

THE STATE OF SOUTH CAROLINA
In the Supreme Court

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S.C. SUPREME COURT

Appellate Case No. 2021-001292

Deutsche Bank National Trust Company, as Trustee for NovaStar Mortgage Funding Trust, Series 2007-1 NovaStar Equity Loan Asset Backed Certificates, Series 2007-1,.....Respondent,

v.

The Estate of Patricia Ann Owens Houck; Tammy M. Bailey; South Carolina Department of Motor Vehicles, Defendants,

Of whom the Estate of Patricia Ann Owens Houck and Tammy M. Bailey are the.....Petitioners.

REPLY BRIEF OF PETITIONERS

Andrew S. Radeker
S.C. Bar No. 73743
Harrison, Radeker & Smith, P.A.
Post Office Box 50143
Columbia, South Carolina 29250
(803) 779-2211
drew@harrisonfirm.com
Attorney for Petitioner

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

STATEMENT OF ISSUES/QUESTIONS PRESENTED 1

ARGUMENT2

I. Deutsche Bank cannot explain away a mutual success scenario. 2

**II. Res judicata is reckoned by what could have been sought in
 an action.3**

**III. The relevant point in time is when Deutsche Bank served its answer in
 Bailey v. Novastar.5**

**IV. There is nothing to fear from concluding the master was right to decide
 that res judicata barred the foreclosure claim.5**

**V. Of course the remedies in S.C. Code Ann. § 37-10-105 apply to
 mortgage loans.10**

VI. Deutsche Bank has not found cases that truly help its position.11

**VII. The claims bore a logical relationship to one another, as both law and
 common sense logic show. 14**

CONCLUSION15

TABLE OF AUTHORITIES
CASES

Beach Co. v. Twillman, Ltd.,
351 S.C. 56, 566 S.E.2d 863 (Ct. App. 2002) 4, 5, 7, 8

Blyth v. Marcus,
335 S.C. 363, 517 S.E.2d 433 (1999) 13

Carolina First Bank v. BADD, L.L.C.,
414 S.C. 289, 778 S.E.2d 106 (2015) 12

Carrigg v. Cannon,
347 S.C. 75, 552 S.E.2d 767 (Ct. App. 2001) 13

Columbia Natl. Bank of Columbia v. Arthur,
151 S.E. 274 (S.C. 1930) 7, 10, 15

Deutsche Bank v. Estate of Houck,
434 S.C. 500, 863 S.E.2d 829 (Ct. App. 2021) 3, 5, 13, 14, 15

Encore Technology Group, LLC v. Trask,
436 S.C. 289, 871 S.E.2d 608 (Ct. App. 2021) 12, 13

Garris v. Governing Bd. of S.C. Reinsurance Facility,
333 S.C. 432, 511 S.E.2d 48 (1998) 4

In re: Mortgage Foreclosure Actions,
396 S.C. 209, 720 S.E.2d 908 (2011) 5, 6, 7

Judy v. Judy,
393 S.C. 160, 712 S.E.2d 408 (2011) 3

Nelson v. QHG of S.C., Inc.,
362 S.C. 421, 608 S.E.2d 855 (2005) 7

N.C. Fed. Sav. & Loan Ass’n v. DAV Corp.,
298 S.C. 514, 381 S.E.2d 903 (1989) 2, 3, 4, 14

Plum Creek Dev. Co. v. City of Conway,
334 S.C. 30, 512 S.E.2d 106 (1999) 3

S.C. Pub. Interest Foundation v. Greenville County,
401 S.C. 377, 737 S.E.2d 502 (Ct. App. 2013) 3, 4

| | |
|--|--------|
| <u>U.S. Bank, Natl. Assn. v. Bell,</u> 385 S.C. 364, 684 S.E.2d 199 (Ct. App. 2009) | 15 |
| <u>Vaughn v. State,</u> 362 S.C. 163, 607 S.E.2d 72 (2004) | 9 |
| <u>Wachovia Bank, Natl. Assn. v. Blackburn,</u> 407 S.C. 321, 755 S.E.2d 437 (2014) | 11, 12 |

STATUTES

| | |
|------------------------------------|---------------|
| S.C. Code Ann § 37-3-105(3) | 11 |
| S.C. Code Ann § 37-10-102 | 10, 11 |
| S.C. Code Ann § 37-10-105(A) | 11 |
| S.C. Code Ann § 37-10-105(C) | 2, 10, 11, 15 |

