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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM FAIRFIELD COUNTY
Court of Common Pleas

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 its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1 is the Appellant.

PETITION FOR REHEARING

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Pursuant to Rule 221, SCACR, Appellant respectfully requests that the Court grant rehearing and review of ArrowPointe Federal Credit Union v. Jimmy Eugene Bailey, et al., Op. No. 28129 (S.C. Sup. Ct. filed January 11, 2023) (Howard Adv. Sh. No. 2 at 170-76) (the "***Opinion***"). The Opinion is a departure from this Court's equitable subrogation jurisprudence and the unanimous trend around the country recognizing the replacement mortgage doctrine in some form; it leaves practitioners and lenders without clear guidance on the availability of any equitable relief for lost lien priority in refinance transactions; and it will ensure a marked increase in malpractice litigation, increased costs in refinance transactions, and foreclosure litigation.

A. The Opinion effectively vacates this Court's seminal equitable subrogation cases by incorrectly stating the doctrine applies where the original mortgage remains unsatisfied and a new mortgage is not recorded.

Citing to a line of authorities from Prudential Inv. Co. v. Connor, 120 S.C. 42, 112 S.E. 539 (1921) to Indep. Nat. Bank v. Buncombe Pro. Park, LLC, 411 S.C. 605, 769 S.E.2d 663 (2015) ("***Indep. Nat. Bank***"), the Opinion acknowledges that this Court has, for a hundred years, recognized that equity operates as an exception to the harsh windfalls that could otherwise arise under South Carolina's race-notice statute. [Op. at 173.] As detailed by *amici curiae* American Land Title Association and the Palmetto Land Title Association in their brief, this Court has fostered and embraced the equitable subrogation doctrine despite the recording statute's adoption, always acknowledging that an action to establish the priority of a lien is fundamentally within this Court's equity jurisdiction.

However, the Opinion makes South Carolina the first state to openly reject the equitable doctrine of replacement mortgage despite a heretofore unanimous trend of courts adopting the replacement mortgage doctrine in some form. The Opinion does so even though, in the context of a refinance transaction, the replacement mortgage doctrine is analogous to the equitable

subrogation doctrine in every way except that it affords equitable priority to a lender that refinances its own prior loan rather than the loan of another. Presumably acknowledging that this is an arbitrary and capricious distinction counter to the principles of equity, the Opinion attempts to distinguish the two doctrines as follows:

> Although there is an intervening mortgage — such as ArrowPointe's — in both scenarios, the two doctrines have different effects. Under the equitable subrogation doctrine, a substitute mortgagee steps into the shoes of the original mortgagee, ***and the original mortgage remains intact in all respects relative to "race-notice." The mortgage remains unsatisfied, and a new mortgage is not recorded***. In that sense, the "race" began before the substitute mortgagee stepped into the shoes of the original mortgagee, and the junior mortgagee has not lost anything at all. ***However, under the replacement mortgage doctrine, the original first mortgage is satisfied of record and replaced with a new mortgage that is recorded after the intervening mortgage.***

[Op. at 175.] Appellant seeks rehearing and review of the Opinion, in part, because the emphasized portion of the Opinion mischaracterizes customary practice in every refinance transaction where equitable subrogation applies, a fact highlighted by this Court's prior jurisprudence — including the seminal authorities cited within the Opinion.

Barring some abnormality or error, when a lender conducts any secured refinance transaction, whether of its own prior note and mortgage or another's, the original note is paid, the original mortgage is satisfied or canceled, and a new mortgage is recorded.[1] For illustration, in this Court's most recent application of the doctrine of equitable subrogation in the context of a mortgage priority dispute, Indep. Nat. Bank, this Court reversed the South Carolina Court of Appeals and held that equitable subrogation granted Independence National Bank priority where it paid off the existing loan and "***satisfied*** the existing first mortgage at closing." 411 S.C. at 607, 769 S.E.2d at 664 (emphasis added).

[1] Mortgagees are statutorily required to satisfy mortgages of record, S.C. Code Ann § 29-3-310, and mortgagees are subject to severe penalties if they fail to do so. S.C. Code Ann § 29-3-320.

