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ATTORNEYS FOR PLAINTIFF AND
COUNTER-DEFENDANT

MONTANA EIGHTEENTH JUDICIAL DISTRICT COURT
GALLATIN COUNTY

* * * * *

No. DV 87-407

WALEN F. LILLY,

Plaintiff,

vs.

FRED TERWILLIGER, CLARA TERWILLIGER, JAMES BONNETT, and DEBORAH BONNETT,

Defendants,

JAMES BONNETT and DEBORAH BONNETT,

Defendants and Counter-plaintiffs,

vs.

WALEN F. LILLY,

Plaintiff and Counter-defendant.

BRIEF IN SUPPORT OF AMENDED PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

INTRODUCTION

(A) PROCEDURE.

Plaintiff filed his complaint on the 27th day of May, 1987. In essence, plaintiff contends that defendants have breached a sales agreement wherein The Trout Shop, Inc. was named as seller and all of the defendants were named as buyers. The plaintiff prosecutes this action by virtue of an assignment dated the 30th day of January, 1982 (a copy of said assignment is attached hereto, marked Exhibit "A", and incorporated herein by reference).

Defendants Fred Terwilliger and Clara Terwilliger have filed bankruptcy under Chapter 7 of the United States Bankruptcy Code. As a result, the parties have stipulated to their dismissal as parties defendant.

Defendants filed their answer to the complaint on the 16th day of July, 1987. Defendants admit all of the allegations in the complaint numbered ¶¶ 1-14. Essentially, defendants have admitted a breach of the sales agreement, but deny their personal liability. In so doing, defendants rely solely on their first affirmative defense for relief from liability. That affirmative defense contends that plaintiff failed to properly notify them of the sale of the remaining assets after possession and are therefore barred from any deficiency judgment.

Defendants' answer also contains a counter-claim including two (2) claims for relief. The first claim for relief alleges that Greg Lilly, a shareholder of The Trout

Shop, Inc., competed against them, and therefore, breached the terms of the sales agreement. The second claim for relief alleges that plaintiff failed to live up to a consultation paragraph in the sales agreement, and therefore, breached the agreement.

Plaintiff has filed a reply to the counter-claim. Plaintiff admits that Greg Lilly did compete with defendants, but alleges that said competition does not render the plaintiff liable. In response to defendants' second claim for relief, plaintiff denies any failure to consult, and, as a result, denies any liability.

Trial was held on the 21st day of April, 1989. Thereafter, plaintiff filed his amended proposed findings of fact and conclusions of law. This brief is in support thereof.

(B) UNDISPUTED FACTS.

The Trout Shop, Inc. and defendants entered into a sales agreement on the 30th day of January, 1982. By that agreement, The Trout Shop, Inc. agreed to sell its fixtures, inventory and equipment to the defendants, among other things.

In conjunction with that sales agreement, the defendants executed a promissory note in favor of The Trout Shop, Inc., and a security agreement securing the payment of the sum set forth in the promissory note in favor of The Trout Shop, Inc. On the same date that the sales agreement, promissory note and security agreement

were executed, The Trout Shop, Inc. executed an assignment of its interest in those documents to Walen F. Lilly and Patricia B. Lilly. Patricia B. Lilly has since deceased.

The promissory note and sales agreement required the defendants to make payments to the plaintiff in the amount of $2,599.62 per month. Defendants made those payments from January 30, 1982 through September of 1986, at which time, payments ceased.

Plaintiff caused to be mailed a notice of default on the 9th day of December, 1986. Defendants failed to cure that default within the time prescribed. As a result, plaintiff caused to be mailed a notice of acceleration on the 27th day of January, 1987. Again, the defendants failed to pay the total sum due. Thereafter, plaintiff caused to be mailed to defendants a notice of repossession. Defendants failed to object to the proposed sale identified in the notice of repossession. As a result, plaintiff entered into a sales agreement for the fixtures, equipment and inventory repossessed from defendants to James Criner.

ARGUMENT

I. PLAINTIFF IS ENTITLED TO JUDGMENT ON THE ISSUE OF LIABILITY PURSUANT TO HIS FIRST CLAIM FOR RELIEF.

Plaintiff's complaint alleges the breach of a sales agreement, a security agreement, and the default on a promissory note by defendants. Defendants admit the breach of these two (2) agreements and their default on

the promissory note. However, they deny liability to plaintiff.

