

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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APPEAL FROM FAIRFIELD COUNTY
Court of Common Pleas

S.C. SUPREME COURT

Carol A. Tolen, Special Referee
Trial Court Case No. 2012-CP-20-00132

Appellate Case No. 2021 -- 000149

ArrowPointe Federal Credit Union Respondent,

v.

Jimmy Eugene Bailey; Laura Jean Bailey; and U.S. Bank National Association not in its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1 Defendants,

Of which U.S. Bank National Association not in it individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1 is the Appellant.

RESPONDENT’S REPLY TO AMICUS CURIAE BRIEF

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ARGUMENT IN REPLY TO AMICUS CURIAE¹

Equitable Subrogation Cases

The *Amicus Curiae* brief discusses the cases touching on subrogation and equitable subrogation. Enterprise Bank v. Federal Land Bank, 139 S.C. 397, 138 S.E. 146 (1927), United Carolina Bank v. Caropop, 316 S.C. 1, 446 S.E.2d 415 (1994), Meaders Brothers v. Skelton, 234 S.C. 134, 107 S.E.2d 1 (1959), Sutton v. Sutton, 26 S.C. 33 (1886), and Norton v. Sitton, 11 S.C. 593 (1867). This line of cases deals with the assignment of a mortgage, or the subrogation of the rights of one mortgagee to another mortgagee. Enter. Bank v. Fed. Land Bank, 139 S.C. 397, 138 S.E. 146 (1927). The cases also discuss a surety paying off a current obligation and taking the place of the first creditor. United Carolina Bank v. Caroprop, Ltd., 311 S.C. 376, 429 S.E.2d 197 (Ct. App. 1987). They involve one party paying off an existing debt and stepping into the shoes of the original creditor. It is a replacement of creditor in name only, not a replacement of the recording date of the obligation, and certainly not a replacement of the amount due. This is no small difference, and this is why Matrix signals that, while potentially analogous to equitable subrogation, Replacement Mortgage theory is not the same. Matrix Financial Serv. Corp. v. Frazer, 394 S.C. 134, 714 S.E.2d 532 (2011). Matrix makes it clear that equitable subrogation should not be used when a mortgage creditor is refinancing its own loan. It instructs readers that equitable subrogation cannot be strained and expanded to contain within it a creditor refinancing its own loan.

Like a spring that has been pulled and stretched too far, torturing the doctrine of equitable subrogation into this fact pattern will render it useless for its intended purpose of dispensing equity.

¹ Many issues have already been addressed in the earlier filings in this matter and are therefore not restated again, but Respondent hereby incorporates those previous arguments herein.

The recitation of the line of cases involving equitable subrogation comes to a full stop at Matrix. Matrix Financial Serv. Corp. v. Frazer, 394 S.C. 134, 714 S.E.2d 532 (2011). We already know that this Court does not envision equity being served by expanding the doctrine of equitable subrogation to include a creditor refinancing its own debt. Id.

Material Prejudice versus No Injustice

The Amici argue that “material prejudice” element of Replacement Mortgage theory is analogous with the “no injustice” element of equitable subrogation. However, the requirement of “no injustice” when applying equitable subrogation is a much stricter standard than “material prejudice.” The “no injustice” criterion of equitable subrogation means that the junior creditor should be in “no worse condition” than it was before the substitution of creditors. Enter. Bank v. Fed. Land Bank, 139 S.C. 397, 138 S.E. 146 (1927). The requirement to apply Replacement Mortgage theory is that there should be no “material prejudice” done to the innocent junior lienholder. Restatement (Third) of Property (Mortgages) § 7.3 (1997).

