THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM RICHLAND COUNTY
Master-in-Equity

Hon. Joseph M. Strickland, Master-in-Equity

Case No. 2015-001807

Winrose Homeowners' Association, Inc and Regime Solutions, LLC.....Respondents,

v.

Devery A. Hale and Tina T. Hale .....Appellants.

FINAL REPLY BRIEF OF APPELLANTS

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I. THERE ARE IMPORTANT DIFFERENCES BETWEEN A FORCOSURE OF A HOMEOWNERS' ASSOCIATION LIEN AND A FORECLOSURE OF A MORTGAGE.

Respondent Winrose Homeowners' Association, Inc. (Winrose) argues that Appellants have not shown how a homeowners' association (HOA) foreclosure is fundamentally different than any other foreclosure. In a typical HOA foreclosure fact pattern, the owner has a first and/or second mortgage, which may or may not be in default and/or in active foreclosure. The owners of these homes appear in court and routinely complain that the attorney fees are more than the amount owed to the association and that they are bewildered that they can be current on their mortgage, yet be foreclosed for a homeowners' association lien, evicted from their home, and lose all their equity. The owner learns that the property was bought pursuant to Covenants, Restrictions, and Bylaws that allow for foreclosure and eviction, and that attorney fees, if authorized by covenants and deemed reasonable by court review, can be greater than the amount of the debt to the association.

A HOA foreclosing its lien is a similar situation to a second mortgage foreclosing subject to a first mortgage ahead of the homeowners' association lien. A second mortgage has an advantage in that it made its business decision to lend money on knowledge that the first mortgage amount was based on the fair market value of the property. Purchasers of the property at the foreclosure sale will then take the property "subject to" any other encumbrance not extinguished by the foreclosure.

It is critical to understand the difference between "assuming" a senior mortgage and taking "subject to" a senior mortgage. The "assumption of mortgage" is defined as

"[t]he acquisition of real property coupled with the assumption of personal liability for debt secured by that property." Black's Law Dictionary (10th ed. 2014). Thus a purchaser may assume or take over the mortgage of the seller. Often this requires permission of the mortgagee. This is distinguishable from taking equity of redemption subject to a mortgage because in the latter case the grantee is not contractually bound to pay the mortgage. In a case where the grantee assumes the mortgage, he binds himself to the mortgagee to pay the mortgage and all its terms and conditions. Because a third-party bidder takes the property "subject to" and does not assume the senior loan debt, the third-party bidder can simply choose not to pay the senior lien and walk away with only the bid at risk.

II. A STATEMENT THAT A THIRD-PARTY BIDDER WANTS OR INTENDS TO PAY OFF SENIOR ENCUMBRANCES IS NOT EVIDENCE THAT IT HAS MADE SUCH PAYMENT OR WILL MAKE SUCH PAYMENT. FURTHERMORE, IT IS NOT GROUNDS TO ADD THE AMOUNT OF THE ENCUMBRANCE TO THE BID PRICE.

Winrose argues that Regime Solutions, LLC (Regime) indicated its intention to pay off the senior mortgage, and because of its desire to pay off the mortgage, the lien should be added to Regime's bid to calculate its true bid amount. Winrose reasons that the language in *Arrow Bonding Co. v. Warren*, 399 S.C. 603, 732 S.E.2d 622 (2012), implies that a senior encumbrance should be added to the bid price. These arguments fail scrutiny, both factually and legally.

The *Arrow Bonding* court infers that the third-party bidder has or will pay off the debt. Certainly if a third-party bidder actually pays off a senior mortgage, it should get credit for doing so in the analysis. In such a situation, a court would have to consider the homeowner's equity against a third-party bidder's actual amount paid. Such a fact pattern seemed to have occurred in *Bloody Point Prop. Owners Ass'n, Inc. v. Ashton*, 410 S.C. 62,

762 S.E.2d 729 (Ct. App. 2014), where the trial court added "$2,793 in taxes and fees unpaid by Appellants" to the purchase price. *Id.* at 65, 762 S.E.2d at 731. It is implied the amounts were actually paid by the third-party bidder and that the payment was the reason taxes and fees were added to the bid amount. No language existed in *Bloody Point* to indicate the taxes due were still pending.

