

THE STATE OF SOUTH CAROLINA
In the Supreme Court

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APPEAL FROM GEORGETOWN COUNTY
Court of Common Pleas

MAY 26 2015

The Honorable Joe M. Crosby, Master-In-Equity **S.C. Supreme Court**

Case No. 2011-CP-22-00180
Appellate Case No. **2015-06/125**

Kennedy Funding, Inc. as predecessor-in-interest, and BNP Paribas Respondents,

v.

Pawleys Island North, LLC, Will Darwin Wheeler, Peggy Wheeler-Cribb, and
J. Mars Sapp, Defendants,
of whom Pawleys Island North, LLC, Will Darwin Wheeler and Peggy Wheeler-
Cribb are Respondents and

J. Mars Sapp is the Petitioner .

PETITION FOR WRIT OF CERTIORARI

Paul H. Hoefler
Thomas W. Bunch, II
Daniel T. Brailsford
ROBINSON, MCFADDEN & MOORE P.C.
Post Office Box 944
Columbia, SC 29202
(803)779-8900
Counsel for Petitioner

Other Counsel of Record:

Robert H. Jordan
Merritt G. Abney
Nelson Mullins Riley & Scarborough LLP
Post Office Box 1806
Charleston, SC 29401
(843) 854-5200

Robert H. Gwin, III
Gwin Law Office, LLC
5001 N. Kings Highway
Suite 210 Rainbow Harbor
Myrtle Beach, SC 29577
(843) 839-2239

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INTRODUCTION

Petitioner, Appellant below, J. Mars Sapp respectfully moves for a review of the final decision of the Court of Appeals in this matter (the Decision) because the Decision is in direct conflict with the binding precedent of the Supreme Court, thereby denying Mr. Sapp the ability to satisfy a judgment against an insolvent debtor. In this equity case neither the trial court nor the Court of Appeals properly focused on the overwhelming equities of the case favoring a defrauded innocent creditor whose collection rights will be denied by a lender taking a mortgage on fraudulently conveyed property where the lender had full knowledge of the facts constituting the fraudulent conveyance. The facts which would bring this case squarely within the scope of the Supreme Court’s previous decision are uncontroverted, and the only distinctions employed by the Court of Appeals to avoid following this Court’s binding precedent are without substance.

QUESTION PRESENTED

WHERE A CREDITOR SUES A DEBTOR FOR COLLECTION, AND THE DEBTOR THEREAFTER MAKES A FRAUDULENT CONVEYANCE TO A FAMILY OWNED LLC (THE FRAUDULENT GRANTEE), CAN THE FRAUDULENT GRANTEE CONVEY A MORTGAGE ON THAT PROPERTY, WHICH IS SUPERIOR TO THE CREDITOR'S JUDGMENT, EVEN THOUGH THE MORTGAGEE INSTIGATED THE FRAUDULENT TRANSFER AND TOOK THE MORTGAGE WITH KNOWLEDGE OF THE CREDITOR'S SUIT?

STATEMENT OF THE CASE

FACTUAL BACKGROUND

Sapp sued Will Darwin Wheeler in September 2008 for breach of a lease guaranty. (Appx. p. 764). At that time, Wheeler owned two parcels of beachfront property on Pawley's Island (collectively, the "Property"). Thereafter, Wheeler entered negotiations with Kennedy Funding, Inc. about obtaining a loan to be secured by a mortgage on the Property. As part of those negotiations, Kennedy required that the Property be transferred out of Wheeler's name into the name of Defendant Pawleys Island North, LLC ("Pawleys"), a newly formed company of which Wheeler was the 99% owner. (Appx. p. 661, ll. 4-9, Deposition of Wolfer, Kennedy's President and CEO). While the Sapp/Wheeler litigation was still pending, on 28 April 2009, Wheeler quitclaimed the Property to Pawleys for five dollars. (Appx. p. 758).