The basis for defendants' denial of liability is found in their second affirmative defense. Their second affirmative defense provides:

SECOND AFFIRMATIVE DEFENSE

> Plaintiff failed to give notice to the defendants that the sale proposed by him to James Criner was to be a sale of all of the assets purchased from the plaintiff by defendants. Failure to send such notice to the defendants renders the plaintiff's sale commercially unreasonable and requires that they forfeit any deficiency under their contract.

Defendants' reliance on this affirmative defense to escape liability under the terms of the sales agreement, security agreement and promissory note executed by them, is not supported by either the facts or the applicable law.

By executing that security agreement, the defendants pledged inventory, fixtures, and equipment to The Trout Shop, Inc. and its assigns - the plaintiff in this case - as security for the performance of the terms of the promissory note. That inventory, those fixtures, and that equipment were repossessed by the plaintiff. Plaintiff notified defendants of his intention to sell said inventory to James Criner. Absent any objection from the defendants to that sale, the plaintiff consummated it. Defendants now claim that the sale was commercially unreasonable and that plaintiff, therefore, is not entitled to a deficiency judgment.

It appears that the defendants' first objection arises out of the fact that the sale to James Criner included inventory, fixtures, equipment, use of the name "Bud Lilly's Trout Shop," outfitter licenses and a mailing list. The notice does not reference the mailing list, the outfitter licenses or the use of the name. Apparently, defendants believe the addition of these three (3) items in the Criner sale render it commercially unreasonable.

Defendants' position overlooks the clear language of the security agreement. The security agreement only pledges inventory, fixtures and equipment as collateral. It does not pledge the use of the name, the outfitter licenses or the mailing list. Since the plaintiff was proceeding in accordance with the Uniform Commercial Code and the security agreement, he was under no obligation to notify the defendants of the sale of anything, other than that which was specifically pledged as collateral.

Indeed, the defendants should be thankful that additional items were sold to Mr. Criner. As the Criner sales agreement indicates, sums were received for these additional items. Thus, the sales price was greater than could have been received had only the furniture, fixtures and equipment been sold. As a result, the size of the deficiency is smaller.

In their trial brief, defendants argue that they were entitled to notice of sale of the outfitter licenses, mailing list and business name. Again, it must be noted

that these items were not listed in the security agreement as collateral. In addition, it is important to bear in mind that the mailing list was abandoned by Fred Terwilliger when he turned the keys over to plaintiff. Likewise, he abandoned the business name when he vacated the business premises. Neither defendants nor Fred Terwilliger has ever entered an objection to Mr. Criner's use of the business name which was registered with the Secretary of State.

The outfitter licenses is another story altogether. Plaintiff did not have any outfitter licenses to sell to James Criner. As Mike Lilly testified, the Criner sales affidavit recited the outfitter licenses sale to aide Mr. Criner in obtaining an Idaho outfitter license. As he explained, one person cannot transfer an Idaho outfitter license to another. However, the sale of an existing business which utilizes an outfitter license is given preference in the issuance of a new license. Thus, the Criner sales agreement contained this provision to give Mr. Criner the preference.

Defendants cite a number of cases to the Court in their trial brief for the proposition that sale of items not pledged as collateral prevents the secured party from obtaining a deficiency judgment. None of the cases cited stand for that proposition. They do stand for the rule that a commercially unreasonable sale does bar a

deficiency judgment. With this rule, plaintiff has no quarrel.

Defendants also argue that the conduct of the sale itself renders it commercially unreasonable. Defendants seem to think that plaintiff should have taken other steps to allegedly assure a higher sales price. It must be remembered that no one was more anxious to realize the most money on the sale than plaintiff. He was working to recover as much of his life's investment in the business with the resale as possible. This isn't a case where the secured party had the peace of mind knowing that other assets were available to satisfy any deficiency judgment.

Defendants' retrospective analysis of sales possibilities is erroneous. Plaintiff was faced with selling a business, upon repossession, on the eve of fishing season. No guide trips were booked when normally 50% of all bookings were normally logged; the landlord was pressing for a commitment and rent; the inventory was decimated; no guides were hired; and a large capital investment was required to replenish it. Obviously, under these circumstances, it is easier to suggest another methodology of sale than to carry it out.

Finally, defendants suggest the price received by plaintiff indicates that the sale was commercially unreasonable. Defendants produced two (2) witnesses who testified that the inventory and fixtures were worth twice the amount received by plaintiff from Criner. It must be

borne in mind that neither of these individuals personally observed either the inventory or the fixtures. They just looked at a list. They were also operating under the misunderstanding that the Idaho outfitter licenses were transferable. Clearly, their opinions are simply not supported by the facts.

