Knight and Palmetto Mortuary operated primarily in Lexington and Richland Counties. Don Lintal testified that Palmetto Mortuary wanted a statewide territorial restriction simply because it might someday expand into other areas of South Carolina. *See*, App. p. 36, ¶ 30. But, it has not done so.

Palmetto Mortuary's thought that it might expand in the future does not justify a statewide restraint of trade. *See*, *Team IA, Inc. v. Lucas*, 395 S.C. 237, 717 S.E.2d 103, 107 (Ct. App. 2011) (geographic restriction generally considered reasonable if the area covered is limited to territory in which employee was able, during employment, to establish contact with employer's customers); *Somerset*, 233 S.C. 324, 104 S.E.2d 344, 347 (1958) (even though seller told buyer that covenant not to compete could include whole state, because seller had no intention of going back into that business, seller was not estopped from attacking the validity of covenant on the ground that it covered greater territory than necessary). A restrictive covenant requires a reasonable connection between the territorial restriction and the business area and good will actually purchased as part of the sale. Because there is no legitimate basis to restrain Knight from working in the entire state, the Court of Appeals correctly overruled the master and found the restraint of trade unenforceable.

C. <u>The agreement requiring Palmetto Mortuary to buy body bags from Knight cannot save the unreasonable restraint on competition.</u>

Palmetto Mortuary argues the covenant not to compete is enforceable because a provision of the Asset Purchase Agreement contained an exclusivity provision which

required Palmetto Mortuary to purchase body bags from Knight. It argues that this exclusivity provision is a mutual benefit such that as Palmetto Mortuary expanded its business throughout South Carolina, Knight's body bag business would also benefit. Palmetto Mortuary argues this mutual benefit justifies a ten-year, statewide ban on competition. This novel argument cites has no support and cannot support the ten-year, statewide restriction on competition.

Palmetto Mortuary bought the business in January 2007. In the following ten years it did not expand its business beyond Richland and Lexington Counties. In fact, Don Lintal testified that, at the time of the asset purchase, there were no plans to expand the business to other parts of the State. (App. pp. 223-225). Lintal 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." (App. p. 223, line 22 - p. 224, line 2). Palmetto Mortuary was uncertain of future expansion plans for its own business. As a result, Knight could not rely on future profits from Palmetto Mortuary's contemplated statewide expansion as consideration supporting the Agreement.

Palmetto Mortuary claims there was an unwritten symbiotic relationship between the covenant not to compete and the exclusivity provision which required Palmetto Mortuary to buy body bags from Knight. Palmetto Mortuary argues this symbiotic relationship should have been considered by the Court of Appeals in determining the reasonableness of the statewide restraint of trade. It appears to argue that the exclusivity provision was distinct compensation to Knight for entering the statewide restraint of trade.

However, the Covenant itself recites its consideration as $1,000.00. (App. pp. 31-32, ¶¶ 16-18).

Palmetto Mortuary did not argue during the trial or appeal that the exclusivity provision justified its statewide territorial restriction. In fact, Mr. Lintal was cross examined about whether the exclusivity provision was additional consideration for the covenant not to compete, and he repeatedly declined to state that the provision was consideration for the covenant not to compete. (App. pp. 243-254). Thus, the Court of Appeals correctly did not consider the exclusivity provision as a factor supporting the statewide restraint of trade.

II. AS AN ADDITIONAL SUSTAINING GROUND, THE NON COMPETITION COVENANT RESTRICTS COMPETITIVE BIDDING FOR A PUBLIC CONTRACT. THUS IT IS VOID AS AGAINST PUBLIC POLICY.

Although the issue has not been directly addressed in South Carolina, many other jurisdictions hold that agreements restricting competition between potential competitors for public contracts are invalid and void as against public policy. "Agreements designed to suppress bidding and competition in the letting of public contracts, such as agreements not to compete with another in making bids, to withdraw a bid for a public or quasi-public contract, or to share in the result or profits, are against public policy and void." 12 Ill. Law and Prac. Contracts § 107, *citing, Premier Elec. Const. Co. v. Miller-Davis Co.*, 291 F. Supp. 295 (N.D. Ill. 1968); *Conway v. Garden City Paving & Post Co.*, 60 N.E. 82 (Ill. 1901). Agreements not to compete with one another in making bids or other agreements having a direct tendency to prevent bidding or competition for public contracts are against public policy. *See e.g.*, 17A C.J.S. Contracts § 300, *citing, Board of Ed. of Floyd County v. Hall*, 353 S.W.2d 194 (Ky. 1962); *Application of Caristo Const. Corp.*, 30 Misc.2d 185