Two days after the conveyance from Wheeler to Pawleys, Kennedy made a loan to Pawleys and took a mortgage on the Property. Prior to the conveyance of the Property and prior to closing the loan, Kennedy knew of Sapp's pending suit against Wheeler (Appx. p. 200, line 21-p. 207, line 20; and Kennedy's Trial Exs. 1, 4, and 5, (Appx. pp. 513, 514, 533-545, and 547). Kennedy knew that Wheeler had owned the Property solely in his name (Appx. p. 197, line 15-p. 200, line 17; and Kennedy Trial Ex. 2, Appx. p. 529).

Kennedy knew that Wheeler was the 99% owner of Pawleys (Appx. p. 191, line. 6-p. 193, line 9); and Kennedy Trial Ex. 1, Appx. pp. 400–403, 440, 247). Further, when Kennedy took its mortgage on the Property, which appraised for \$1,920,000.00, Kennedy knew that Wheeler had no income with which to repay the loan, and it was solely looking to the value of the Property for payment of the loan (Appx. p. 196, lines 17-24).

On these facts, Kennedy’s counsel, concerned about the litigation and its impact on the loan, twice asked Wheeler’s counsel for an explanation of the litigation, but got none. (Appx. p. 207, lines. 9–20). Ultimately, Kennedy decided a possible fraudulent conveyance did not matter as long as Kennedy obtained a title opinion on the lots and title insurance (Appx. p. 204, lines 5–13, and p. 219, line 19–p. 216, line 5), and Kennedy proceeded with the loan and mortgage transaction. After a jury trial in June 2010, Sapp secured a money judgment against Wheeler. Because of the fraudulent conveyance and Kennedy’s mortgage made with full knowledge of the facts giving rise to the fraudulent conveyance, this judgment has proven uncollectible. (Appx. pp. 794, 795, *nulla bona* return).

A summary chart of the above, without record references, is as follows:

| Date | Transaction |
|------------------------|---|
| September 2008 | Sapp sues Wheeler for breach of a lease guaranty |
| Prior to 28 April 2009 | Wheeler loan negotiations with Kennedy. |
| Prior to 28 April 2009 | Kennedy learns that Sapp is suing Wheeler to collect on a lease guaranty. As a precondition of the loan, Kennedy requires that Wheeler convey the property out of his name. |
| 28 April 2009 | Wheeler transfers the Property to Pawleys by quitclaim deed for \$5.00 |

| | |
|---------------|---|
| 30 April 2009 | Loan closing/mortgage transaction between Kennedy and Pawleys (note and mortgage executed 28 April) |
| June 2010 | Georgetown County jury awards Sapp judgment against Wheeler |
| April 2011 | Georgetown County Sheriff returns execution, <i>nulla bona</i> |

HISTORY OF THE LITIGATION

This litigation began when the loan from Kennedy to Pawley's went into default and Kennedy filed an action, on 9 February 2011, to foreclose on the Property. Sapp was made a defendant by virtue of his judgment against Wheeler. Sapp responded and alleged that the conveyance from Wheeler to Pawley's was fraudulent and that his judgment lien had priority to Kennedy's mortgage. The master ruled that the conveyance was not fraudulent, Kennedy's mortgage was superior, and that the Property should be sold in foreclosure to satisfy Pawley's indebtedness to Kennedy. This appeal followed. (A more detailed history of the litigation with dates and references, is reflected at pages 2-4 of the Brief of Appellant). (Appx. 823-825).

The Court of Appeals' Decision reversed the Master, in part, by holding that the transfer of the Property from Wheeler to Pawley's was indeed fraudulent. No exception was taken to this holding. The Decision also held that the mortgage from Pawleys to Kennedy was not itself a fraudulent conveyance. That portion of the Decision, that the mortgage itself was not fraudulent, is not relevant the Question presented for review. However, the Court of Appeals held -- notwithstanding Kennedy's extensive knowledge of, and even involvement in, the fraudulent conveyance from Wheeler to the mortgagor Pawley's -- that Kennedy's mortgage still had priority over Sapp's judgment against the

fraudulent transferor, Wheeler. It is this last aspect of the Decision which the Court is requested to review.