COURT RULES

| | |
|-------------------------|------------|
| Rule 13(a), SCRCP | 4, 5, 7, 8 |
|-------------------------|------------|

REGULATIONS

| | |
|------------------------|------|
| 12 CFR § 1024.39 | 6, 8 |
| 12 CFR § 1024.41 | 6, 8 |
| 78 FR 10696 | 8 |
| 78 FR 10708 | 8 |
| 78 FR 10842 | 8 |
| 78 FR 10855 | 8 |

OTHER SOURCES

| | |
|---|---|
| 59A C.J.S. <u>Mortgages</u> § 1051 (2009) | 7 |
| <u>Restatement (Second) of Judgments</u> § 24 | 4 |

| | |
|---|---|
| <u>Restatement (Second) of Judgments § 25</u> | 4 |
| Rptr.'s Note to Rule 13, SCRCP | 4 |

STATEMENT OF ISSUES/QUESTIONS PRESENTED

- I. **Did the Court of Appeals err in reversing the grant of summary judgment to Petitioners on Respondent's foreclosure claim?**

ARGUMENT

The Respondent (hereinafter “Deutsche Bank”) argues with vehemence. Nothing in Deutsche Bank’s brief, though, can explain away the relationship between the foreclosure cause of action the master determined was barred and the cause of action under S.C. Code Ann. § 37-10-105(C) that the Petitioners (hereinafter “Bailey and Owens”) asserted in Tammy M. Bailey, et al. v. Novastar Mortgage, Inc., et al., Case No. 2013-CP-32-02210 (hereinafter “Bailey v. Novastar” or “the 2013 action”). Because there was “any logical relationship between the claim and the counterclaim” that Deutsche Bank chose not to bring in the 2013 action, the foreclosure counterclaim was compulsory and is now barred by the judgment in that case. N.C. Fed. Sav. & Loan Ass’n v. DAV Corp., 298 S.C. 514, 518, 381 S.E.2d 903, 905 (1989). The master was right (App’x pp. 31, 37-38), and the Court should reverse the Court of Appeals and reinstate his ruling.

I. Deutsche Bank cannot explain away a mutual success scenario.

Deutsche Bank struggles to address the hypothetical alternate scenario in which Bailey and Owens won a judgment that the note and mortgage were unenforceable and Deutsche Bank pursued a foreclosure action later and won. Deutsche Bank tries to dismiss how this illustrates the logical relationship between the claims by writing that “[i]f, hypothetically, the Note and Mortgage were deemed unenforceable in a prior action, Deutsche Bank would not bring a subsequent foreclosure action, much less prevail in any such action[.]” stating that this somehow shows that “[t]here is no conflict here, not even a possible conflict.” (Brief of Respondent p. 30 n. 19.) Of course “Deutsche Bank would not bring a subsequent foreclosure action, much less prevail in any such action” – it *could not*, if Bailey and Owens had received this relief on their claim under S.C. Code Ann. § 37-10-105(C). Deutsche Bank has no credible

explanation for why there was not “any logical relationship between” its claim and a claim that had the capacity to make Deutsche Bank’s claim impossible to win. DAV Corp., 298 S.C. at 518.

The test for whether a counterclaim is compulsory is whether there is “any logical relationship between the claim and the counterclaim[.]” Id. Here – putting aside for a moment that the claims arise out of common facts – the ability of the claims’ remedies to effect each other so significantly demonstrates that there is a “logical relationship between the claim and the counterclaim[.]” Id.

II. Res judicata is reckoned by what could have been sought in an action.

Deutsche Bank’s argument in support of the Court of Appeals’ unprecedented focus on the prayer for relief in the 2013 action, Deutsche Bank v. Estate of Houck, 434 S.C. 500, 508-09, 863 S.E.2d 829 (Ct. App. 2021), misses a very important point. It would have been strange indeed for our cases ever to have focused on the prayer for relief in reckoning whether a counterclaim was compulsory in an earlier action and thus barred by res judicata. Res judicata is not limited by what was sought in an earlier case; rather, res judicata bars the parties to the first case “from raising any issues which were adjudicated in the former suit *and any issues which might have been raised in the former suit*” – regardless of what was prayed for in the first suit. Judy v. Judy, 393 S.C. 160, 175, 712 S.E.2d 408, 413 (2011) (emphasis added, quoting Plum Creek Dev. Co. v. City of Conway, 334 S.C. 30, 34, 512 S.E.2d 106, 109 (1999)).