(N.Y. 1961); *Borden v. Ellis*, 44 A.2d 530 (Pa. 1945); *Wade v. Ingram*, 528 F. Supp. 495 (E.D. Ar. 1981); *City of Oakland v. California Const. Co.*, 104 P.2d 30 (1940); *Uvalde Const. Co. v. Shannon*, 165 S.W.2d 512 (Tx. 1942).

Courts have ruled that whether or not the public has received any actual injury by reason of the anticompetition contract or agreement will not relieve the contract of its illegality. *See*, *Finley Method Co. v. Standard Asphalt Co. of Fla.*, 139 So. 795 (1932); *Pyle v. Kernan*, 36 P.2d 580 (Or. 1934); *Borden v. Ellis*, 44 A.2d 530 (Pa. 1945). While South Carolina has not directly addressed the issue of covenants not to compete restricting bidding on public contracts, South Carolina courts have held that contracts violating public policy are illegal and unenforceable. "Whether a contract is against public policy or is otherwise illegal or unenforceable is generally a question of law for the court." *Milliken & Co. v. Morin*, 399 S.C. 23, 731 S.E.2d 288, 291 (2012). South Carolina law is well established that a contract "which is contrary to public policy, is void, and cannot be enforced in a court of justice." *Atlantic Coast Builders and Contractors, LLC v. Lewis*, 398 S.C. 323, 730 S.E.2d 282, 288 (2012), C.J. Toal *concurring in part* (citations omitted).

In *Sloan v. School District of Greenville County*, 342 S.C. 515, 537 S.E.2d 299 (2000), the South Carolina Court of Appeals discussed the importance of public policy upholding free and open competition for public contracts. Sloan challenged contracts entered by a local school district and sought a declaration that those contracts violated the district's procurement code and were illegal. *Sloan, supra*. The Court noted that, although the local school district had adopted its own procurement code, "the [South Carolina] General Assembly's intent is relevant when examining the public policy of competitive sealed bidding in the award of public contracts." *Sloan*, 537 S.E.2d at 303. "The

expenditure of public funds pursuant to a competitive bidding statute is of immense public importance." *Id.* Further, the Court of Appeals held that competitive bidding for public contracts is so important "that in some states 'once a contract is proved to have been awarded without the required competitive bidding, a waste of public funds [is] presumed ... without showing that the municipality suffered any injury.'" *Id.* at 303-04, *citing*, 18 Eugene McQuillin, The Law of Municipal Corporations § 52.26 (3d ed. 1993); *see also*, 5 Sandra M. Stevenson, Antieau on Local Government Law § 73.04 (2d ed. 1999).

Courts have long held that covenants not to compete which restrict bidding for public contracts are void and unenforceable as a violation of the public interest. In *Spokane Sav. & Loan Soc. v. Park Vista Imp. Co.*, 294 P. 1028 (Wa. 1930), the Supreme Court of Washington held that any agreement to "chill or suppress bidding is void." *Id.* at 1036. "The authorities clearly recognize the principle that where an agreement, without regard to its form, is made for the purpose of preventing free and fair competition, or of stifling or chilling bids at public sales or in the letting of contracts by the government, or for the purpose of giving undue advantage to either of the parties thus engaged in dealing with reference to the biddings, it is contrary to public policy and void." *Id.*; *see also, Heid Bros. v. Riesto*, 281 S.W. 638 (Tx. 1926) (agreement stifling competition on government contracts is violative of state antitrust statutes and contrary to public policy).