ARGUMENT

ULTIMATE EFFECT OF THIS COURT'S DETERMINATION

The Court's action on this petition will determine if a judgment creditor is left with no remedy after a debtor fraudulently transferred unencumbered property (thereby leaving the debtor insolvent) to a fraudulent grantee, which then gave a mortgage on the property for new money to a lender who had actual knowledge of both the judgment creditor's claim and the badges of fraud connected with the debtor's fraudulent transfer of his property.

THE DECISION OF THE COURT OF APPEALS IS IN CONFLICT WITH A PRIOR DECISION OF THIS COURT

In *Coleman v. Daniel*, 261 S.C. 198, 199 S.E.2d 74 (1973), after acquiring property in a fraudulent transfer, the fraudulent grantees (the Daniels) borrowed \$32,000 from an unidentified financial institution, which will be referred to herein as "New Lender." New Lender paid off an existing \$29,000 mortgage on the fraudulently conveyed property, and recorded a new mortgage executed by the fraudulent grantees. After the execution and recording of New Lender's mortgage in 1964, Coleman secured judgments in May 1966 against the Daniels' fraudulent grantor. The fraudulent grantor's indebtedness to Coleman had arisen prior to New Lender's loan and mortgage recording.

The material fact pattern in *Coleman* is identical to the fact pattern of the case now before this Court. The Supreme Court held that the conveyance to the Daniels was void as to the creditor (Coleman), that the property was subject to Coleman's later-filed judgments, and that Coleman could seek an order of the lower court for sale of the property in satisfaction of his judgments.

Further, unlike the instant matter, in *Coleman* there was no finding that New Lender knew or was on notice of the fraudulent conveyance. Nevertheless, by finding the transfer void as to Coleman, the Supreme Court subordinated New Lender's mortgage to Coleman's rights as judgment creditor. In the instant matter, Kennedy's knowledge of the badges of fraud -- which are uncontroverted in the record -- are even more compelling, and make the Decision even more flawed in light of the *Coleman* precedent.

Although the Decision properly relied on *Coleman* in making the determination that the conveyance by Wheeler to Pawleys was fraudulent, the Decision then mistakenly attempted to distinguish the facts of *Coleman* and *Coleman's* impact on the priority that should have been accorded Sapp's judgment. In an effort to distinguish *Coleman* from the case before it, the court was able to cite only one factor:

Sapp also cites to *Coleman v. Daniel*, 261 S.C. 198, 199 S.E.2d 74 (1973), and *Messervy v. Barelli*, 11 S.C. Eq. (2 Hill Eq.) 576 (1837). Each of these cases involves transactions between close friends or family. Whereas here, the transfer was between an LLC and a corporation.

Legally, the above distinction is illusory as the distinction between an individual mortgagor and legal entity as a mortgagor is of no consequence. This distinction, the only one specifically related to *Coleman*, is surely one without a difference, judicially or factually, since a corporate entity in South Carolina is a legal person for the purpose of all legal rights and remedies. S. C. Code Ann. 33-3-102 (1976). Under *Coleman*, neither a corporation nor an individual could give a mortgage enforceable against a defrauded creditor, and certainly neither could give one under the facts of this case, where the mortgagee had knowledge of the fraud. Moreover, in this case as in *Coleman*, the parties

to the lien-priority litigation itself were an individual defrauded creditor and a corporate lender.

While the facts in the two cases are substantially identical, the equities favoring the rights of the good faith judgment creditor (Sapp) are stronger in the present case than they were in *Coleman*. In the present case, Kennedy required the transfer of property, had full knowledge of the fraudulent grantor's (Wheeler's) debt owed to Sapp, and had full knowledge of all the facts giving rise to the fraudulent conveyance. Kennedy was either going to be repaid the \$775,000 it advanced by Pawley's selling the Property, or Kennedy was going to foreclose and own beachfront property at Pawley's Island valued at almost \$2 million.

As has been stated, the question presented assumes only uncontested facts. Indeed, the Decision affirms no findings of the Master and makes none of its own (except to specifically find that there was no legitimate reason for the transfer from Wheeler to Pawleys). All of the facts which are necessary for this court to address the question presented are uncontested, as is the evidence establishing Kennedy's complicity in the fraudulent transfer and knowledge of the facts of the fraudulent transfer.