The scope of res judicata is determined by both what was sought and what could have been sought in the first case. Id. It applies when a litigant “is ‘prepared in the second action (1) [t]o present evidence or *grounds or theories of the case* not presented in the first action or (2) [t]o seek remedies or forms of relief not demanded in the first action.’” S.C. Pub. Interest

Foundation v. Greenville County, 401 S.C. 377, 386, 737 S.E.2d 502, 507 (Ct. App. 2013) (emphasis in original, quoting Restatement (Second) of Judgments § 25 (1982 & Supp. 2012)). It applies to all rights and remedies, whether they were sought or simply could have been sought in the earlier case, “with respect to *all or part of the transaction, or series of connected transactions, out of which the action arose.*” Id. at 388 (emphasis in original; quoting Restatement (Second) of Judgments § 24).

Consistent with this is the purpose of Rule 13(a), SCRCP, “to prevent multiplicity of actions and to achieve resolution in a single lawsuit of all disputes arising out of common matters.” Beach Co. v. Twillman, Ltd., 351 S.C. 56, 62, 566 S.E.2d 863 (Ct. App. 2002).

The South Carolina Reporter’s Note following Rule 13 states: “[c]ounterclaims arising out of the same transaction or occurrence that is the subject of the action are ‘compulsory’ under Rule 13(a) and are barred by res judicata or estoppel by judgment if not asserted.”

Beach Co., 351 S.C. at 62.

One of “[t]he primary purposes” of res judicata is “to bring an end to litigation[.]” Garris v. Governing Bd. of S.C. Reinsurance Facility, 333 S.C. 432, 449, 511 S.E.2d 48 (1998). Accordingly, if in the first action there was “any logical relationship between the claim and the counterclaim[.]” DAV Corp., 298 S.C. at 518, regardless of what was specifically sought, the counterclaim is “‘compulsory’ under Rule 13(a) and [is] barred by res judicata or estoppel by judgment if not asserted.” Beach Co., 351 S.C. at 62.

The Court of Appeals’ focus on the specifics of the prayer in the first action is inconsistent with the precedent we have on compulsory counterclaims and res judicata.

III. The relevant point in time is when Deutsche Bank served its answer in Bailey v. Novastar.

Deutsche Bank notes a few times in its brief that its foreclosure counterclaim had not arisen at the time the complaint was filed in the Bailey v. Novastar case. This seems something of a red herring, because the relevant point in time for determining whether the counterclaim was compulsory was when Deutsche Bank served its answer in the first case. Rule 13(a), SCRPC (“[a] pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party”). Deutsche Bank agrees that it had its foreclosure claim *then*, and that is the point in time that matters.

IV. There is nothing to fear from concluding the master was right to decide that res judicata barred the foreclosure claim.

Deutsche Bank contends that this Court’s decision to reinstate the master’s ruling will be bad for financial institutions’ customers. This is a paper tiger.

First, Bailey and Owens note that, as wrong as its decision was, the Court of Appeals was not taken in by this argument when Deutsche Bank raised it to that court. Deutsche Bank made the same argument then. (App’x pp. 561-68.) The Court of Appeals declined to use any of that argument as a basis for reversing the master. Deutsche Bank, 434 S.C. at 508-09.

That is not surprising. On examination, this argument falls apart.

Deutsche Bank is correct that there is a public policy that favors negotiated settlement of mortgage default disputes. This is shown by this Court’s mortgage foreclosure action administrative order, In re: Mortgage Foreclosure Actions, 396 S.C. 209, 720 S.E.2d 908 (2011) (South Carolina Supreme Court Administrative Order 2011-05-02-01) (hereinafter “the Administrative Order”), which created a procedural mechanism within mortgage foreclosure actions to foster their settlement through various foreclosure intervention methods. It is also

indicated by the adoption of federal regulations 12 CFR §§ 1024.39 and 1024.41, which took effect after the operative events in this case but, among other things, now require mortgage servicers to wait a specified period of time after sending a defaulting mortgage customer information about ways to resolve that default before servicers may refer out the matter for the bringing of a foreclosure action.