Here, however, there is no proof that the first mortgage debt has been released or ever will be released. Respondents are asking for Regime to receive a credit for something it did not pay. Regime is not obligated to pay the senior lien and has bought the property subject to the lien.[1] As noted in the Black's Law Dictionary definition above, "paying off" and being "subject to," are two entirely different matters.

Furthermore, when a third-party bidder bids on property with a senior encumbrance, it has several options: pay off the senior lien, negotiate and then assign the bid to another person who then must pay off the lien, evict the owner and rent the property until first the mortgagee completes its foreclosure process, or simply default in complying with the bid, thereby forfeiting the initial bid fee. Court records in multiple counties can provide the numbers of monthly bid assignments and forfeited bids that the courts encounter during the sales process. There is a calculated analysis by third-party bidders and homeowners' associations when bidding that involves their bet on whether they can foreclose or evict on an owner and rent property on monthly terms fast enough to recoup

[1] A search of Richland County public records reveals Regime has purchased 43 properties between November 4, 2013, and September 8, 2015. Of those 43 properties, 18 have entered foreclosure, and 25 have open mortgages of record. Regime does not appear to have paid off one single encumbering lien of properties purchased within Richland County. Such searches were performed through the Richland County Public Index (http://www5.rcgov.us/SCJDWeb/PublicIndex/disclaimer.aspx) and the Richland County Register of Deeds (http://www.richlandonline.com/Government/Departments/BusinessOperations/RegisterofDeeds.aspx).

funds owed to the homeowners' association or spent by third-party bidders on a bid before the senior lien holder forecloses. There are records of numerous foreclosures where a senior lienholder forecloses on a homeowners' association or the entity that obtained title at a previous foreclosure.

Additionally, the third-party bidder receives the Master-in-Equity deed to the property without having to pay off the senior lien because the third-party bidder does not have to pay off the lien until the senior lien starts and completes the normal 5-6 months minimal to 2-3 years maximum process of filing the senior lien foreclosure, going through pre-hearing and post hearing loss mitigation before going to sale and foreclosing on the third-party bidder, who is now the record owner of the property. Again, this fact illustrates the critical difference between paying off versus being subject to a senior lien. Unless the lien is officially assumed or paid off by Regime, only Appellants will be liable to pay off the loan. Not doing so will harm their credit and could result in a significant monetary judgment against them.

Finally, Respondents' suggestion that a third-party purchaser's bid should be added to the encumbrance to determine whether the purchase price shocks the conscience has previously been rejected. Regime notes that the Supreme Court in *Arrow Bonding* seemed to have actually approved such methodology. However, Regime fails to recognize that in *Arrow Bonding*, the Master-in-Equity had no evidence presented to him that demonstrated the true value of the property. *Arrow Bonding* at 608, 732 S.E.2d at 624. Therefore there was nothing in the record, under the circumstances of that case, for the Supreme Court to give reason to alter the trial court's decision. *Id.* at 607, 732 S.E.2d at 624. In the present

case, evidence of the value of the property was presented, which the Trial Court failed to properly take into account.

Despite the decision in *Arrow Bonding*, in *Federal Nat. Mortg. Ass'n v. Brooks*, 304 S.C. 506, 405 S.E.2d 604 (Ct. App. 1991), the respondent third-party purchaser argued that his bid of $875 added to the first mortgage balance represented "almost forty-nine percent of the total value of the property" and was therefore sufficient to not shock the conscience of the court. *Id.* at 509, 405 S.E.2d at 605-06. However, the Court of Appeals dismissed this argument and used a formula, which Appellants have set forth in their initial brief, to determine the bid of "$875 for equity of over $27,000" was inadequate and effectively shocked the conscience. *Id.* 510, 405 S.E.2d at 606.

III. RESPONDENT REGIME SOLUTIONS, LLC IS NOT A BONA FIDE PURCHASER, AND THE EXISTENCE OF A BONA FIDE PURCHASER WOULD NOT AFFECT THE COURT'S ABILITY TO REVERSE THE SALE.