Further, in this Court's leading equitable subrogation case in the context of a mortgage priority dispute, Enter. Bank v. Fed. Land Bank of Columbia, it reversed the circuit court and held that Federal Land Bank was entitled to priority under the equitable subrogation doctrine where it paid off and filed "***satisfactions***" of three (3) first lien mortgages and "***recorded***" its new mortgage securing its refinance loan that same day. 139 S.C. 397, 138 S.E. 146, 147 (1927) ("***Enter. Bank***") (emphasis added). The weight of this Court's authorities demonstrates that the Opinion's distinction between the two equitable doctrines is incorrect; and it is not supported by either the record on appeal or citation to any authority. Under both doctrines, the newly recorded mortgage is afforded the priority of the lien that the refinance discharged.

Likewise, the Opinion fails to address the South Carolina Court of Appeals' decision in Dodge City of Spartanburg, Inc. v. Jones, 317 S.C. 491, 454 S.E.2d 918 (Ct.App.1995) ("***Dodge****"*). In Dodge, the Court of Appeals gave priority to a subsequently recorded mortgage by Carolina Investors over a prior, properly recorded judgment by Dodge City. The Court held that equitable subrogation was proper where Carolina Investors' subsequently recorded mortgage secured a refinance loan that "paid and satisfied of record" Carolina Investors' ***own prior mortgage*** and the prior mortgage of First Federal. Id., 317 S.C. at 493, 454 S.E.2d at 919 (emphasis added). Notably, the Court of Appeals agreed Carolina Investors could avail itself of the doctrine of equitable subrogation and obtain the priority of its own prior, satisfied loan. This decision stands in contrast to the arbitrary windfalls that would otherwise arise by embracing equitable subrogation but rejecting the replacement mortgage doctrine.

Under the Opinion's reasoning, Enter. Bank, Indep. Nat. Bank, and Dodge are effectively vacated, as each of the prevailing lenders in those cases — Federal Land Bank, Independence National Bank, and Carolina Investors — would not be entitled to equitable subrogation under this

Opinion. Each lender satisfied the prior mortgage(s) in which it was subrogated, and each lender recorded a new mortgage that was granted priority through the doctrine of equitable subrogation.

Moreover, none of these prior opinions turn on whether an adequate title examination was conducted by the closing attorney or his/her supervisee. Therefore, under the Opinion's reasoning, equity should not avail the refinancing lender in any of these cases. The Opinion represents a drastic departure from the doctrine of *stare decisis* and will result in significant confusion among practitioners and lenders, as it creates serious doubt about the availability of any equitable relief for lost lien priority in refinance transactions.

B. The Opinion fundamentally alters the "no injustice" element of equitable subrogation, further undermining this Court's equitable subrogation jurisprudence.

In rejecting the replacement mortgage doctrine, the Opinion dictates that equitable subrogation only applies where "the junior mortgagee has not lost anything at all." [Op. at 175.] This dictate is incorrect, as it ignores this Court's prior decisions approving the application of the equitable subrogation doctrine where the subrogated mortgage secures a lien that exceeds the initial mortgage. For example, in Meaders Bros. v. Skelton, this Court affirmed the trial court's application of equitable subrogation, which allowed Independent Life to be proportionally subrogated to the initial mortgage of Fidelity Federal "to the extent of [the payoff]" and granted Independent Life priority "to the extent [Fidelity Federal's] mortgage constituted a first mortgage lien superior to the mortgage." 234 S.C. 134, 137, 107 S.E.2d 1, 2–3 (1959). In its effort to distinguish the replacement mortgage doctrine, the Opinion takes away the flexibility previously found in South Carolina's equitable subrogation jurisprudence – which mirrors the RESTATEMENT's ameliorating principal of the replacement mortgage doctrine. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 7.3 ("***RESTATEMENT***"), cmt. B and illus. 2.

This Court has never limited the application of the equitable subrogation doctrine to cases where "the junior mortgagee has not lost anything at all" – rather, this Court has consistently held that equitable subrogation must do "no injustice" to the other party. Dedes v. Strickland, 307 S.C. 155, 414 S.E.2d 134 (1992). In United Carolina Bank v. Caroprop, Ltd., this Court stated that no injustice occurs when priority is given to a subsequent mortgage where the other party intended to take a second position. 316 S.C. 1, 4, 446 S.E.2d 415, 417 (1994) ("***Caroprop***") ("Finally, our holding imposes no injustice upon First South, it having knowingly taken a second mortgage from Caroprop. Auten's payment of the Interstate mortgage in no way disadvantages First South, which has done nothing to advance its priority.") This case is indistinguishable from Caroprop, as ArrowPointe stipulates it "intended the [LOC Mortgage] to be a junior mortgage on the Subject Property second in lien priority position behind the [Purchase] Mortgage." (App. 274). The RESTATEMENT's iteration of the replacement mortgage doctrine aligns with this Court's longstanding principles of equity jurisprudence, and the Court should adopt the replacement mortgage doctrine rather than issue an opinion that undermines this Court's formulation of the equitable subrogation doctrine.