As the master found, though, “the public interest in foreclosure intervention and the public interest in finality of litigation served by *res judicata* are not necessarily in conflict.” (App’x p. 23.) The master observed that “[b]y complying with the Administrative Order at the same time as it asserted foreclosure as a counterclaim in the Bailey v. Novastar case, Deutsche Bank could have both served the interest of trying to avoid the property’s foreclosure sale and held on to its foreclosure claim.” (App’x pp. 23-24.)

Doing so would have been both simple and procedurally required. The Administrative Order does not require delay in *asserting* a foreclosure claim; rather, it requires the service on a mortgagor defendant of a notice of right to foreclosure intervention at the same time as the pleading asserting the foreclosure cause of action is served. In re: Mortgage Foreclosures, 396 S.C. at 212. The Administrative Order then provides that no “foreclosure hearing[,]” i.e., final hearing on the foreclosure cause of action, may be held until the mortgagee’s attorney certifies to the court either that the mortgagor did not avail himself of foreclosure intervention or that the foreclosure intervention process did not result in resolution of the claim. Id. at 212-13. The process under the Administrative Order *uses* the pending foreclosure claim as a vehicle to facilitate negotiated resolution of mortgage loan defaults through foreclosure intervention. Id. It does not require a mortgagee to exhaust foreclosure intervention efforts *before* commencing its mortgage foreclosure claim. Id.

There would have been nothing inconsistent with Deutsche Bank serving the public policy of foreclosure intervention – and complying with the Administrative Order – by serving an answer and counterclaim asserting its foreclosure claim in the Bailey v. Novastar action and serving a notice of right to foreclosure intervention at the same time, then letting the ensuing foreclosure intervention process play out however it did. Id. If the foreclosure intervention process had resolved the foreclosure intervention claim, then the claim would have been ended by agreement; if not, Deutsche Bank would have retained that claim and its right to litigate it. See id. The policy as stated by this court is to avoid the ultimate loss of homes to foreclosure, not to keep mortgagees from asserting claims for foreclosure. Id.

As the master found, there is no imperative to depart from established doctrine and create a new res judicata exception, never before recognized in South Carolina, for foreclosure claims. (App’x pp. 25-26.) Such an exception would be a radical departure – and, where the existing process under the Administrative Order serves the aim of trying to avoid the loss of property to foreclosure, an entirely unwarranted one. See In re: Mortgage Foreclosures, 396 S.C. at 212; Columbia Natl. Bank of Columbia v. Arthur, 151 S.E. 274, 275, 276 (S.C. 1930); 59A C.J.S. Mortgages § 1051 (2009). Since Deutsche Bank could have asserted its foreclosure claim in Bailey v. Novastar and served the public policy of foreclosure intervention, “policy considerations do not override the interest in bringing an end to litigation” and preventing multiplicity of actions, an important state interest that is served by res judicata and Rule 13(a). Nelson v. QHG of S.C., Inc., 362 S.C. 421, 427, 608 S.E.2d 855 (2005). Nothing here required a choice between public policy and res judicata. See id.

Judge Spence did not make his decision on the basis that there is a categorical rule saying that mortgagees must always bring foreclosure counterclaims or be barred by res

judicata if they are sued by their mortgage customers. (App’x pp. 5-45.) Bailey and Owens are not asking this Court to approve such a categorical rule, nor would the Court be doing so in reinstating Judge Spence’s order in this case. Decisions about res judicata are always case-specific, not categorical, since no two cases, or sets of two cases, will ever be alike. Indeed, the master observed two variables not present in this case that might have had a significant effect on the outcome if they had been present.

The first concerns 12 CFR §§ 1024.39 and 1024.41. These regulations were not in effect at the time of any of this case’s operative events.¹ Had these rules been in effect at the time that Deutsche Bank answered, it might have had a very good argument that its foreclosure claim had not yet arisen at that point, thus keeping the foreclosure claim out of the ambit of Rule 13(a), SCRCF. Rule 13(a) requires the assertion of counterclaims that a defendant has at the time he answers in a case, not claims that only accrue after that. The federal regulations *now* require a mortgage servicer to wait to refer out a matter for bringing a foreclosure action until the passage of a specified period of time after sending a defaulting mortgage customer information about ways to resolve a mortgage default. 12 CFR §§ 1024.39; 1024.41. These regulations did not require anything when Deutsche Bank served its answer. There is no inherent conflict between Judge Spence’s decision and these regulations. They simply were not in effect at the relevant time. If the prospect of future misapplication of the Court’s decision is of concern, the Court can in its opinion note the regulations’ existence and that they were not in effect at the time Deutsche Bank answered in the 2013 action.

