THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM COLLETON COUNTY
COURT OF COMMON PLEAS

The Honorable Perry M. Buckner
Circuit Court Judge

Appellate Case No. 2014-000661
Circuit Court Case No. 2013-CP-15-1023

James C. Kincannon, James J. Kincannon and Carolyn R. Kincannon, Appellants,

vs.

U.S. Bank National Association, U.S. Bank National Association ND, Palmetto Property Conservation, and Mark Brown, Defendants,

of whom

U.S. Bank National Association and U.S. Bank National Association ND are Respondents.

FINAL BRIEF OF RESPONDENTS

WOMBLE CARLYLE SANDRIDGE & RICE, LLP

Jana B. Baker
M. Todd Carroll
John C. Hawk, IV
5 Exchange Street
Post Office Box 999
Charleston, SC 29401
(843)722-3400

Attorneys for Respondents

December 29, 2014
Charleston, South Carolina

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STATEMENT OF ISSUE

After Appellants failed to make payments on a note and mortgage, U.S. Bank brought a foreclosure action that was resolved by modifying the parties' loan agreement. Appellants then brought a lawsuit against U.S. Bank, alleging claims associated with U.S. Bank's collection efforts under the loan agreement. Appellants' lawsuit was dismissed by stipulation of the parties without any reference to the parties' underlying note and mortgage. The day after dismissing their first case, Appellants filed a second lawsuit, this time seeking a declaration that res judicata rendered the parties' note and mortgage unenforceable. Judge Buckner dismissed their new claims, held that the note and mortgage remain fully enforceable, and refused to give Appellants an unjust windfall. Was Judge Buckner's decision correct?

STATEMENT OF THE CASE

This case involves Appellants' efforts to use res judicata to avoid repaying a $300,000 loan that is secured by Appellants' beach house on Edisto Island. It is before this Court on appeal from a decision by The Honorable Perry M. Buckner that the bulk of Appellants' claims fail as a matter of law, a holding that is consistent with hornbook law. The background of the case is as follows.

On February 10, 2010, two of the three Appellants—James John Todd Kincannon and James Charles Kincannon—executed a promissory note to U.S. Bank promising to repay $300,000, plus interest, over a period of thirty years. That note was secured by a mortgage on Appellants' beach house, which is owned by all three Appellants. (R. p. 59; Complaint ¶ 12.) Though there is no dispute as to the validity of the loan documents,

Appellants freely admit that they have not made payments when they were due, and they further pledge to "not make any [payments] going forward." (R. p. 62; Complaint ¶ 25.)

Appellants' failure to pay on their loan forced U.S. Bank to bring a foreclosure action, which was styled *U.S. Bank v. Kincannon*, 2012-CP-15-885, and was filed on November 9, 2012. (R. pp. 11–14; Foreclosure Complaint.) To resolve that litigation, the parties agreed to modify the terms of the loan, and their loan modification agreement was filed with the Colleton County Register of Deeds on May 2, 2013. U.S. Bank dismissed the foreclosure action without prejudice on July 18, 2013. (R. pp. 59–60; Complaint ¶¶ 14, 16.)

The day after the parties resolved U.S. Bank's foreclosure action, Appellants filed a lawsuit against U.S. Bank, which was styled *Kincannon v. U.S. Bank*, 2013-CP-15-708. In that complaint, Appellants alleged thirteen causes of action against U.S. Bank that arose out of U.S. Bank's alleged mishandling of its earlier foreclosure action. (R. p. 60; Complaint ¶ 17.) U.S. Bank denied all allegations against it and asserted no claims for relief. The parties stipulated to dismiss that case with prejudice. (R. p. 60; Complaint ¶ 20.)

The day after the parties resolved Appellants' first case, Appellants filed a second lawsuit against U.S. Bank—the one from which this appeal arose. In this case, Appellants seek a declaration that the parties' note and mortgage are unenforceable and that they are now entitled to their beach house for free. As U.S. Bank understands Appellants' theory of relief, Appellants believe that U.S. Bank should have raised "foreclosure" as a counterclaim in Appellants' first lawsuit, and the fact that U.S. Bank did not allege any counterclaims now renders the loan agreement "unenforceable because

U.S. Bank can no longer maintain an action of any type against [Appellants] for breach of the terms of the Note and Mortgage." (R. p. 63; Complaint ¶ 31.)

On November 5, 2013, U.S. Bank filed a motion to dismiss Appellants' most recent complaint pursuant to Rule 12(b)(6), SCRCP. (R. pp. 122–123; Mot. to Dismiss.) Appellants did not file anything in opposition to U.S. Bank's motion. On December 5, 2013, Judge Buckner held a hearing on U.S. Bank's motion, and he subsequently dismissed all of the Appellants' causes of action that sought to render the note and mortgage unenforceable. (R. pp. 3–7; Order (Dec. 18, 2013).)[1] On January 21, 2014, Appellants filed a motion to reconsider, which was denied by order dated February 24, 2014. (R. pp. 8–10; Order (Feb. 24, 2014).) On March 28, 2014, Appellants filed a notice of appeal of Judge Buckner's rulings.