C. The Opinion overlooks its adoption of a judicial policy that will cause more harm than could possibly arise from recognizing the replacement mortgage doctrine.

"A court of equity abhors forfeitures, and will not lend its aid to enforce them." Jones v. N.Y. Guar. & Indem. Co., 101 U.S. 622, 628 (1879). "Equity does not favor forfeitures or penalties and will relieve against them when practicable in the interest of justice." Lane v. N.Y. Life Ins. Co., 147 S.C. 333, 374, 145 S.E. 196, 209 (1928). This Court has the power in equity to deny or delay forfeiture when fairness demands. Lewis v. Premium Inv. Corp., 351 S.C. 167, 172, 568 S.E.2d 361, 364 (2002).

The Opinion blames Appellant for its predecessor's adherence to this Court's directives and reliance on South Carolina legal counsel, and it makes Appellant bear the loss of an inequitable windfall due to its reliance on the licensed closing attorney. In refusing to afford Appellant the same equitable protection it has given past refinancing lenders like Federal Land Bank, Independence National Bank, and Carolina Investors, the Opinion states:

> We see no reason to adopt a doctrine that excuses the failure to conduct such a title examination—or, when a title examination is conducted, the failure to ascertain the existence of an intervening lien.

[Op. at 176.] The Record on Appeal confirms Appellant's predecessor had no actual notice or knowledge of ArrowPointe's mortgage; and it relied on its learned counsel, Stacey E. Besser, Esq. f/k/a/ Stacey Pope Gardner, Esq., to supervise its loan closing. [App. 275, 283.] While the Opinion seems to question whether a title search occurred for the closing of Appellant's loan, the closing attorney's Settlement Statement proves that a title search occurred. [App. 512, line 1103.]; *See* Pee Dee State Bank v. Prosser, 295 S.C. 229, 237, 367 S.E.2d 708, 713 (Ct. App. 1988) ("***Prosser***"), *overruled on other grounds by* Caroprop (finding that, where there is some indication on the settlement statement a title examination occurred, but "the record contains … no evidence of the results of the examination" equitable subrogation *should* apply because there was not actual knowledge of the intervening lien). There is nothing more a lender could have done without being advised of the intervening lien, because this Court mandates that Appellant and other lenders ***must*** permit South Carolina attorneys to supervise all title searches and loan closings. Matrix Fin. Servs. Corp. v. Frazer, 394 S.C. 134, 139, 714 S.E.2d 532, 534 (2011) (***"Matrix"***) ("Performing a title search, preparing title and loan documents, and closing a loan without the supervision of an attorney constitutes the unauthorized practice of law." (citing Doe v. McMaster, 355 S.C. 306, 585

S.E.2d 773 (2003) and State v. Buyers Serv. Co., 292 S.C. 426, 357 S.E.2d 15 (1987)).

The Opinion's statement that an equitable doctrine should not excuse an inadequate title search by a South Carolina lawyer contradicts starkly this Court's last equitable subrogation decision in a mortgage priority context, leaving that doctrine in doubt. In Indep. Nat. Bank, the Court of Appeals held that equitable subrogation could not apply because the refinancing lender's closing attorney had actual knowledge of the junior lien. 411 S.C. at 608, 769 S.E.2d at 665. This Court reversed the Court of Appeals, and it allowed Independence National Bank to avail itself of the equitable subrogation doctrine. Specifically, this Court held that the closing attorneys' actual knowledge of the intervening junior lien is not imputable to the refinancing lender. Id. In allowing equitable subrogation to avoid the harsh results of the recording statute in Indep. Nat. Bank, this Court highlighted how the exercise of its equitable powers can avoid unintended windfalls.