¹ As shown by the Federal Register at 78 FR 10696, 10708, 10842, 10855 (Feb. 14, 2013), and as Deutsche Bank agrees, the rules under these federal regulations that Deutsche Bank references did not go into effect until January 10, 2014 – nearly four months after September 26, 2013, which is when Deutsche Bank served its answer in the Bailey v. Novastar case.

Second, the master observed that his decision did not address how it might have been different if the subject note had not matured at the time that Deutsche Bank served its answer. (App'x p. 36.) It may well have been very different. If the default under the note and mortgage had simply been in making monthly payments, Deutsche Bank might have forgone its claim as to all defaults *before* the time it answered and did not assert its counterclaim, but, when the *next* month's payment deadline came and went, a new default would have occurred, and the claim arising from *that* default would be unaffected by the operation of Rule 13(a). Here, however, the underlying note had *matured*, and maturation of the note without payment of the balance was the ultimate and final default under the note and mortgage. (App'x p. 27.)

The fact that these absent variables could be present in another case and affect the outcome of that case does not mean that they should affect the outcome here, where they are not present.

What Deutsche Bank in fact protests is not a sweeping categorical ruling by the master, but a correct, thorough application of established legal principles to an odd set of facts. The specters Deutsche Bank sees do not exist. Applying these established legal principles does not prevent anyone from engaging in foreclosure intervention efforts at all.

Arguing entirely outside the record, Deutsche Bank claims that “preemptive suits by mortgagors in anticipation of foreclosure are a frequent tactic, including suits invoking the Attorney Preference statute.” (Brief of Respondent p. 31 n. 21.) This is improper argument without anything to support it, but it does allow the undersigned counsel to say something he would not otherwise be allowed to say. When a party makes improper argument, the opposing party is permitted to make “an appropriate response” to it, even if the response would otherwise be impermissible. Vaughn v. State, 362 S.C. 163, 169, 607 S.E.2d 72 (2004). In the

undersigned's 17 years practicing law, the only case he has seen that comes remotely close to being a "preemptive suit[] by mortgagors in anticipation of foreclosure" is the Bailey v. Novastar action – and it was filed when it was to avoid being barred by the statute of limitations under S.C. Code Ann. § 37-10-105(C), not to avoid a foreclosure claim. Indeed, the undersigned had anticipated that Deutsche Bank would assert a counterclaim for foreclosure in that case and was surprised that it never did.

But that is really beside the point. Whether such suits are frequent or rare, that does not change the law of res judicata.

Deutsche Bank claims that this Court's decision to reinstate the master's ruling would create a situation in which "a borrower can force a lender to file a foreclosure counterclaim[.]" (Brief of Respondent p. 32.) Poppycock. Whether to assert a claim for foreclosure is always the mortgagee's choice. Here, Bailey and Owens ask for this Court to reaffirm its previous jurisprudence and state that a mortgagee's decision to assert or not to assert a foreclosure counterclaim has consequences either way – just like it does for other litigants with other kinds of claims. See Columbia Natl. Bank, 151 S.E. at 275, 276; Beach Co., 351 S.C. at 62.

V. Of course the remedies in S.C. Code Ann. § 37-10-105 apply to mortgage loans.

Deutsche Bank argues that "[i]t is doubtful that the remedies under S.C. Code 37-10-105(c) even apply to mortgage loans[.]" (Brief of Respondent p. 25 n. 15.) Of course S.C. Code Ann. § 37-10-105(C) applies to mortgage loans. The plain words of statutes in the South Carolina Consumer Protection Code state that it does.

The attorney preference statute is in Chapter 10 of the Consumer Protection Code, Title 37 of the South Carolina Code of Laws. A statute in the same chapter, S.C. Code Ann. § 37-

10-105, provides the remedies for a violation of § 37-10-102, the attorney preference statute, which is also in Chapter 10, stating:

If a creditor violates a provision *of this chapter*, the debtor has a cause of action, other than in a class action, to recover actual damages and also a right in an action, other than in a class action, to recover from the person violating this chapter a penalty in an amount determined by the court of not less than one thousand five hundred dollars and not more than seven thousand five hundred dollars. No debtor may bring a class action for a violation of this chapter. No debtor may bring an action for a violation *of this chapter* more than three years after the violation occurred, *except as set forth in subsection (C)*.