On the other hand, both the plaintiff and his son, Gregory F. Lilly, testified that under the circumstances, the $60,000 received was as much as could be expected. Plaintiff, as defendants' counsel so generously noted, is considered one of Fly Fishing's Grand Masters, having an international reputation. Gregory F. Lilly is also an expert of note having been involved in the fishing business almost all of his adult life. Surely, their opinions should be given at least equal weight with that of the defendants' experts.

Perhaps the most telling facts in determining which opinion to accept are found in Greg Lilly's conduct. He was keenly interested in purchasing The Trout Shop in 1985 and again in 1986. In both instances, it was not for sale. However, in March of 1987, he continued to be interested in purchasing the business only plaintiff repossessed it. He looked at the repossession inventory and fixtures, but refused to pay the $60,000. Surely, in light of Greg Lilly's long standing interest in purchasing the business and his refusal to pay $60,000 for it, speaks more authoritatively and convincingly than anyone's

opinion. This is so especially when it is recalled that he personally viewed the inventory and fixtures in March of 1987. Defendants' experts didn't.

Plaintiff properly proceeded under the Uniform Commercial Code. He negotiated a private sale with James Criner of the inventory, fixtures and equipment. Thereafter, he notified the defendants of the proposed sale and gave them an opportunity to object. The Uniform Commercial Code requires nothing more.

The pertinent section of the Uniform Commercial Code is § 30-9-504, Mont. Code Ann. It provides in pertinent part:

> (3)(a) Disposition of the collateral may be by public or private meeting and may be made by one or more contracts . . . every aspect of the disposition, including the method, manner, time, place and terms must be commercially reasonable . . . reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor . . . .

Obviously, plaintiff was entitled to consummate the private sale and the notice provided a time after which any private sale would be made. The Code requires nothing more.

It even appears the notice sent by the plaintiff to the defendants went beyond that required by the Code. It identified the party with whom the plaintiff was to contract, as well as a proposed sales price.

The plaintiff's notice is far superior to that approved by the Court in Dulan v. Montana Nat. Bank of

Roundup (1983), ___ Mont. ____, 661 P.2d 28. In that case, Montana National Bank sent the following letter:

> This letter is to advise you that a demand is being made on you in the amount of $1,499.38 which is relative to your note of May 22, 1972, in the original amount of $7,500.00. This includes principal of $1,427.44 and interest of $71.94. This pays interest through August 31, 1974, and if not received by that date, we will then proceed against the stock certificates consisting of 4,995 shares of Shannon Studio stock which you have assigned to the Montana National Bank.

The court approved this notice. Clearly, it does not advise the debtor of the selling price of the stock or of any proposed purchaser. Therefore, it must be concluded that plaintiff's notice satisfies the requirements of the Uniform Commercial Code. Defendants are not entitled to now complain. Plaintiff therefore respectfully requests the Court to enter judgment in his favor and against defendants pursuant to his first claim for relief.

II. PLAINTIFF IS ENTITLED TO JUDGMENT ON THE FIRST CLAIM FOR RELIEF CONTAINED IN DEFENDANTS' COUNTER-CLAIM.

Defendants' answer contains a counter-claim setting forth two (2) claims for relief. The first claim for relief alleges that Greg Lilly, a shareholder of The Trout Shop, Inc., violated the covenant not to compete contained in the sales agreement. Plaintiff admits that Greg Lilly did, in fact, compete directly with the defendants, but denies any liability for those actions.

Paragraph 12 of the sales agreement provides:

> Covenant not to Compete. Seller and its shareholders hereby agree not to compete with

> Buyer with a like business involving the sale of fishing tackle, outdoor clothing, artwork or outfitting and guide business for a period of five (5) years within a radius of 500 miles of the City of West Yellowstone, County of Gallatin, Montana.

Greg Lilly was not a shareholder of The Trout Shop, Inc. at the time of execution of this agreement; nor was he a signator to the sales agreement.

At the outset, it must be borne in mind that Greg Lilly is not a named plaintiff in this case. Defendants attempt to seek damages from plaintiff for the alleged violation of the sales agreement by Greg Lilly.

Defendants apparently reason that plaintiff as the assignee of all of The Trout Shop, Inc.'s rights in the sales agreement, assumes all liability for the corporation's shareholders and former shareholders. This assignment makes no difference. If there was breach of this agreement, it was by Greg Lilly, not The Trout Shop, Inc. Therefore, defendants' first claim for relief is not being prosecuted against a named party, and therefore, judgment should be issued in favor of plaintiff.