STANDARD OF REVIEW

Rule 12(b)(6), SCRCP, tests the legal sufficiency of a complaint. Under this rule, the Court should dismiss a claim if it fails "to state facts sufficient to constitute a cause of action." *Id.* When evaluating a motion under this rule, the Court is not to read unalleged facts into the pleadings, *Overcash v. S.C. Elec. & Gas Co.*, 364 S.C. 569, 572, 614 S.E.2d 619, 620 (2005), nor need it credit the claimant's legal conclusions couched as factual allegations. *Builder Mart of Am., Inc. v. First Union Corp.*, 349 S.C. 500, 512, 63 S.E.2d 352, 358 (Ct. App. 2002). An appellate court applies the same standards as the circuit court when reviewing dismissal. *Disabato v. S.C. Ass'n of Sch. Adm'rs*, 404 S.C. 433, 441, 746 S.E.2d 329, 333 (2013).

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[1] Judge Buckner did not dismiss Appellants' final cause of action, which seeks to enjoin U.S. Bank from inspecting Appellants' beach house without first receiving Appellants' "express prior permission." (R. p. 69; Complaint ¶ 59.) That claim is not before the Court on this appeal.

ARGUMENTS AND AUTHORITIES

At its core, Appellants ask this Court to fundamentally rewrite foreclosure law in South Carolina in a way that would eliminate their $300,000 debt and award them a free beach house. Judge Buckner rightly rejected Appellants' efforts to manipulate the legal process, and his decision is consistent with established law: "[T]he ends of justice require that the doctrine of res judicata not be applied so strictly so as to prevent mortgagees from being able to challenge multiple defaults on a mortgage." 59A C.J.S. *Mortgages* § 1053. The Court should affirm the circuit court's unassailable decision.

I. A note and accompanying mortgage are not rendered unenforceable by the dismissal of a prior action where there are ongoing breaches of the loan agreement.

This is not the first time a borrower has attempted to void a loan agreement by claiming that res judicata from a prior suit bars all future efforts to enforce the note and mortgage. Not surprisingly, courts around the country have rejected such posturing.

Singleton v. Greymar Associates, 882 So.2d 1004 (Fla. 2004), is a leading example. There, a lender brought two consecutive foreclosure actions against a delinquent borrower. In the first foreclosure action, the lender alleged that the borrower defaulted on the note and mortgage by failing to make payments due from September 1, 1999, to February 1, 2000. *Id.* at 1005. The trial court dismissed the first foreclosure action with prejudice. Nevertheless, the lender brought a second foreclosure action, this time alleging failure to make payments for a separate, subsequent period from April 1, 2000 onward. *Id.* The trial court granted summary judgment in favor of the lender in the second case and specifically rejected the mortgagor's position that "the prior dismissal barred relief in the second action"—the precise argument urged by Appellants here. *Id.*

The Florida Supreme Court affirmed and agreed that the debt was not eliminated by the dismissal of the first foreclosure action, and that this outcome holds true even if a deficiency is sought or the debt was accelerated in the first lawsuit:

> While it is true that a foreclosure action and an acceleration of the balance due based upon the same default may bar a subsequent action on that default, an acceleration and foreclosure predicated upon subsequent and different defaults present a separate and distinct issue.

Id. at 1007. It rejected the notion that res judicata applies in these circumstances for a variety of reasons.

First, the court identified the "the unique nature of the mortgage obligation and the continuing obligations of the parties in that relationship" as a basis for rejecting the application of traditional res judicata principles in these circumstances. *Id.* It then explained that the equitable nature of a foreclosure action is in "some tension" with res judicata, and observed that "[t]he ends of justice require that the doctrine of res judicata not be applied so strictly so as to prevent mortgagees from being able to challenge multiple defaults on a mortgage." *Id.* at 1008.