In *Richmond Co., Inc. v. Rock-A-Way, Inc.*, 404 So.2d 121 (Fla. 1981), the courts explained the nature of the harm to the public interest and why such collusive agreements restricting bidding on public contracts are void as a matter of law. The *Rock-A-Way* court noted that:

> The principal contracts involved in this case were subject to the competitive bidding statutes. The rule is well settled in the United

> States that all agreements, whether principal or subsidiary in character, which, in their necessary operation upon the action of contractors engaged in bidding for public work, tend to restrain the natural rivalry and competition of the parties, and thus produce a result disadvantageous to the public, are against public policy and void. What the public has to be on guard against in the violation of such salutary statutes as these is not the violation direct, but the violation oblique; not the frank disregard of what the statutes in terms require, but the suave and insidiously evasive arrangements which, operating in secret understandings between contractors and their privies, tend to produce an effect as harmful in result as the most direct misconduct or malfeasance.

Id. at 122-23.

Therefore, this Court should find that the covenant not to compete between Palmetto Mortuary and Knight is void and unenforceable because it violates the important public policy interest in competitive bidding on public contracts. *See e.g.*, *City Nat. Bank of Corpus Christi v. City of Corpus Christi*, 233 S.W. 375 (Tx. 1921) (rule of law is settled that arrangements among prospective bidders, for government contracts, to prevent competition among themselves are contrary to public policy and void); *Kimball Elevator Co., Inc. v. Elevator Supplies Co., Inc.*, 272 P.2d 583 (Utah 1954); *Premier Electrical Const. Co. v. Miller-Davis Co.*, 291 F. Supp. 295 (N.D. Ill. 1968); *Conway v. Garden City Paving & Post Co.*, 190 Ill. 89 (1901); *Re Salmon*, 145 Fed. 649 (D.C. 1906) (there is a uniform and inflexible rule of law that all combinations which would stifle competition as applied to bidding on public contracts are "immoral, vicious, and void.").

III. AS AN ADDITIONAL SUSTAINING GROUND, PALMETTO MORTUARY FIRST BREACHED THE ASSET PURCHASE AGREEMENT. AS A RESULT, IT CANNOT ENFORCE THE COVENANT NOT TO COMPETE.

The contract between Palmetto Mortuary and Knight requires that Palmetto Mortuary purchase all of its body bags from Knight's body bag manufacturing business.

See, App. p. 389, Section 3.4.8. It obligates Palmetto Mortuary to buy all its body bags from Knight for the term of the covenant not to compete. *Id.*

Palmetto Mortuary agrees that it purchased body bags specifically listed in the contract section from other suppliers. *See e.g.*, App. p. 168, line 25 - p. 169, line 5; p. 169, line 24 - p. 171, line 11. It maintains that its admitted breach of the Agreement was not material by comparing the total amount paid for body bags purchased from Knight with the total amount paid for the purchase of body bags from other vendors. *See*, App. p. 168, line 21 - p. 169, line 25; p. 171, lines 4-23; p. 175, lines 10-20 (approximately $45,000.00 versus slightly less than $900.00). Palmetto Mortuary maintains that some of the bags it bought from other vendors were excluded from the contract, but even excluding the disputed purchases of infant and extra-large body bags, Palmetto Mortuary admits spending nearly $500.00 on body bags from sources other than Knight.

Palmetto Mortuary's purchase of body bags from Evident, Medical Products Limited and Southland Medical Corporation constitute material breaches of the Agreement. And, a "party who first commits a material breach cannot enforce the contract." *See*, Williston on Contracts, § 63:3, *citing*, *In re Krueger*, 192 F.3d 733 (7th Cir. 1999).

Palmetto Mortuary asserts that its repeated violations of its obligation to buy only from Knight and its lies about these violations are not material because the amount lost is only between $500 and $1,000. Incidentally, this is approximately equal to the $1,000 Palmetto Mortuary paid for the covenant not to compete that it argues is material to the agreement. Furthermore, focus merely on the dollar amount lost by Palmetto Mortuary's intentional breach is not appropriate. In *Brazell v. Windsor*, 384 S.C. 512, 682 S.E.2d 824

(2009), this Court held that it is improper to focus merely on the dollar amount involved in the breach, rather than the essential nature of the term breached.