Even if we assume that defendants have a right of recourse against the plaintiff for the competitive actions of Greg Lilly, plaintiff is entitled to judgment on defendants' first claim for relief. Plaintiff's third, fourth and fifth affirmative defenses are dispositive of this claim for relief. Each will be addressed separately.

First, plaintiff's third affirmative defense is founded upon simple contract principles. Greg Lilly was

not the signator on the sales agreement. To be bound by that agreement, he must have been a signator on it.

Montana law discourages covenants not to compete. Section 28-2-703 Mont. Code Ann. provides:

> Any contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind, otherwise than is provided for by 28-2-704 or 28-2-705, is to that extent void.

Obviously, the operation of a fishing guide and tackle business is a lawful profession. Therefore, the covenant not to compete is void as against Greg Lilly unless it is specifically exempted in § 28-2-704 or § 28-2-705 Mont. Code Ann.

Section 28-2-704 Mont. Code Ann. provides in pertinent part:

> (1) One who sells the good will of a business may agree with the buyer to refrain from carrying on a similar business within the areas provided in section (2) so long as the buyer or any person deriving title to the good will from him carries on a like business therein.

This section specifically exempts a seller of good will. A seller of good will may agree to refrain from competing. However, Greg Lilly was not a seller in the instant case. The seller was The Trout Shop, Inc. As a result, even had Greg Lilly been a signator to this sales agreement, or in some other manner bound by this agreement, the covenant not to compete as against him was null and void because he did not sell good will.

In fact, Greg Lilly, as a former shareholder of The Trout Shop, Inc., had no good will which he could sell.

The Montana Supreme Court has specifically held that a shareholder in a corporation has no interest in the good will of the corporation which he can sell. Wylie v. Wylie Permanent Camping Co. (1920), 187 P. 289. Section 28-2-704 Mont. Code Ann. specifically allows a covenant not to compete only when the seller sells good will of a business. Greg Lilly had no good will which he could sell. Therefore, he could not enter into a valid covenant not to compete.

The only other occasion in which a covenant not to compete is valid is found in § 28-2-705 Mont. Code Ann. That section concerns itself with the dissolution of a partnership. Obviously, that does not apply in the instant case.

In sum, Greg Lilly was not the seller of any good will. In addition, he had no good will which he could sell. Therefore, the covenant not to compete is void as it concerns him and is unenforceable. Plaintiff is entitled to judgment as a result.

Plaintiff's fourth affirmative defense alleges that the covenant not to compete in question is violative of public policy, and therefore, void. Section 28-2-704 Mont. Code Ann. provides:

> (2) The agreement authorized in subsection (1) may apply in:
>
> (a) the city where the principal office of the business is located;
>
> (b) the county where the principal office of the business is located;

(c) a city in any county adjacent to the county in which the principal office of the business is located;

(d) any county adjacent to the county in which the principal office of the business is located; or

(e) any combination of the foregoing.

The covenant not to compete in question does not limit competition to a specific city, specific county, or a combination of the two (2). Rather, it limits competition within a 500 mile radius of West Yellowstone, Montana. Therefore, it is void.

In Treasure Chem v. Team Lab. Chemical Corp. (Mont.), 609 P.2d 285, the Montana Supreme Court specifically held that a covenant not to compete must be drafted in strict conformance with the above-referenced statutory language. It must limit competition to a specific city or a specific county. If it fails to do so, it is void.

The covenant not to compete involved in this case, is not limited to a specific city or a specific county. Rather, it is drafted in such a way that a number of counties could be accounted for and, indeed, several states could be accounted for. Therefore, it must be struck down as invalid as against public policy.

Finally, plaintiff's fifth affirmative defense is founded upon the theory of waiver. Greg Lilly commenced his competition with defendants in the spring of 1982. Defendants became aware of that competition shortly before he commenced his competition. Indeed, defendants came to

Greg Lilly to solicit his wholesale fly business. Greg Lilly gave defendants that account and defendants serviced it until shortly before trial. Additionally, Greg Lilly called Fred Terwilliger shortly before he commenced his competition and advised him of his intentions. Thereafter, the two businesses cooperated from time to time, exchanging merchandise and referring clients. Defendants also continued to make their monthly payments to the plaintiff through the fall of 1986.

The record is clear that despite their knowledge of Greg Lilly's competition, they took no affirmative action to halt it. There were no notices of default and no withholding of payments. A clearer case of waiver could not be made.