Based on these considerations, the court concluded that "the doctrine of res judicata does not necessarily bar successive foreclosure suits, regardless of whether or not the mortgagee sought to accelerate payments on the note in the first suit." *Id.*

Other courts agree with this sound reasoning, which recognizes that each new failure to make installment payments on a note and mortgage is a new instance of default, and merits a new foreclosure action. *See, e.g.*, *Fairbank's Capital Corp. v. Milligan*, 234 F. App'x 21, 24 (3d Cir. 2007) (holding that a stipulated dismissal with prejudice of an earlier foreclosure action "cannot bar a subsequent mortgage foreclosure action based on

defaults occurring after dismissal of the first action"); *Afolabi v. Atl. Mortgage & Inv. Corp.*, 849 N.E.2d 1170, 1175 (Ind. Ct. App. 2006) (holding that "the claim preclusion part of the doctrine of res judicata does not bar successive foreclosure claims, regardless of whether or not the mortgagee sought to accelerate payments on the note in the first claim"). As the Third Circuit succinctly concluded:

> If we were to so hold [that res judicata from one case attaches so as render a loan agreement unenforceable], it would encourage a delinquent mortgagor to come to a settlement with a mortgagee on a default in order to later insulate the mortgagor from the consequences of a subsequent default. ***This is plainly nonsensical.***

Fairbank's Capital Corp., 234 F. App'x at 24 (emphasis added).

In the face of this wealth of case law, it is not surprising that Appellants cite only one case in their entire opening brief. Even that case, though, is fundamentally distinguishable from the instant matter.

In *U.S. Bank National Association v. Gullotta*, 899 N.E.2d 987, 991 (Ohio 2008) (5-3 decision), a divided court held that a lender's filing and subsequent dismissal of two separate foreclosure actions triggered an Ohio Rule of Civil Procedure that barred a third foreclosure action based on the "same note, the same mortgage, and the same default." The court properly recognized that the case's unique facts presented a legal question that "defies an answer that can apply to all cases." *Id.* at 990. And, indeed, the peculiar facts at issue in *Gullota* bear no resemblance to those presented here.

As explained above in the Statement of the Case, the parties modified their loan agreement following U.S. Bank's foreclosure action, and U.S. Bank has not filed any subsequent foreclosure actions. The *Gullotta* court specifically noted that its outcome would have been different if "the underlying agreement had significantly changed or the

mortgage had been reinstated following the earlier default." *Id.* at 992. Even as it closed its opinion, the *Gullota* court reiterated that "[h]ad there been any change as to the terms of the note or mortgage, had any payments been credited, or had the loan been reinstated, then this case would concern a different set of operative facts, and res judicata would not be in play." *Id.* at 993.[2] By its own admission, *Gullota* is distinguishable from and inapplicable to this case.

At bottom, Appellants cannot avoid their loan agreement with U.S. Bank by reliance on prior litigation between these parties. Judge Buckner correctly concluded that the note and mortgage remain enforceable following those lawsuits. Traditional res judicata principles and public policy considerations affirm this conclusion.

II. Res judicata is not to be applied mechanically, but instead is designed to serve the efficient administration of justice, which is inconsistent with Appellants' efforts to use prior litigation between the parties to gain a windfall.

Without citing any authority, Appellants argue that their entire case is "nothing but a straightforward application of res judicata." (Appellants' Br. at 7.) This is not so.

In South Carolina, "[r]es judicata may be applied if (1) the identities of the parties are the same as in the prior litigation, (2) the subject matter is the same as in the prior litigation, and (3) there was a prior adjudication of the issue by a court of competent jurisdiction." *Catawba Indian Nation v. State*, 407 S.C. 526, 538, 756 S.E.2d 900, 907 (2014). "Res judicata's fundamental purpose is to ensure that no one should be twice

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[2] Other courts have noted the limited holding of *Gullotta* and have refused to follow it as a result. *See, e.g.*, *Wells Fargo Bank, N.A. v. Vetick*, 820 N.W.2d 160, n.4 (Iowa Ct. App. 2012) (declining to follow *Gullotta* because "the Ohio ruling was based upon very unique facts and did not follow the general rule that subsequent and different defaults present a separate and distinct issue").

sued for the same cause of action." *Yelsen Land Co. v. State*, 397 S.C. 15, 22, 723 S.E.2d 592, 596 (2012) (citation and internal punctuation omitted).

In the foreclosure context, each subsequent default is treated as a new cause of action. Accordingly, a later instance of default would not be the same subject matter as an earlier foreclosure action, rendering res judicata inapplicable. This straightforward reality is a chief basis for the general rule described above in Section I that the dismissal of one case does not render a note and mortgage unenforceable. *See, e.g. Fairbank's Capital Corp.*, 234 F. App'x at 23 (explaining that the borrower "cannot take advantage of [res judicata] because [the lender's foreclosure] claim is not the same claim that was settled in the first action"); *Singleton*, 882 So. 2d at 1008 (holding that a subsequent default creates a new cause of action, and that res judicata would not "bar successive foreclosure suits, regardless of whether or not the mortgagee sought to accelerate payments on the note in the first suit"); *Afolabi*, 849 N.E.2d at 1175 ("[S]ubsequent and separate alleged defaults under the note created a new and independent right in the mortgagee to accelerate payment on the note in a subsequent foreclosure action.").