S.C. Code Ann. § 37-10-105(A) (emphasis added).

Mortgage loans are specifically covered by Chapter 10 as consumer credit transactions, being specifically included in the definition of “consumer loan” in the application Chapter 10, even mortgage loans that are not within that definition for many other parts of the Consumer Protection Code. S.C. Code Ann. § 37-3-105(3). Chapter 10 of Title 37 is where the attorney preference statute (S.C. Code Ann. § 37-10-102) and the corresponding remedies statute (S.C. Code Ann. § 37-10-105) are codified. Especially considering that the attorney preference statute is specifically aimed at mortgage loan closings, it would be baffling if the statute that provides the remedies for violation of the attorney preference statute somehow did not apply to mortgage loans. S.C. Code Ann. § 37-10-105.

VI. Deutsche Bank has not found cases that truly help its position.

Deutsche Bank argues that Bailey and Owens “ignore[]” the proposition stated in Wachovia Bank, N.A. v. Blackburn, 407 S.C. 321, 330 n. 7, 755 S.E.2d 437, 442 n. 7 (2014), that “the ‘logical relationship’ determination is made by asking whether the counterclaim would affect the lender’s right to enforce the note and foreclose the mortgage.” (Brief of Respondent p. 13 n. 6.) Quite the contrary – Bailey and Owens’ position is built on that

proposition, as they have shown the master was right to conclude that the two claims at issue very much do affect the parties' rights to enforce them. Bailey and Owens do not spend a great deal of time discussing Blackburn because the Court did not ultimately decide whether the counterclaim in Blackburn was permissive or compulsory. Id. at 330-31. The Court, rather, determined that, if the counterclaim was compulsory, the Blackburns entered into a valid waiver of their right to a jury trial and, if it was permissive, the Blackburns did not have the right to a jury trial on it as a counterclaim in an equitable action. Id.

Deutsche Bank contends that Bailey and Owens misread Carolina First Bank v. BADD, L.L.C., 414 S.C. 289, 295, 296, 778 S.E.2d 106, 109, 110 (2015). (Brief of Respondent pp. 16-17.) Deutsche Bank points out language from BADD that stated the counterclaims there were permissive because they did not “affect the execution or enforceability of the guaranty agreements[.]” BADD, 414 S.C. at 296. But, as Bailey and Owens have pointed out, their claim in the 2013 action not only arose from the execution of the mortgage loan documents, it affected their enforceability, as it could have rendered all or part of the note and mortgage unenforceable. BADD does not help Deutsche Bank.

With regard to another case, Encore Technology Group, LLC v. Trask, 436 S.C. 289, 871 S.E.2d 608 (Ct. App. 2021), Deutsche Bank seems to argue that the only reason there that “a claim for unfair competition in a subsequent lawsuit was barred on res judicata grounds [was] because the party seeking to assert it had *actually asserted it* as a defense in an earlier action.” (Brief of Respondent p. 17 (emphasis in original).) Language from that opinion, though, belies the contention that the court there viewed compulsory counterclaims and res judicata as narrowly as Deutsche Bank does. The Court of Appeals wrote that “[p]recedent explains a litigant is barred from raising issues which were adjudicated in the former suit and

any issues which might have been raised in the former suit” and “the question of whether a claim in a later case should have been a compulsory counterclaim in a prior case is the same question as whether res judicata applies.” Encore Technology Group, 436 S.C. at 309, 310 (internal quotation marks omitted). The Encore Technology case is consistent with the result that Judge Spence reached in the instant case – but it is inconsistent with the Court of Appeals’ reasoning in reversing him. Deutsche Bank, 434 S.C. at 508-09.

Deutsche Bank cites Carrigg v. Cannon, 347 S.C. 75, 81-82, 552 S.E.2d 767, 770-71 (Ct. App. 2001), for the proposition that South Carolina courts should “decline to apply res judicata where concerns of equity, justice, and public policy override the policy aims of res judicata[.]” (Brief of Respondent p. 21 n. 12.) Carrigg, though, is not a res judicata case; rather, it is about collateral estoppel and judicial estoppel. 347 S.C. at 78-84. The language Deutsche Bank cites is expressly about exceptions to collateral estoppel, not res judicata: “Even where all the elements for collateral estoppel are met, it will not be rigidly or mechanically applied, and the application of the doctrine may be precluded where unfairness or injustice results, or public policy requires it.” Id. at 81.