In its brief, Regime states that there have been no allegations that it is not a bona fide purchaser. Appellants have made no such allegations because they were not necessary. As previously stated in their initial brief, "[a] judicial sale will be set aside when either: (1) the sale price is so gross as to shock the conscience; or (2) the sale is accompanied by other circumstances warranting the interference of the court." *Wells Fargo Bank, N.A. v. Turner,* 378 S.C. 147, 151, 662 S.E.2d 424, 425 (Ct. App. 2008) (citing *Poole v. Jefferson Standard Life Ins. Co.,* 174 S.C. 150, 177 S.E. 24 (1943)). *Turner* is silent on the subject of bona fide purchasers and the existence of a bona fide purchaser does not limit a court's ability to reverse a sale on the basis the sale "shocks the conscience."

In fact, *Turner* emphasis that "a purchaser at a judicial sale is deemed to have notice of all things disclosed by the record." *Id.* at 151, 662 S.E.2d at 426. Regime succinctly

points out that a bona fide purchaser is "in good faith and with integrity of dealing, without notice of lien or defect." *Spence v. Spence*, 368 S.C. 106, 117, 628 S.E.2d 869, 874-75 (2006). The subject property at issue at the time of sale was, and currently still is, encumbered by a mortgage that was recorded with the Richland County Register of Deeds prior to this foreclosure of lien action. Regime is clearly not a bona fide purchaser because it had notice of a senior lien on the property. When a property is sold at foreclosure sale "subject to" a mortgage, there can be no bona fide purchasers.

IV. THERE WOULD BE NO CHILLING EFFECT ON FORECLOSURE SALES IF EITHER OF APPELLANTS' FORUMLAS WERE ADOPTED.

Regime presents many unsupported theories as to why no bright-line rule using equity in consideration to determine adequacy of a judicial sales price exists. One such theory is that such quantity is unknowable to the court and that enabling such rules would produce a chilling effect on sales. Appellants agree there is a strong policy for finality of sale and the desirability of a bright line shock the conscience ruling. There are, however, risks with purchasing properties at a foreclosure sale, of which Regime was aware prior to bidding.

Regime could have completed pre-sale research to obtain a better idea of the fair market value-to-debt ratio simply by reviewing tax assessments, reviewed the principal amount stated on the mortgage, or reviewed foreclosure file jackets to determine if a party to the foreclosure is in default. Further, if there was a foreclosure by the first mortgage holder pending, its complaint will contain allegations of note and mortgage terms, and often contain a copy of the note with the debt amount, interest rate, and terms. A prospective bidder can then make some educated guess as to the balance of the debt since they know they are taking property subject to a maximum first mortgage amount as stated on a

recorded mortgage. If a sales price is later challenged by the homeowner, he can provide evidence of equity, encumbrances, and appraisals of the property. The trial court could determine value of the property from such information, but it is not the duty of the court to investigate *sua sponte*.

Other courts have examined this policy argument. The Arizona *In re Krohn* case is persuasive authority for how courts of equity should evaluate the nature of the parties involved in a dispute seeking to set aside a judicial sale. *In re Krohn*, 203 Ariz. 205, 52 P.3d 774 (2002) (*en banc*). While the specific matter dealt with setting aside a deed of trust, the Supreme Court of Arizona applied a foreclosure sale analysis that mirrors the law of South Carolina. Under Arizona law, a foreclosure sale can be overturned by a showing of gross inadequacy of sale price or by inadequacy of sale price coupled with slight irregularities in the circumstances surrounding the sale. *Id.* at 207, 52 P.3d at 776. The court in *In re Krohn* notes that "where there is an inadequacy of price which in itself might not be grounds for setting aside the sale, slight additional circumstances or matters of equity may so justify. *Id.*

In Re Krohn addressed the stability of the "foreclosure industry" as well as the potential for discouraging bidders and creating a "chilled market." *Id.* at 210, 52 P.3d at 779. In response, the Supreme Court of Arizona states that "we have been presented with no data indicating that the traditional judicial foreclosure market has been disrupted by existing judicial oversight to prevent grossly inadequate prices, and such a result is not self-evident." *Id.;* See also *Ballentyne v. William Smith,* 205 U.S. 285, 291 (1907) (noting that the equities involved and the meager sale price outweigh the Court's concern for impairing the confidence in the stability of judicial sales). The opinion goes on to say that:

> "Indeed, purchasers continue to come forward, making deed of trust purchases without certain knowledge that the trustee has fully complied with the statutory procedural obligations and thus take a risk that the sale may be set aside for that reason. For example, there was no apparent flight from deed of trust sales after we vacated such a sale when we found a ninety-day statutory notice of sale did not negate the additional thirty-day notice required in the deed of trust itself. S*chaeffer v. Chapman,* 176 Ariz. 326, 861 P.2d 611, (1993). Perhaps this is because most purchasers believe, as we do, that only the smallest minority of deed of trust sales are conducted without statutory compliance, just as we also believe that most purchasers will assume only the smallest number of deed of trust sales are concluded at a price that could shock the conscience of the court because of gross inadequacy. That said, we think it just as likely that the possibility of judicial oversight on the ground of gross inadequacy will result in higher prices. If so, we think this will serve rather than impair the public interest." *Krohn* at 211, 52 P.3d at 780.

The opinion concludes that if judicial oversight of foreclosure sales has any effect at all on the bidding market, then that effect would likely be to increase the sale prices reached at judicial sale, thereby promoting the public interest and promoting the actual purpose for which judicial sales are conducted. *Id.;* See *Looper v. Madison Guar. Sav. & Loan Ass'n*, 292 Ark. 225, 231, 729 S.W.2d 156, 159 (1987) (noting that "the law is such that inadequacy of price when so gross, need only be coupled with slight circumstances to justify setting aside the sale. This is a court of equity, and foreclosure is historically an equitable proceeding to protect the debtor."). There is no reason to assume that the concerns expressed for the bidding market of South Carolina judicial sales would be subject to any greater detriment as that of Arizona, and the Supreme Court of Arizona was not influenced in the slightest by this argument. The United States Supreme Court was likewise not persuaded by such a concern. *Ballentyne*, 205 U.S. at 291.

Appellants acknowledge that absent special circumstances, a sale to a bona fide purchaser should not be upset by the courts. *Krohn* at 211, 52 P.3d 52 P.3d at 780. However, "the status of bona fide purchaser by itself cannot insulate even a well meaning

purchaser innocent of wrongdoing when other circumstances are present." *Id.* Bidders are charged with the knowledge that *some* difficulty in dealings exists, or else a property would not be set for public auction. *Id.* The rule of caveat emptor applies, and purchasers at such sales have already assumed the risk that some unknown procedural error may arise. *Id.* "Such bidders can reasonably expect to get bargains because of the nature of foreclosure sales, but public policy and the courts should not endorse extraordinary bargains at the expense of already troubled debtors." *Id.* "Knowledgeable purchasers can reasonably evaluate the fair market value of a property to make an appropriate bid that is not grossly inadequate." *Id.*

Fair market value cannot be realistically expected at a foreclosure sale, the context of the proceeding itself inhibits it. *Id.* However, that does not excuse results that constitute gross inadequacy or even disproportionate prices coupled with very slight evidence of unfairness or irregularity. *Id.* at 213, 52 P.3d at 782.

Krohn, at its core, "is a case about inequity on the one hand and unjust enrichment on the other. When these factors are present, our court has been available to give relief so long as there is no statutory prohibition." *Id.* (citing *Sparks* v. *Douglas & Sparks Realty Co.,* 19 Ariz. 123, 129, 166 P. 285, 288 (1917). The importance of the nature of the parties involved in a foreclosure sale and the repugnance for allowing excessive profits at the expense of the drastic misfortune of a debtor are described by the Supreme Court of Arizona in the following excerpts:

> "There are, of course, those waiting for opportunities based on individual misfortune, and we believe this makes it even more important that courts of equity are open to assure debtors receive not only procedural but fundamental fairness. Windfall profits, like those reaped by bidders paying grossly inadequate prices at foreclosure sales, do not serve the public

> interest and do no more than legally enrich speculators." *Id.* at 210, 52 P.3d. at 779.
>
> "[I]f the legislature believes that the doors of the courthouse should be closed and the courts forbidden to grant relief to those who are unjustly and inequitably deprived of their homes by speculators or others seeking windfall profits, it may say so. . . . [T]he dissent asserts that there is no question of unjust enrichment in the present case because the purchaser at the trustee's sale 'was not the lender, but a third party'. We are unable to understand the distinction. It makes little difference whether a lender or speculator was unjustly enriched. The important considerations are the questions of inequity on the one hand and unjust enrichment on the other. When these are present, the court may use its equitable powers." *Id.* at 214, 52 P.3d. at 783.