In *Brazell*, the sellers sued the purchasers for breach of contract and requested rescission of their contract for the sale of a house. The parties entered a contract to sell a home on Edisto Island. *Id.* at 825. The total price was $550,000. *Id.* The purchasers notified the sellers that the water filtration system did not work and forwarded a check to the sellers for the sale price minus $2,000 for the water system. The sellers refused to accept the check and filed suit alleging breach of contract. The trial court found withholding $2,000 from the contract price was a minor breach of the contract. *Id.* at 827. Similarly, the Court of Appeals held that the remedy of rescission was not available because the breach was not substantial enough to defeat the purpose of the contract. *Id.*

This Court reversed and found a material breach of the contract. It held that, "the trial court and Court of Appeals' error stems from focusing on the dollar amount withheld in determining whether [purchaser's] actions defeated the purpose of the contract and the objective of the contracting parties." *Brazell*, supra at 827.

As in *Brazell*, this Court should not focus on the dollar amount paid to purchase body bags from Knight's competitors. Rather, the proper focus is whether the exclusive purchase provision of Section 3.4.8 is an essential term of the Agreement. The parties negotiated and executed a contract requiring Palmetto Mortuary to purchase "all of their body bags" from Knight's body bag business.

Both Don and Ellen Lintal testified that following the June 16, 2011, conversation between Don Lintal and Buddy Knight, they believed Knight would bid on the Richland County contract as a result of Palmetto Mortuary's breach. *See*, App. p. 191, lines 1-12.

In fact, Ellen Lintal testified that she contacted an attorney to address her fear that Mr. Knight was going to compete in the body transportation business. App. p. 290, lines 2-23. The Lintals' comments and actions following the June 16, 2011, conversation with Knight indicate that they considered section 3.4.8 a material term of the Agreement.

The covenant not to compete contains a termination clause. This clause provides that if Palmetto Mortuary breaches section 3.4.8 of the Agreement, Knight is relieved from the terms of the covenant not to compete. It provides as follows:

> Breach of the Purchase Agreement. Notwithstanding anything contained herein to the contrary, a breach by Buyer of the Purchase Agreement or such other documents ancillary thereto, shall constitute a breach of this Agreement and shall release Seller from any and all restrictions hereunder.

See, App. pp. 408-411. Thus, pursuant to the termination clause, any breach of the Asset Purchase Agreement by Palmetto Mortuary completely releases Knight from the terms of the covenant not to compete.

"Explicit termination clauses are common in many different categories of commercial contracts, including employment agreements, service contracts, merger and acquisition agreements, loans, and franchise and distributorship arrangements." Anticipating Litigation In Contract Design, 115 Yale L.J. 814, 873 (Jan. 2006). "One reason for explicit termination clauses is to provide for the conditions that trigger termination, rather than relying on the common law requirements for material breach." *Id.* at 874. Parties may enter into any contracts that they deem fit, including contracts providing for termination of the agreement for reasons other than the common law material breach. *See e.g.*, *Philadelphia Storage Battery Co. v. Mutual Tire Stores*, 161 S.C. 487, 159 S.E. 825 (1931). "[P]ersons may enter into whatever contracts they see fit, which are

not illegal, immoral, or against public policy." *Id.* at 826 (upholding contractually agreed upon termination provision).

In *Tricat Industries, Inc. v. Harper*, 748 A.2d 48 (Md. 2000), the court noted that a contract may be terminated for a breach of an obligation which did not amount to a material breach of that agreement. *Id.* Thus, the very existence of a termination clause in a contract eliminates the necessity for a court to determine whether a breach of a term or condition of the contract is material, thereby giving rise to the right of a party to terminate the contract.

In *In re Hawker Beechcraft, Inc.*, 486 B.R. 264 (S.D.N.Y. 2013), the United States Bankruptcy Court discussed a termination clause in a matter involving an aircraft manufacturing company and purchase agreements. The court noted that "[o]rdinarily, the materiality of the [breached] promises would be a question of fact requiring a trial." *Id.* at 278, *citing*, *Almena State Bank v. Enfield*, 954 P.2d 724, 727-28 (Kan. 1998). "However, if the parties contractually agree that some or all of the terms are sufficiently important to discharge any further obligations imposed on the party aggrieved by a breach, their intent will govern." *Id.*, *supra*, *citing*, *Gen. Datacomm Indus., Inc. v. Arcara*, 407 F.3d 616, 623-24 (3rd. Cir. 2005) (provision in Benefit Plan that allowed corporation to terminate the employee's rights if he failed to comply with certain covenants, including the agreement not to compete and to maintain confidentiality, rendered those covenants material); *Dunkin' Donuts of Am., Inc. v. Middletown Donut Corp.*, 495 A.2d 66, 75 (N.J. 1985) (enforcing provision in franchise agreement that rendered underreporting of sales a material breach of contract that allowed franchisor to terminate franchise and sue for damages); 23 Richard A. Lord, Williston on Contracts § 63:3 (4th ed. 2002) ("Where the contract itself is clear in making a certain event a material breach of that contract, a court