This case is not dissimilar to that of Bailey v. Lilly (1983), ___ Mont. ____, 667 P.2d 933. In that case, the sellers on a contract for deed continued to accept monthly payments after mailing a notice of default to the contract buyer. The court held that the acceptance of those payments after the notice of default constituted a waiver.

The converse must also be true. In fact, it is even more compelling. When a buyer believes there has been a default of a sales agreement by the seller, surely his continued payment without notice of default constitutes a waiver.

In sum, defendants have waived any rights they may have had to bring an action for breach of the covenant not to compete by failing to give proper notice of default and by continuing to make the payments after the alleged breach, the defendants are barred from prosecuting this action. Therefore, plaintiff is entitled to summary judgment on the issues of both liability and damages pursuant to defendants' first claim for relief.

III. PLAINTIFF IS ENTITLED TO JUDGMENT ON DEFENDANTS' SECOND CLAIM FOR RELIEF.

Defendants' second claim for relief alleges a violation by plaintiff of ¶ 13 of the sales agreement which deals with consultation. That paragraph provides:

> 13. Consultation Agreement. The Seller, through its agents, Walen F. Lilly and Patricia B. Lilly, shall provide such services as are required by Buyer in the maintenance and operation of the business from and after the 31st day of January, 1982, for such periods and for such compensation as Seller's agents and Buyer may determine.

Defendants argue that plaintiff refused to provide such services despite requests therefore. As a result, defendants contend they have been damaged.

It is not disputed that plaintiff and his deceased wife provided services to the defendants for only a limited period of time. However, this fact does not render plaintiff liable.

As ¶ 13 specifically provides, the services are to be provided for such periods as the seller and the buyers may determine. Obviously, this is an agreement to agree. It

does not allow the defendants to unilaterally determine the period of time which plaintiff was required to consult. Rather, it requires the two (2) parties to mutually agree at a future date regarding that period of time. Obviously, there was no mutual agreement and the consultation did not last too long.

Indeed, it appears that defendants James Bonnett and Deborah Bonnett are the only parties who did not terminate consultation. As plaintiff's testimony clearly indicates, the other buyers, the Terwilligers, had no objection to the plaintiff's consultation termination. Thus, it cannot now be seriously argued that defendants have been in any way damaged.

It must also be understood that plaintiff was not paid for any consultation services. The agreement provided for that payment. Absent any payment, defendants cannot now complaint.

Even if the terms of the consultation paragraph were breached, the defendants nonetheless are still barred from prosecuting this action. The consultation was to occur from and after the 31st day of January, 1982. It terminated in June of 1982. No notice of default was sent. Payments were continued by the defendants through the fall of 1986. Again, it must be argued, and can be argued, that the defendants have waived any right they may have to damages. Bailey v. Lilly, supra.

Plaintiff is entitled to judgment on defendants' second claim for relief. There was no breach of ¶ 13 of the sales agreement. Even if there was a breach, the defendants have waived any right to pursue damages as a result thereof.

CONCLUSION

This is a sad case for all concerned. On the one hand, plaintiff's life work was sold to defendants. They defaulted and plaintiff was faced with repossessing that business on the eve of the most important summer season. His only alternative was to resell it for a fraction of its original value. On the other hand, defendants face a significant judgment in the event plaintiff prevails.

The equities, nonetheless, of this case must be put aside. The law and the facts are clear. Defendants breached the sales agreement and plaintiff properly notified them. This much defendants readily admit in their complaint. The only issue of their liability concerns plaintiff's resale of the collateral.

That resale of the collateral was commercially reasonable. Plaintiff properly notified defendants of its intended resale and gave them an opportunity to object. They didn't. In a serious effort to recoup as much of his sales price, plaintiff believed the sales price was the best he could hope for. Indeed, Greg Lilly refused to match it, believing it was too high.

Greg Lilly's competition with defendants did not violate the terms of the sales agreement. He was not a shareholder of The Trout Shop. He was not a signator to the agreement. Therefore, he was not bound by its terms. Even if he was so bound, defendants waived their breach. They knew of his competition, but never notified him of his default and kept making the payments.

RESPECTFULLY SUBMITTED this 1st day of May, 1989.

WHITE & SEEL
Attorneys at Law
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By: _____
DONALD E. WHITE
Attorney for Plaintiff
and Counter-defendant

CERTIFICATE OF MAILING

I hereby certify that I served a copy of the foregoing instrument upon the attorney of record in this matter, PIERRE L. BACHELLER, by mailing a copy of the same to his last known address of P.O. Box 2078, Billings, Montana, 59103, this 1st day of May, 1989.

_____
DONALD E. WHITE