Moreover, even if strict application of res judicata could somehow render the note and mortgage unenforceable, equity should prevent such an unfair result. Importantly, this Court regularly describes the flexible nature of res judicata and explains that the doctrine should not be applied in a manner that results in unfairness to the litigants. *See, e.g., Mr. T v. Ms. T*, 378 S.C. 127, 138, 662 S.E.2d 413, 419 (Ct. App. 2008) ("[P]reclusive doctrines [such as res judicata] are not to be rigidly or mechanically applied and must on occasion, yield to more fundamental concerns. More precisely, the

application of res judicata and collateral estoppel may be precluded where unfairness or injustice results, or public policy requires it.").[3]

In this regard, South Carolina courts have been clear that the law is not to be construed in a manner that would award a party an undue windfall. *See Williamson v. U.S. Fire Ins. Co.*, 314 S.C. 215, 218, 442 S.E.2d 587, 588 (1994) (explaining that public policy does not favor windfalls); *Edwards v. Columbia, S.C., Teachers Fed. Credit Union*, 276 S.C. 89, 275 S.E.2d 879 (1981) (same). But this is precisely how Appellants view this case. They want the Court to misapply res judicata in a way that would prevent U.S. Bank from ever collecting on its $300,000 secured loan to Appellants, which would give Appellants a free beach house on Edisto Island. Such an outcome surely does not serve "the ends of justice." *Singleton*, 882 So. 2d at 1008; *see also* 59A C.J.S. *Mortgages* § 1053 ("[T]he ends of justice require that the doctrine of res judicata not be applied so strictly so as to prevent mortgagees from being able to challenge multiple defaults on a mortgage.").

In addition to disfavoring windfalls, public policy favors construing the law in a manner that promotes efficiency and fairness. Accordingly, the law should not be construed in a manner that would chill lenders from negotiating with borrowers to resolve foreclosure litigation. Indeed, the South Carolina Supreme Court has specifically ordered lenders to work with defaulting borrowers to avoid foreclosures. Administrative Order,

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[3] Further, the foreclosure of a mortgage is an action in equity. *U.S. Bank Trust Nat'l Ass'n v. Bell*, 385 S.C. 364, 373, 684 S.E.2d 199, 204 (Ct. App. 2009). As such, the action is permitted certain flexibility. *See Hooper v. Ebenezer Sr. Servs. & Rehab. Ctr.*, 386 S.C. 108, 116–17, 687 S.E.2d 29, 33 (2009) ("The equitable power of a court is not bound by cast-iron rules but exists to do fairness and is flexible and adaptable to particular exigencies so that relief will be granted when, in view of all the circumstances, to deny it would permit one party to suffer a gross wrong at the hands of the other.").

RE: Mortgage Foreclosure Actions, 2011-05-02-01 (S.C. Sup. Ct.). It would entirely undercut the policies driving that directive if lenders inadvertently exposed themselves to a res judicata-type argument or otherwise rendered their loan agreements and mortgages unenforceable simply by resolving and dismissing foreclosure actions. *See Gullotta*, 899 N.E.2d at 997 (O'Donnell, J., dissenting) (explaining that barring foreclosure actions based on res judicata "will work against Ohio homeowners because mortgagees will have little incentive to resolve defaults with distressed mortgagors").

In short, Judge Buckner rightly declined to apply res judicata here because this case does not meet the elements of that doctrine. Even if it did, the Court should not apply res judicata in a manner that would reward Appellants' procedural jockeying or that would create a disincentive for lenders to work with borrowers to resolve litigation. The lower court's decision should be affirmed accordingly.

CONCLUSION

Because the circuit court's order is consistent with the law that dismissal of litigation between a borrower and a lender does not render a loan agreement and mortgage unenforceable, U.S. Bank respectfully submits that the circuit court's ruling should be affirmed.

WOMBLE CARLYLE SANDRIDGE & RICE, LLP

By: _____

Jana B. Baker
M. Todd Carroll
John C. Hawk, IV
5 Exchange Street
Charleston, SC 29401
Attorneys for Respondents

December 29, 2014
Charleston, South Carolina

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CERTIFICATE OF COUNSEL

The undersigned certify that this Final Brief complies with Rule 211(b), SCACR.

WOMBLE CARLYLE SANDRIDGE & RICE, LLP

By: _____

Jana B. Baker
M. Todd Carroll
John C. Hawk, IV
5 Exchange Street
Charleston, SC 29401

Attorneys for Respondents

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PROOF OF SERVICE

I do hereby certify that on December 29, 2014, I served the Final Brief of Respondents on Appellants by depositing a copy of the same in the United States Mail, postage prepaid, addressed to:

J. Todd Kincannon, Esq.
The Kincannon Firm
Post Office Box 7901
Columbia, SC 29202
Attorney for Appellants

Edwin T. Mathis

December 29, 2014