The Supreme Court of Arizona is not alone in its defense against the sanctioning of unjust enrichment. This is the same conclusion reached by the Supreme Court of Arkansas, wherein the Court argues that "it is not the purpose of the law to protect one who seeks to procure valuable property for little or no outlay." *Looper*, 292 at 233, 729 S.W.2d at 160. Collectively, the courts that have addressed "the nature of the parties" inquiry, as it pertains to setting aside of judicial sales and have concluded that the rights of a real estate speculator are far outweighed by the right of fundamental fairness owed to the debtor.

V. HISTORY SHOWS THE PRINCIPLES OF EQUITY ARE ESSENTIAL AND SHOULD ALWAYS BE OBSERVED IN FORECLOSURE MATTERS.

The maxims of equity cited by Appellants merely reinforce the public policy and history of our state in protecting property and the rights of owners. While foreclosure law has developed over the centuries to reflect the changing market and government oversight, two things have remained constant. One, the lender is entitled to repayment of the mortgage debt, but no more. The lender does not have a right to claim any surplus or equity in the property. *See* Robert Kratovil, Modern Mortgage Law and Practice, 32 (2d ed. 1981). Two, the owner's right to redeem their home equity is guarded.

Similarly, when the equity battle shifted to contracts for deed, installments sales contracts, equitable type mortgages, etc, the court developed a series of questions required to be examined to determine if the owner had no equity in the property which requires termination of contract; some equity which allows for a period to redeem or pay-off debt; or if sufficient equity, the ability to sell property just like a legal mortgage. *See* Andrew S. Radeker, Esq., Installment Land Sales Contracts, *Pleading Special Property Matters* (Master-in-Equity Bench Bar October 10, 2008) at pages 45-49.

Another example of policy reflecting equity protection occurs during a tax sale. A defaulting taxpayer has the right to right to redeem property from a third party bidder when it provides for a post tax sale time limit to allow the defaulting taxpayer to redeem property sold at tax sale. S.C. Code Ann. § 12-51-90, 100 (1976 as amended).

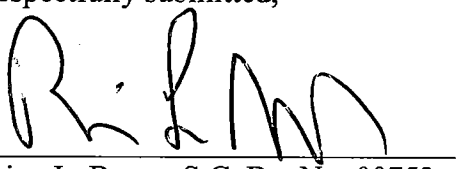
These examples represent our state's efforts to equitably address these issues in the battle between the owner/debtor and the lender/creditor. Now, the examination has shifted to a determination if the owner's equity should be protected from a stranger to the transaction, a third party bidder, in a sale subject to a senior lien.

The primary focus of the bid process is to pay off the plaintiff/creditor and protect equity in property so that in the event the third party bidder's bid generates surplus money, those funds representing the owner's equity would, by law, go first to the other entitled creditors, and then to the owner. South Carolina recognizes that the owner's equity, arguably at least to 10%, has a protected position in a first mortgage sale scenario as explained in the "shock the conscience" cases.

CONCLUSION

Based on the foregoing arguments and citation of authority, the Appellants, Devery A. Hale and Tina T. Hale, respectfully request that the order of the Master-in-Equity be reversed and sale vacated because the sale price shocks the conscience, and our courts should consistently utilize a single formula to determine bid price to value ratio.

Respectfully submitted,



February 3, 2016

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CERTIFICATE OF COUNSEL

The undersigned certifies that the Final Brief of Appellants and Final Reply Brief of Appellants comply with Rule 211(b), SCAR.

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February 4, 2016

Columbia, South Carolina

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February 4, 2016

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