Replacement Mortgage allows for some prejudice, an unknown, unpredictable, and subjective amount of loss or damages done to an innocent third party. Far from being analogous, these two exceptions highlight a distinction, which is the severity with which this Court has protected innocent junior lienholders. If this Court has been unwilling to merely substitute creditors if there is even the most miniscule amount of injustice done to an innocent junior creditor, then it is clear that this Court would not allow a lender to refinance its own debt, increasing the amount due, so long as the prejudice to the innocent junior creditor is not material. See Matrix Financial Serv. Corp. v. Frazer, 394 S.C. 134, 714 S.E.2d 532 (2011). The line of cases cited by the Amici do not demonstrate that equitable subrogation is harmonious with the race-notice statute or that equitable subrogation is analogous to Replacement Mortgage theory. The cases show the

incompatibility of equitable subrogation with Replacement Mortgage theory, due to the fact that Replacement Mortgage theory allows the refinancing creditor to hurt the position of the innocent junior lienholder up to a substantial amount, which this Court has never allowed to happen. See Id.

South Carolina's Race-Notice Statute

The first recording statute in South Carolina predates its existence as a state. It was an effort to prevent outright fraud by wrongdoers seeking to sell or mortgage the same parcel multiple times. The “Act of 1698, was known as ‘An act to prevent deceits by double mortgages and conveyances of lands’ The preamble recites the hardships which have resulted from the opportunity given to ‘knavish and necessitous persons to make two or more sales, conveyances and mortgages of the same [property]’” David H. Means, The Recording of Land Titles in South Carolina (Herein of Bona Fide Purchase of Land): A Title Examiner's Guide, 10 S.C. Law Rev. 346, 352 (1958). Under this Act, the first mortgage to be registered at the Register's Office in Charleston for any given parcel was to be given priority over all others. Id.

“In the absence of statute, priority between conflicting legal interests in land is determined by application of the maxim, first in time, first in right.” Id. at 350. Hence, we see that even before the first recording statute in 1698, Respondent would prevail because its mortgage predates the Appellant's mortgage. “Where the contest is between a legal interest and an equitable one, the legal interest, if prior in time, will prevail.” Id. at 351. Here, ArrowPointe's interest is a legal interest, determined by its place in the chain of title; whereas U.S. Bank National Association is arguing for the Court to acknowledge a heretofore unrecognized equitable interest obtained through the Replacement Mortgage theory.

After the Act of 1698, the statute was amended in 1731, then in 1785, 1789, 1817, 1823, 1843, 1872, 1876, and 1952. Id. at 352 – 354. In 1731, it was determined that deeds must be recorded within eighteen months, and a provision for lost or destroyed deeds was added. Id. at 352, citing 3 STAT. 296 (1731). The Act of 1785 required a deed be recorded within six months. Id., citing 4 STAT. 656 (1785). This Act also included marriage contracts to the list of documents that should be recorded. Id. In 1789 it was decided that the timing requirements of the prior act should be extended. Id. at 353, citing 5 STAT. 127 (1789). The Act of 1792 required settlements to be recorded. Id. at 352, citing 5 STAT. 203 (1792). Leases that were longer than twelve months were required to be recorded in the Act of 1817. Id., citing 6 STAT. 67 (1817). One of the changes enacted in 1843 stated that subsequent creditors would not be bound by a mortgage unless it was recorded within sixty days. Id. at 353, citing 11 STAT. 277 (1845). “[N]o mortgage ... of real estate, shall be valid so as to affect the rights of subsequent creditors or purchasers for valuable consideration, without notice, unless the same shall be recorded . . . within sixty days from the execution thereof” Id.

In 1872, it was decided that all conveyances not recorded within 33 days would be void. Id. at 354, citing 15 STAT. 5 (1872). The statute changed in 1876 so that subsequent creditors or purchasers would only be bound if the conveyance was filed within forty days. Id., citing 16 STAT. 92 (1876). The 1916 changes were intended to bring South Carolina within a national structure called the Torrens System, but South Carolina practitioners never used the new system, and it was apparently abandoned. Id., citing 29 STAT. 943 (1916).

The author of the guide to title examiners noted an instance where South Carolina courts held that the dowery of a wife is not prejudiced by the husband’s failure to record a deed, lamenting that, “[n]ot only is this result unfortunate as a matter of policy because destructive of the integrity

of the recording system, but the court's rationale in support of the result is questionable.” *Id.* at 365. Here is echoed the concept that exceptions to the recording statute work a disservice to the efficiency of the recording system.