The Decision ultimately determined not to follow *Coleman*. In its erroneous conclusion to deny Sapp priority, the Decision based this holding on the irrelevant finding that the "[mortgage] from Pawleys to Kennedy was not a fraudulent transaction" or conveyance. Decision, Parts II and III. Under *Coleman* there was no finding that New Lender's mortgage was fraudulent, but this Court provided for sale of the property to satisfy the defrauded creditor's claim.

In reaching the irrelevant conclusion that the Kennedy mortgage was not a fraudulent transaction, the Decision referred to certain arguments made by Kennedy's counsel. To the extent that this court might deem them relevant these matters are discussed herein. Some of the legal points discussed, but not explicitly ruled upon in the Decision, include the concept of a good faith purchaser for value without notice (which is partially and referred to in the Decision as a good faith purchaser for value, omitting the notice obligation of the legal concept), the case of *Atlas Supply Co. v. Davis*, 273 S.C. 392, 256 S.E.2d 859 (1979), the possible need for filing of a *lis pendens*, a partially quoted statement in an opinion letter from borrower's counsel, and a statement from Kennedy that it would not have closed the loan if it knew the Property was encumbered..

In Part II of the Decision where the Court of Appeals determines that the mortgage was not a fraudulent transaction, the panel partially refers to a legal concept of a "good faith purchaser for value." The Decision misapprehended this concept, and the misapprehended application of the law could have improperly impacted the rationale of the panel of the Court of Appeals.

The partial legal concept, as stated in the Decision, overlooked Kennedy's actual knowledge of facts which put it **on notice** of the fraudulent conveyance. The case of *Kirton v. Howard*, 137 S.C. 11, 134 S.E. 859, 868 (1926), demonstrates how the Decision misapplied this legal concept. *Kirton* sets out the three elements that one must meet in order to be deemed a purchaser for value, *none* of which were met by Kennedy. To qualify as a good faith purchaser for value **without notice**, Kennedy must: (1) not have had notice of the debt to Sapp and the pending lawsuit before paying the purchase price; (but it did)

(2) must not have had notice before acquiring the mortgage; (but it did) and therefore; (3) must have purchased “bona fide without notice.” (but it did not).

Another legal concept and distinction upon which the Decision may have relied was the case of *Atlas Supply Co. v. Davis*, 273 S.C. 392, 256 S.E.2d 859 (1979). *Atlas Supply*, however, only addresses a lien priority question under the Recording Act, S.C. Code Ann. 27-23-10(A) (1976). The Question before this Court is not based upon the Recording Act; but rather on the Statute of Elizabeth, which creates, in effect, an exception to the Recording Act. There is no dispute about the order or nature of the recordings which relate to the Question herein, but the Recording Act is not applicable. To so apply *Atlas* and the Recording Act would nullify the Statute of Elizabeth, and would conflict with *Leasing Enterprises, Inc. v. Livingston*, 294 S.C. 204, 363 S.E.2d 410 (Ct. App. 1987.) If *Atlas* be blindly applied in fraudulent conveyance cases, a creditor who secures his judgment (which is always based on an antecedent debt) after the fraudulent conveyance would never have a remedy.

In *Leasing Enterprises* a judgment creditor (“LEI”) brought an action to attack as fraudulent a conveyance of real property from a judgment debtor (“Livingston”) to his mother (Margaret Schlee). The Court stated:

Section 30-7-10, Code of Laws of South Carolina, 1976, is the recording statute. If this deed was acceptable for recording, Leasing’s judgment would not have priority over Schlee under the current recording statute **unless Leasing shows the deed is a fraudulent conveyance.**

Id. at 207, S.E.2d at 411. (emphasis added)

After a discussion of *Atlas*, the Court further stated:

Our reading of the current statute indicates the recording act is a race-notice act which will provide protection to the subsequent purchaser or creditor provided he records first. Therefore, even though Leasing had no actual or constructive notice

of the deed between Livingston and Schlee when the Lease Purchase agreement was made and was a subsequent creditor of Livingston, it has no protection under the recording statute **unless . . . Leasing can demonstrate a fraudulent conveyance.**

