THE STATE OF SOUTH CAROLINA

In The Court of Appeals

Appellate Case No. 2013-001483

First National Bank of the South, Successor in interest to Carolina National Bank and Trust Company,
Respondent,

v.

James T. Callihan a/k/a James Callihan; Edward L. Williams; Frank J. Pennisi a/k/a Frank Pennisi; Dean J. Karavan a/k/a D.J. Karavan; Charles T. Walls, Jr. a/k/a Charles Walls; Robert S. Guyton; and Jeffrey H. Skelley,
Defendants,

Of whom Frank J. Pennisi and Charles T. Walls are the Appellants

MEMORANDUM IN SUPPORT OF APPELLANTS' PETITION FOR REHEARING EN BANC

This matter is pending before the Court on the Appellants' Petition for Rehearing En Banc from the Opinion of the Court of Appeals filed March 11, 2015, in which this Court affirmed the trial court's order of June 28, 2013. Citations to documents or other evidence refer to the Record on Appeal previously filed.

1. **The Evidence Demonstrates a Legal Change in the Relationship between Appellants and Respondent.**

Appellants Frank J. Pennisi and Charles T. Walls were participants and members of Sand Dollar Cottages, LLC ("Company"). The Company borrowed $400,000.00 from Carolina National Bank ("CNB") and with this money it sought to purchase a small house on a pier in the Abaco Islands. It was necessary in order for that purchase to take place that the property be titled in someone's name and the group decided to title that property in the name of Carolyn Pennisi, wife of Frank J. Pennisi, and give her responsibilities as trustee over the property.

Thereafter, the bank insisted on additional funding. Appellants conversed with the bank's representatives, conversed with the other members of Sand Dollar, LLC and agreed to put up together approximately $100,000 to reduce the principal balance due on the loan, with Pennisi putting up Sixty-Six Thousand Four and no/100 ($66,400.00) Dollars and Walls putting up Thirty-Three Thousand Three Hundred Sixty and no/100 ($33,360.00) Dollars. [R.p. 139, lines 18-24; p. 159, lines 2- p. 160, line 2; p. 175, line 7-24]

There were additional conversations with representatives of the bank, there was e-mail communication confirming Mr. Pennisi's testimony at trial that the bank was aware of the fact that Pennisi considered himself to no longer be a guarantor on the note creating an equitable and legal circumstance which should have released Mr. Pennisi and Mr. Walls based on the payment of funds and the written communication with the bank (though not a writing which was signed by all parties). . [R.p. 123, line 22 - p. 124, line 12; p. 159, line 2 – p. 160, line 2; p. 162, line 2 – p. 164, line 25; p. 175, line 7 – p. 177, line 12].

The Court sets forth the general principal that a guarantee is a contract and is to be construed by the principal's governing contracts and that an action to construe a contract is an action at law and certainly this is the case throughout South Carolina and is well settled law. However, there is every indication based on the testimony at trial that the parties understood there to be a different arrangement with Mr. Pennisi going forward. The case of *Adams v. B & D, Inc.*, 297 S.C. 416, 419, 377 S.E.2d 315, 317 (1989) would stand for the proposition that with Mr. Pennisi's testimony having not been contradicted by any bank representative or witness on behalf of the bank that the novation or change in the arrangement based on the payment by Appellants was valid and was an effective amendment, a legal change in the contractual relationship between the parties. Further, it is true that Mr. Pennisi had the burden to so prove the change but having testified to it without contradiction and having produced an e-mail referring to the "guarantors"

and not including Mr. Pennisi, Mr. Pennisi met his burden and under the cases as cited by the Court established an amendment to the original contract. There is no dispute that 1) Mr. Pennisi had this conversation with representatives of the bank; 2) that he and Mr. Walls paid approximately $100,000 to the bank; and 3) that an e-mail confirming at least in part or tending to confirm his testimony was introduced into evidence at the trial without contradiction.

Appellants seek this Court's rehearing and reconsideration that the legal relationship between Appellants changed and they were released from their obligations in return for their payment to the bank.

2. **The Appellants' obligations as guarantors of the Original Note were satisfied or extinguished by the Second and/or Third Notes when each such subsequent note reflects the lender issued a single advance received by the borrower thus creating new and different obligations for which Appellants gave no new guaranty.**

The Second and Third Notes reflect new agreements between the lender and borrower. While Respondent disputes there was a new agreement extinguishing the debt of the Original Note, the loan documents show otherwise.

As evidenced by the Original Note, the Company borrowed $400,000 from CNB. [R.p.210]. Appellants guaranteed this loan. [R.p.216-229]. Subsequently, the lender and borrower entered into a new agreements, the terms of which are contained in the Second Note. [R.p. 212-213]. The plain language of the Second Note shows this transaction included a "Single Advance" of $400,000 and the parties agreed the Company would "receive" that sum on the date of the note, December 21, 2007. [Id.].