As of the law review article printed in 1958, the South Carolina legislature (and before that, the colonial governing body) had amended the recording statute at least nine times. It is clear that the legislature is capable of curing any perceived shortcomings and inequities doled out by the race-notice statute that it enacted. “The modern system of priorities of land titles is peculiarly a product of the legislature, and in few, if any, other areas of the law has the legislature been so ready to tinker with and alter the structure erected by prior legislative sessions.” *Id.* at 349. Here, upholding the race-notice statute will not work an inequity, because the party that missed the recorded mortgage is the party that bears the loss. “[T]he legislative architects have worked at more or less frequent intervals either to alter drastically the design of the original plan, or else to remedy defects which experience has shown to exist in the system.” *Id.*

Policy Considerations

If Replacement Mortgage theory is adopted as advocated by Appellant, title abstractors in South Carolina, when confronted with a fact pattern such as the instant case, will issue a title report that makes a notation regarding the replaced mortgage, and those who issue title insurance policies will merely make an exception to the replaced mortgage. The abstractors will not determine whether and to what extent the new mortgage constitutes material prejudice for existing junior lienholders. The abstractors will instead note the replaced mortgage, note the issue and leave the determination of the priority among creditors such as the parties in this case to determine for themselves. Of course, junior creditors will be unaware that this process of priority determination is taking place at all. Title abstractors are highly unlikely to determine whether the replacing

mortgage works a material prejudice to an existing junior lienholder. This will leave a gaping hole in the insurability of the title to the real property serving as collateral for the proposed mortgage loan, which in turn hurts the efficient closing of refinanced loans.

Junior creditors will be forced to accept an unknown amount of risk that future events outside of their control will significantly alter the equity in the real property serving as collateral. This risk will be unacceptable to many junior creditors, and those willing to sustain such undetermined future risk will increase interest rates to the detriment of the public. Home equity lines of credit, often products that are in second place behind purchase money mortgages, will not be as readily available to homeowners. First lien creditors will no longer seek subsequent lienholders' approval, by way of subordination agreements, of refinances that cash out equity. More concerning, first lien creditors may not even search title prior to refinancing mortgage loans, which would be in contravention of the Buyers Services line of cases. State v. Buyers Serv. Co., 292 S.C. 426, 357 S.E.2d 15 (1987); Wachovia Bank v. Coffey, 389 S.C. 68, 698 S.E.2d 244 (Ct. App. 2010); Doe v. McMaster, 355 S.C. 306, 585 S.E.2d 773 (2003).

As the law stands now, practitioners benefit from the certainty and predictability that the race-notice statute affords. An example of this idea in practice is the opinion letter of attorney Milton Hamilton of Chester, South Carolina, who searched title and found all of the recorded mortgages in this instant case. (R. p. 405 -- 406). Mr. Hamilton noted that the "mortgage in the amount of \$99,000.00 [ArrowPointe's] is a first mortgage on the property and the last mortgage to Quicken Loans, Inc. dated November 23, 2009 and recorded December 15, 2009 in the amount of \$296,000.00 is a second mortgage to ArrowPointe." (R. p. 406). It is the same set of information that Appellant would have discovered had Appellant properly searched title before refinancing its own loan.

CONCLUSION

In discussing the interest of Amici Curiae, the Amici observe that if Replacement Mortgage is adopted, it will have a significant impact on the practice of real estate law in South Carolina. Significantly impacting this state's real estate practice is unnecessary. There is no need. The current method of expecting all mortgage creditors to thoroughly and accurately search title is effective. If title abstractors miss a recorded mortgage, there are avenues for relief for the aggrieved mortgage lender. While missing a recorded mortgage is the stuff of nightmares for title abstractors and real estate practitioners, it is the careful and skillful job they do that makes them so valuable to the industry. Adopting Replacement Mortgage will result in lowering the bar for abstractors, increasing priority disputes for the courts to adjudicate, and lessening predictability for lenders. This Court should not adopt Replacement Mortgage theory.

Respectfully submitted,

s/Christy C. Jones

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