Id. at 208, S.E.2d at 412. (emphasis added)

Atlas is further not applicable here because of Kennedy's knowledge of the facts of the fraudulent conveyance, and Wheeler's indebtedness to Sapp. As a matter of equity Kennedy's lien cannot take priority and it must be subordinated to Sapp's judgment lien. This distinction was elucidated by the court in the equitable subordination case of *Regions Bank v. Wingard Properties, Inc.*, 394 S.C. 241, 715 S.E.2d 348 (Ct. App. 2011). Regions Bank made a construction loan to Wingard secured by a recorded mortgage on three lots. At the time of the loan and mortgage, Regions knew that Covington had given Wingard a \$276,700 down payment to purchase one of the lots. There was no public recording of the purchase agreement showing Covington had any interest in the lot. Nevertheless, based upon Regions' knowledge of the down payment, the court found that Covington's unrecorded interest in the property had priority over Regions' recorded mortgage. Here, Kennedy had knowledge of Wheeler's indebtedness to Sapp and Sapp's unrecorded interest in the Property.

The third possible legal distinction mentioned in the Decision is that Sapp did not file a *lis pendens* on the property before securing his money judgment against Wheeler for defaulting on the lease guaranty. Although this is an accurate statement of the facts, if relied upon by the Court of Appeals, it would have been an improper application of law relating to filing a *lis pendens* and Kennedy's actual knowledge of Sapp's suit. The filing of a *lis pendens* is not appropriate for an action simply seeking money damages. *Carolina Park Associates, LLC v. Marino*, 400 S.C. 1, 732 S.E.2d 876 (2012). Thus, Sapp could not

have filed a *lis pendens*. Moreover, the filing of a *lis pendens* -- even in a proper case -- is designed to put parties on notice. Here, Kennedy was on notice of Sapp's claim. The notice of Sapp's equity in the Property came to a head when Sapp secured his judgment which then required Kennedy to include Sapp as a party to its foreclosure case. Thus, the filing of a *lis pendens* by Sapp would have made no difference to Kennedy as Kennedy determined to move forward with the loan despite its actual knowledge of Sapp's pending claim.

A fourth possible legal distinction mentioned in the Decision is the quotation taken Pawleys' counsel's opinion letter to Kennedy to the effect that "[t]here is no action, suit, (etc.) . . . against the borrower or the guarantors . . . or any of the Borrower's or Guarantors' properties or rights. . . ." The relevant remainder of the quoted sentence reads, "which, if determined adversely to the borrower or the guarantors, would impair or materially affect . . . (iv) the validity or enforceability of . . . the Loan Documents [*e.g.*, the mortgage given to Kennedy]" (Appx. pp. 490, 491)

The partial quotation immediately follows the Decision's *lis pendens* discussion. However, just as the *lis pendens* discussion would be an erroneous basis for the Decision, Kennedy had actual knowledge of Sapp's pending suit. The purported opinion expressed by Pawleys counsel in the quotation is plainly incorrect based on the Question in this Petition and as shown by Kennedy later including Sapp in the foreclosure case because of Sapp's actual interest in the Property.¹

¹ Notably, even if the opinion had been correct based on an examination of the record title made by counsel, Kennedy would have had no right to rely upon that counsel's opinion when Kennedy had actual notice of Sapp's outstanding equity in the Property. *Brunson v. Sports*, 239 S.C. 58, 121 S.E.2d 294 (1961). Further, though Sapp's judgment was entered after the recording of the mortgage, Sapp's interest in the Property dated back to the inception of the debt, and Sapp's later procured judgment would have priority over

After discussing the *lis pendens* and the opinion letter, the Decision then cites the testimony of Kennedy that it would not have closed the loan if there were encumbrances on the property. Although not specifically making any findings on these three concepts, after advertng to them, the Decision reached the conclusion that “the transfer from Pawleys to Kennedy was not a fraudulent transaction” - - the erroneous basis upon which the Decision accorded Kennedy priority.