The Court's Opinion does not specifically address the effect of the new advances. Appellants submit that while the Company did not physically receive another $400,000 in 2007, the advance and receipt of that money had the effect of extinguishing the debt of the Original Note. This is true because, if the new advance of the Second Note was not paid directly to the Company,

which would have increased its debt to $800,000, the newly advanced funds had to be received and accounted for somehow, and the evidence taken as a whole reflects that the new funds acted to extinguish the debt of the Original Note. The same holds true of the Third Note, whereby after Appellants paid Respondent $100,000, the Respondent loaned the Company $300,000 by issuing a "Single Advance" of the same amount that the Company would "receive" effective April 30, 2008. [R.p. 214-215].

The bank documents reflect that the borrower's prior obligations were extinguished and new obligations were created.

> "A novation may be accomplished in three ways: (1) By the substitution of a new obligation between the same parties, with intent to extinguish the old obligation; (2) By the substitution of a new debtor in the place of the old one, with intent to release the latter; (3) By the substitution of a new creditor in the place of an old one, with intent to transfer the rights of the latter to the former." *Moore v. Weinberg*, 373 S.C. 209 (S.C.App. 2007).

In this case, the Second Note reflects the lender agreed to "advance" and the borrower agreed to "receive" $400,000, and this new advance shows the parties' agreement to substitute a new obligation in place of the existing one. Further, the Third Note reflects that a new creditor, Respondent, was substituted in the place of the old one, CNB, with the alleged intent to transfer the rights of CNB to Respondent. Indeed, the Third Note shows Respondent as the lender on the loan designated by CNB's loan number. These new obligations are buttressed by the fact that Appellants paid Respondent $100,000 before Respondent entered into the new agreement set forth in the Third Note.

Appellants did not guaranty the new obligations created by the Second and Third Notes and therefore Appellants seek rehearing and review and a finding that reverses the trial court order in this regard.

3. **Whether the Appellants' obligations as guarantors of the Original Note were discharged under the general law of suretyship and guaranty due to the modifications found in the Second and Third Notes.**

The Court's Opinion does not specifically address the effect of the general law of suretyship and guaranty in this case. S.C. Code 36-3-605 sets forth standards for when a guarantor can be discharged from their obligations on negotiable instruments and parallel modern interpretations of the law of suretyship and guaranty that apply to guarantors not a party to negotiable instruments. Official Comment #1 to S.C. Code 36-3-605; *Restatement of the Law, Third, Suretyship and Guaranty* (1996).

Appellants contend that the general law of suretyship and guaranty support a discharge of their guarantor obligations due to the time extensions and losses they suffered.

> "If the obligee [bank] grants the principal obligor [borrower] an extension of the time for performance of its duties pursuant to the underlying obligation... (b) to the extent that the secondary obligor [guarantor] has not performed its duties pursuant the secondary obligation, it is discharged from those duties to the extent that the extension would otherwise cause the secondary obligor a loss." .Section 40 of *The Restatement of the Law–Security, Suretyship and Guaranty* There is no dispute that the Second and Third Note, to the extent they do not create new obligations that extinguish prior obligations, extended the time for performance by the borrower. Section 40 of *The Restatement of the Law–Security, Suretyship and Guaranty*

Appellants also suffered a loss as a result, as they paid the $100,000 to be relieved of any further obligations and testified they would have never paid that money but for securing their release from the debt. In this regard, they were told by the bank that the bank would be "satisfied" and the Appellants would be released and "free" from their guaranty obligations upon said payment. Appellants' losses translate into an unfair benefit to the creditor and co-guarantors, as Appellants paid money as a condition of the bank extending the time for performance but for which they did not receive the benefit they were promised.

Appellants further contend that the general law of suretyship and guaranty support a discharge of their guarantor obligations due to the changes of the borrower's underlying obligations.

> "If the principal obligor and the obligee agree to a modification, other than an extension of time or a complete or partial release, of the principal obligor's duties pursuant to the underlying obligations: ...(b) the secondary obligor is discharged from any unperformed duties pursuant to the secondary obligation: (i) if the modification creates a substituted contract or imposes risks on the secondary obligor fundamentally different from those imposed pursuant to the transaction prior to modification; (ii) in other cases, to the extent that the modification would otherwise cause the secondary obligator a loss". Section 41 of *The Restatement of the Law–Security, Suretyship and Guaranty.*

The series of loan transactions in this case meet this ground for discharge. First, the Second and Third Notes should be deemed substituted contracts as discussed above since there were new "advances" which were "received" by the borrower. Moreover, Appellants suffered a loss, as described above. As such, Appellants' obligations as guarantors should be discharged as set forth above, and the Trial Court's decision should be reversed.

CONCLUSION

For the above reasons, Appellants seek rehearing and a finding that the trial court erred and its decision should be reversed.

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