

THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM GEORGETOWN COUNTY
Court of Common Pleas

The Honorable Joe M. Crosby, Master-in-Equity

Case No. 2011-CP-22-00180

Appellate Case No. 2013-001447

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AUG 16 2016

SC Court of Appeals

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 theAppellant.

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ISSUE ON APPEAL

Even assuming the Court correctly held the transfer from Will Wheeler (“Wheeler”) to Pawleys Island North, LLC (“Pawleys”) was a fraudulent conveyance,¹ what impact, if any, does such a finding have on the mortgage transaction between Kennedy Funding, Inc. (“Kennedy”) and Pawleys?

INTRODUCTION

While Respondents maintain the Court incorrectly held in Section I of its original Opinion (“Opinion”) that the transfer from Wheeler to Pawleys was a fraudulent conveyance and ask the Court to reconsider its decision in that section, regardless, the Court correctly answered the remanded question in Sections II and III. The Court found Kennedy was a *bona fide* purchaser without notice which entitled it to lien superiority under the South Carolina Recording Statute, S.C. Code Ann. 30-7-10 (“the Recording Statute”). The Court included in its Opinion a recitation of Sapp’s arguments and stated it “disagreed” with Sapp’s contention that Kennedy’s lien was voided or subordinated to Sapp’s lien as a result of the fraudulent transfer from Wheeler to Pawleys. (Opinion p. 8). The Court correctly decided the remanded issue in reliance on the South Carolina Recording statute, applicable case law, and the equities in the case, and should reaffirm the result in its previous Opinion.

STATEMENT OF THE CASE

In the interest of brevity, Respondents incorporate by reference the Statement of the Case set forth in their original Respondents’ brief. Respondents do, however, highlight the following uncontroverted facts which support the result in the Court’s Opinion:

¹ The Court should reconsider its finding that the transfer from Wheeler to Pawleys was a fraudulent conveyance. Respondents incorporate by reference all the arguments they previously made in support of a finding that Wheeler’s transfer of the property to Pawleys was not a fraudulent conveyance. Sapp argues that no one took exception to this aspect of the Opinion, but Respondents do take exception and rely upon the absence of a fraudulent conveyance as an additional sustaining ground. See *I’On, L.L.C. v. Town of Mt. Pleasant*, 338 S.C. 406, 418, 526 S.E.2d 716, 722 (2000); SCACR, Rules 208(b)(2) & 220(c).

- Sapp argues Kennedy instigated a fraud by requiring Wheeler to transfer the subject property to a single purpose LLC, yet Sapp did not plead fraud or any fraudulent conduct against Kennedy in his pleadings.² (R. pp. 101–06).
- Kennedy recorded its mortgage fourteen months prior to Sapp obtaining his judgment. (R. pp. 25–26, 103–04).
- Kennedy did not learn of Sapp’s judgment until February 2009 when it ran updated title work before filing its foreclosure action—twenty-two months after Kennedy recorded its mortgage. (R. pp. 28, 640).
- Sapp presented no evidence that Kennedy knew or had reason to know Wheeler was insolvent at the time of the mortgage or would become insolvent thereafter. To the contrary, the only evidence submitted was that Sapp obtained a \$304,000 judgment against Wheeler but that Kennedy left Wheeler, via his interest in Pawleys, with \$1,317,000 in assets at closing. (R. pp. 103–04, 191–92, 228–29, 513–18).

STANDARD OF REVIEW

A clear and convincing evidentiary standard governs fraudulent conveyance claims brought under the Statute of Elizabeth, S.C. Code Ann. § 27-23-10 . *See, Oskin v. Johnson*, 400 S.C. 390, 396, 735 S.E.2d 459, 463 (2012).

ARGUMENT

I. EVEN WERE THERE A FRAUDULENT CONVEYANCE BETWEEN WHEELER AND PAWLEYS, KENNEDY WAS A *BONA FIDE* PURCHASER WITHOUT NOTICE AND RECORDED ITS MORTGAGE FOURTEEN MONTHS PRIOR TO WHEN SAPP OBTAINED HIS JUDGMENT; KENNEDY’S LIEN IS, THEREFORE, SUPERIOR UNDER THE SOUTH CAROLINA RECORDING STATUTE.

The South Carolina Recording statute protects bona fide purchasers without notice. S.C. Code Ann. 30-7-10; *Epps v. McCallum Realty Co.*, 129 S.C. 481, 138 S.E. 297 (1927). As this Court correctly cited and relied on in its Opinion:

To entitle one to take advantage of the plea that he is a purchaser for value without notice, it is necessary for him to show three things: (1) [t]hat the purchase money was actually paid before notice of outstanding incumbrances or equities (giving security for the payment is not sufficient, nor is past indebtedness

² Failure to plead fraud against the mortgagee (Kennedy) is an independent ground for denying Sapp’s claim. *See S.C. Nat’l Bank v. Halter*, 293 S.C. 121, 133 n.5, 359 S.E.2d 74, 80 n.5 (Ct. App. 1987) . Sapp did not plead fraud against Kennedy, and it is inherently unfair for Sapp to now claim on appeal that Kennedy failed to prove the bona fides of its transaction below where Sapp failed to plead or preserve such a claim.

a sufficient consideration); (2) that he has purchased and acquired the legal title, or the best right to it, before notice of outstanding incumbrances or equities; and (3) that he purchased bona fide without notice.