The Decision’s mistaken holding defeating Sapp’s priority was legal error because it has no bearing on the priority of Kennedy’s and Sapp’s interest and the Question presented. Once having correctly determined that the conveyance to Pawley’s was fraudulent, the granting of the mortgage by Pawleys was void as to Sapp under the Statute of Elizabeth. The Question presented is the effect of Sapp’s pending suit, once determined adversely to the fraudulent grantor, in light of the mortgagee’s knowledge and complicity in the fraudulent transfer in question. The Question presented is based on the uncontroverted facts in the record.

Even though no *lis pendens* was filed, even though Kennedy purportedly relied upon an opinion letter of counsel (despite not having a legal right to do so), and even though Kennedy testified it would not have made the loan with an encumbrance on the property, those arguments cannot be grounds upon which Sapp could lose his collection remedy to sell the Property in satisfaction of his judgment, the remedy ordered in *Coleman*.

Kennedy’s interest in the Property. *See, e.g., Matthews v. Montgomery*, 193 S.C. 118, 7 S.E.2d 841 (1940) (judgment creditor stated a cause of action to set aside deed procured by downstream purchaser from a fraudulent grantee where downstream purchaser was on notice of the fraudulent transfer which led to his title).

CONCLUSION

This case began in a court of equity, and it has been said, “The law follows justice.” The Statute of Elizabeth recognizes that justice favors the payment of honest debts, and that sham conveyances to avoid them must not be sanctioned. Thus came the principle that fraudulent conveyances are void as to existing creditors.

This Court faithfully applied that principle in the case of *Coleman v. Daniel*, although to do so required choosing between the interests of two innocent parties. There is no such requirement here. This is an aggravated case of conveyance fraud in which the subsequent mortgagee, Kennedy, actually required the fraudulent conveyance as a precondition of the loan.

And yet the Court of Appeals rejected this Court’s decision in *Coleman*, rewarded a lender who had instigated the fraudulent conveyance of the mortgaged Property, protected the fraudulent grantor who had guaranteed the loan, and thus denied justice to the only innocent party in the dispute.

It is respectfully submitted that additional review of this case is warranted as substantial justice has been denied.

Respectfully submitted,

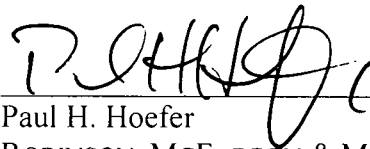


Paul H. Hofer
Thomas W. Bunch, II
Daniel T. Brailsford
ROBINSON, MCFADDEN & MOORE P.C.
Post Office Box 944
Columbia, SC 29202
(803)779-8900

Counsel for Petitioner

CERTIFICATE OF COUNSEL

Counsel for Petitioner certifies that the Petition for Rehearing was filed and finally ruled on by the Court of Appeals on April 24, 2015. The Petition is being filed and served on 26 May 2015 and within the 30 day requirement of Rule 242(c), SCACR, 26 May being the first business day coming after 30 actual days.



Paul H. Hoefler
ROBINSON, MCFADDEN & MOORE P.C.
Post Office Box 944
Columbia, SC 29202
(803)779-8900

Counsel for Petitioner

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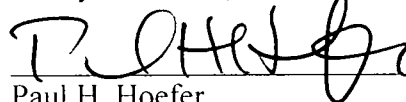
J. Mars Sapp is the Petitioner

PROOF OF SERVICE

I certify that I have filed the Petition for Writ of Certiorari and Appendix and served
opposing counsel by depositing a copy in the United States Mail, postage prepaid, on **May 26,**
2015 addressed as follows:

Robert H. Jordan, Esquire
Nelson Mullins Riley & Scarborough, LLC
Post Office Box 1806
Charleston, SC 29401

Robert H. Gwinn, III, Esquire
Gwinn Law Office, LLC
5001 N. Kings Highway
Suite 210 Rainbow Harbor
Myrtle Beach, SC 29577



Paul H. Hoefler
Thomas W. Bunch, II
Daniel T. Brailsford
ROBINSON, MCFADDEN & MOORE, P.C.
Post Office Box 944
Columbia, SC 29202
(803) 779-8900
Attorneys for Petitioner