Deutsche Bank also cites quite a few federal cases from various jurisdictions involving scenarios different from this one. Those cases are exactly that: non-precedential examples of what some other court in some other place has done with different facts and different law. These cases are not precedent in South Carolina state courts and have no binding effect upon this Court. Blyth v. Marcus, 335 S.C. 363, 368 n. 3, 517 S.E.2d 433 (1999) (South Carolina federal district court decision “[o]f course . . . is not binding on this Court”). That Deutsche Bank has to look so far afield for cases illustrates that the precedent in this state does not help its position. The test to be applied under this state’s law is whether in the first case there was

“any logical relationship between the claim and the counterclaim” Deutsche Bank chose not to bring. DAV Corp., 298 S.C. at 518.

VII. The claims bore a logical relationship to one another, as both law and common sense logic show.

The weight of the law and the record is against Deutsche Bank’s position that there was not “any logical relationship between” its claim and a claim that arose from common facts and had the capacity to make Deutsche Bank’s claim impossible to win. DAV Corp., 298 S.C. at 518. It seems Deutsche Bank must recognize this, as it actually goes so far as to ask this Court to ignore common sense in order to rule for Deutsche Bank. (Brief of Respondent p. 18.)

As discussed above, Deutsche Bank cannot escape that its position depends upon Bailey and Owens somehow being able to obtain a judgment in the 2013 action that the note and mortgage are unenforceable and Deutsche Bank later being able to win a foreclosure case that would necessarily determine them to be enforceable. Deutsche Bank’s (and the Court of Appeals’) “leading claim” distinction, Deutsche Bank, 434 S.C. at 508-09, does not pass logical, common-sense muster, as the relationship between any two claims is the same regardless of which is asserted by a plaintiff and which is asserted by a defendant. Neither here nor below has Deutsche Bank ever offered any example of a situation in which the relationship between any two claims is different based on which is asserted from which side of the “v.”

Further, as Deutsche Bank phrases the logical relationship test, the claims here are compulsory to one another. Deutsche Bank writes that “[u]nder this test, the logical relationship determination is made by asking whether the counterclaim would affect the plaintiff’s right to enforce its claims.” (Brief of Respondent p. 12.) Deutsche Bank’s foreclosure claim depended upon enforcement of the note and mortgage per their written terms.

See U.S. Bank. Natl. Assn. v. Bell, 385 S.C. 364, 684 S.E.2d 199, 205 (Ct. App. 2009) (elements of foreclosure action). Deutsche Bank's success on it as a counterclaim would have made it impossible for Bailey and Owens to achieve some available relief under the attorney preference claim. S.C. Code Ann. § 37-10-105(C)(1-3). The foreclosure counterclaim would have rather heavily affected Bailey and Owens' right to enforce their claim under S.C. Code Ann. § 37-10-105(C).

Despite Deutsche Bank's urging, this Court should not forgo the use of common sense. That is especially so where, as here, common sense and precedent both support a decision that reinstates the master's judgment.

CONCLUSION

The law of compulsory counterclaims and res judicata has been fairly consistent in this state since the adoption of the Rule of Civil Procedure. The aberration in the law at present is the Court of Appeals' opinion in this case. Deutsche Bank, 434 S.C. at 508-09. Deutsche Bank's foreclosure claim bore a logical relationship to Bailey and Owens' claim under S.C. Code Ann. § 37-10-105(C). The master was not wrong to conclude the foreclosure claim was compulsory in the earlier case and is now barred by res judicata. Columbia Natl. Bank, 151 S.E. at 275, 276; Beach Co., 351 S.C. at 62. The Court of Appeals was wrong to reverse him.

This Court should reverse the Court of Appeals' erroneous decision, reinstate the master's ruling, and return the law in this area to consistency with this Court's precedent.

Respectfully submitted,

/s/ Andrew S. Radeker

Andrew S. Radeker

S.C. Bar No. 73743

Harrison, Radeker & Smith, P.A.

Post Office Box 50143

Columbia, South Carolina 29250

(803) 779-2211

drew@harrisonfirm.com

Attorney for Petitioners

February 23, 2023