The Opinion's statement that an equitable doctrine should not excuse an inadequate title search by a South Carolina lawyer is also contrary to the long-established purchase money mortgage doctrine, whereby a purchase money mortgage "is accorded priority over all other claims or liens arising through the mortgagor although they are prior in time to the execution of the purchase money mortgage." SunTrust Bank v. Bryant, 392 S.C. 264, 268, 708 S.E.2d 821, 823 (Ct. App. 2011). "The rationale for this special priority is that the mortgagor's interest in the property is made possible by the purchase money loan, so that the mortgage should come ahead of other interests that attach merely because the mortgagor acquires the property." South Carolina Federal Sav. Bank v. San–A–Bel Corp., 307 S.C. 76, 80, 413 S.E.2d 852, 855 (Ct. App. 1992). The rationale the Court employes in the Opinion is contrary to and leaves in doubt the future availability of any of the equitable doctrines that this Court and the Court of Appeals have routinely utilized to ameliorate the harsh effects of the recording statute. *See, e.g.*, Crystal Ice Co. of

Columbia v. First Colonial Corp., 273 S.C. 306, 310, 257 S.E.2d 496, 498 (1979) ("Stripped of the protection of the recording statute, Crystal Ice cannot prevail at common law.") Regions Bank v. Wingard Properties, Inc., 394 S.C. 241, 255, 715 S.E.2d 348, 356 (Ct. App. 2011) ("The intervention of equity does not impugn the integrity of the recording statute in this case.");

Without considering Appellant's policy arguments, the Opinion declares that there is "no reason" to adopt the replacement mortgage doctrine because title searches should be performed correctly. However, other courts and commentators, including former Chief Justice Pleicones in his dissent in Matrix, have noted that subrogation doctrines like the replacement mortgage doctrine can save billions of dollars of loss through avoidable foreclosure litigation and title insurance costs passed to borrowers in refinance transactions. *See* Bank of Am., N.A. v. Prestance Corp., 160 Wash. 2d 560, 568, 160 P.3d 17, 22 (2007) (discussing Grant S. Nelson & Dale A. Whitman, *Adopting Restatement Mortgage Subrogation Principles: Saving Billions of Dollars for Refinancing Homeowners*, 2006 BYU L.Rev. 305, 315–16).[2]

Without weighing the positive impact of the RESTATEMENT's approach, the Opinion criticizes the replacement mortgage doctrine as inviting needless litigation that "could be avoided by a simple examination of the title to the real property." [Op. at 175-76.] However, the same logic applies to the equitable subrogation doctrine, which this Court most recently applied despite the closing attorney's actual knowledge of an intervening junior lien. Indep. Nat. Bank, *supra*. If this Court's normative principles are reflected in the equitable subrogation doctrine, then the Opinion defies those normative principles by rejecting the replacement mortgage doctrine and reaching an inequitable result.

[2] In addition, South Carolina's equitable subrogation jurisprudence shows that negligence in conducting a title search is not a bar to equitable subrogation. *See, e.g.*, Indep. Nat. Bank and Prosser, *supra*.

Finally, while the Opinion denounces Court-made policy decisions, it nevertheless makes a more damaging policy decision than the adoption of the replacement mortgage doctrine. Specifically, the Opinion chooses to trade one form of litigation for two other, less desirable forms of litigation. First, the Opinion makes refinance transactions in South Carolina more expensive and less available, which increases the rate of residential foreclosures. 2006 B.Y.U. L. Rev. at 309.

Second, unlike this Court's decision in Indep. Nat. Bank, the Opinion favors legal malpractice litigation over equitable actions regarding the replacement mortgage doctrine. With no equitable doctrine to aid an innocent refinancing lender, like Appellant, who complies with this Court's directives and relies upon a South Carolina attorney to supervise its loan transaction, the innocent lender is left with no remedy other than to sue its closing attorney for its damages at law. Closing attorneys do not consistently reupdate title to avoid a secretly made and recorded gap mortgage up until the moment a refinance mortgage is recorded, and the Opinion strips trial courts of the ability to apply equity and ameliorate the impact of such fraud. Where, as here, both the closing attorney and the lender have been deceived by borrowers who misrepresented the truth and denied the existence of an intervening equity line of credit [App. 275], this is a poor result. The replacement mortgage doctrine is the better judicial policy when, as is the case here, an inequitable windfall intended by no lienholder can be avoided by simply placing an intervening lender in the position it intended to be when it recorded a junior mortgage.

CONCLUSION

Therefore, Appellant asks, respectfully, that this Court grant its petition for rehearing and review the Opinion to address the unintended effects of the Opinion.

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Respectfully submitted,

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