must ordinarily respect that contractual provision."); *cf. Dexter v. Brake*, 269 P.3d 846, 856 (Kan. 2012) ("The doctrine of substantial performance does not apply where the parties, by the terms of their agreement, make it clear that only complete performance will be satisfactory.").

Palmetto Mortuary and Knight included a termination clause in the covenant not to compete. The termination provision provides that a breach of the Asset Purchase Agreement by Palmetto Mortuary releases Knight from the restrictions imposed by the covenant not to compete. *See*, App. p. 411. Don and Ellen Lintal's fear that Knight would compete for the Richland County contract following the June 16, 2011, conversation is consistent with their knowledge that the termination clause allowed Knight to terminate the covenant not to compete. The conversation between Don Lintal and Knight included statements by Lintal indicating that he was concerned that Knight would see Palmetto Mortuary's purchases of body bags from Knight's competition as a breach of the Agreement. *See*, App. pp. 340-344. During the same conversation, Lintal lied to Knight denying that he had purchased any bags, other than the infant body bags, from other vendors. App. p. 342, lines 4-9; *see also* App. pp. 340-344. Don Lintal also discussed with his wife, and later their attorney, the issue of whether Palmetto Mortuary's breach of the Asset Purchase Agreement would be grounds for Knight to bid on the Richland County contract.

Knight had the right to terminate the covenant not to compete after Palmetto Mortuary breached the Agreement by purchasing body bags from sources other than Knight. The termination clause does not require a material breach of the Agreement for Knight to terminate the covenant not to compete, and this Court should not create one. *See*,

Ebert v. Ebert, 320 S.C. 331, 465 S.E.2d 121 (Ct. App. 1995), *cert denied*, Oct. 17, 1996 (court will not supply omitted terms to an agreement between contracting parties). Further, Palmetto Mortuary's purchase of body bags from vendors other than Knight constituted a material breach.

CONCLUSION

The 150 mile, ten-year restraint of trade in the covenant not to compete is too broad. It far exceeds the scope of the business purchased from Knight or the business performed by Palmetto Mortuary. As a result, it is unenforceable as an overreaching restraint of free trade. As an additional sustaining ground, the covenant not to compete is void because it is an agreement to restrain bidding on public contracts and because Palmetto Mortuary violated the exclusive purchasing provision of the Agreement.

Respectfully submitted,

July 21, 2017

James Edward Bradley, SC Bar # 66130
Moore Taylor Law Firm, P.A.
1700 Sunset Boulevard (29169)
P.O. Box 5709
West Columbia, SC 29171
803-796-9160
ward@mttlaw.com

Attorney for the Respondents

THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

James Randall Davis, Special Master/Referee

Opinion No. 2016-5402 (S.C. Ct. App. filed May 4, 2016)
Appellate Case No. 2016-001531

Palmetto Mortuary Transport, Inc.,..Petitioner,

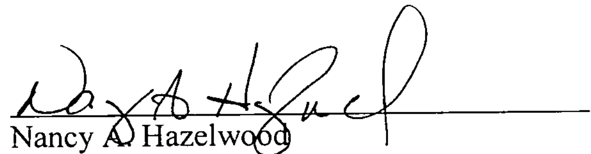
v.

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

PROOF OF SERVICE

I, Nancy A. Hazelwood, an employee of Moore Taylor Law Firm, P.A., certify that I have served the Respondents' Brief upon counsel of record in this matter by depositing a copy of same in the United States Mail, postage prepaid, on July 24, 2017, addressed as follows:

John J. Pringle, Jr., Esquire
Lyndey Ritz Zwingleberg, Esquire
1501 Main Street, Fifth Floor
Columbia, SC 29201



Nancy A. Hazelwood

West Columbia, South Carolina

July 24, 2017