Kirton v. Howard, 137 S.C. 11, 36, 134 S.E. 859, 868 (1926).

In its Opinion, the Court correctly based its decision on the South Carolina Recording statute and the holding in *Atlas Supply Co. v. Davis*, 273 S.C. 392, 256 S.E.2d 859 (1979). In Section II of the Opinion, the Court also cited and relied on the above holding in *Kirton* in deciding whether Kennedy was a good faith purchaser for value without notice—that is, whether Kennedy’s mortgage should be rendered void on the basis that it knew of the purportedly fraudulent conveyance between Wheeler and Pawleys. This Court decided Kennedy was a good faith purchaser for value without notice and, therefore its mortgage was intact and superior.

Next, in Section III of the Opinion, entitled “Voiding of Mortgage,” this Court addressed whether Kennedy’s mortgage should be set aside, which it refers to as “voiding” in the title of Section III, or declared subordinate to Sapp’s lien. The Court acknowledged Sapp’s argument for the mortgage to be set aside (“voided”); however, having found that Kennedy was a good faith purchaser for value without notice and its mortgage valid in Section II, the Court moved on to whether Kennedy’s mortgage should be subordinated to Sapp’s lien.

The Court then expressly stated that it disagreed with Sapp’s argument for setting aside (“voiding”) the mortgage. After reciting the arguments of both parties and properly relying on *Atlas Supply*, the Court upheld the mortgage and found the Kennedy lien superior. In upholding Kennedy’s mortgage and superior lien position, this Court obviously found that it was not void or subordinated as a result of the Wheeler transfer to Pawleys. In sum, this Court’s analysis answers the Supreme Court’s question and resolves the remand issue in Respondents’ favor.

Respondents suggest that perhaps the Court's second heading in the Opinion created some confusion with the Supreme Court. The second heading infers the Court looked at the Kennedy mortgage transaction with Pawleys in a vacuum and did not consider the impact, if any, of its finding in section one that the transfer from Wheeler to Pawleys was a fraudulent conveyance. Despite the heading, the Court's citation to *Kirton* and finding that Kennedy was a bona fide purchaser without notice correctly answers the remanded question.

A. A bona-fide purchaser without notice means one without actual or constructive knowledge of an existing lien affecting title.

The bona fide purchaser test set forth in *Kirton v. Howard* was more recently addressed by our Supreme Court which stated:

“A purchaser may assert a plea in equity of a bona fide purchaser for value, without notice of defect in his title, by showing (1) he has actually paid in full the purchase money (giving security for the payment is not sufficient, nor is past indebtedness a sufficient consideration); (2) he purchased and acquired the legal title, or the best right to it; and (3) he purchased bona fide, *i.e.*, in good faith and with integrity of dealing, **without notice of a lien or defect**. The bona fide purchaser must show all three conditions-actual payment, acquiring of legal title, and bona fide purchase-occurred before he had **notice of a title defect or other adverse claim, lien, or interest in the property.**”

Spence v. Spence, 368 S.C. 106, 117, 628 S.E.2d 869, 874–75 (2006) (emphasis added). The Court further explained: “[A] purchaser of real property has actual notice of a **title defect** or other claim, lien, or interest adverse to his own **in a particular property** when he actually knows about the defect or claim.” *Id.* at 118, 628 S.E.2d at 875 (2006).

Sapp cannot satisfy the test in *Kirton* or *Spence* as he did not have a lien or claim in the “particular property.” *Id.* When Kennedy recorded its mortgage with Pawleys, it was on notice only that Sapp asserted a claim against Wheeler on a personal guarantee related to a commercial lease wholly unrelated to the property in this case. Sapp did not have a claim affecting title to the subject property and did not have an existing lien on the subject property. This fact ends the

analysis in Respondents' favor. The only notice Kennedy had of a lien affecting title was the lien of First South Bank for \$300,000 which Kennedy paid off at closing. Therefore, the Court correctly found Kennedy was a bona fide purchaser without notice and should affirm its Opinion.

B. *Coleman v. Daniel* is distinguishable.

Sapp's supplemental brief relies almost exclusively on the holding in *Coleman v. Daniel*, 261 S.C. 198, 199 S.E.2d 74 (1973), to argue for subordination of Kennedy's lien. In addition to the arguments in Respondents' brief distinguishing *Coleman*, a careful reading of the case in light of the Supreme Court's remand order further supports Respondents' position. The Court in *Coleman* stated:

Certain circumstances so frequently attend conveyances to defraud creditors that they are recognized and referred to as 'badges of fraud'. The badges tend to excite suspicions as to the Bona fides of a challenged conveyance. Unexplained, they may warrant an inference of fraud. Whether the inference is warranted depends in large measure on **whether a satisfactory explanation** is presented.

'The facts which are recognized indicia of fraud are numerous, and no court could pretend to anticipate or catalog them all. Among the generally recognized badges of fraud are the insolvency or indebtedness of the transferor, lack of consideration for the conveyance, relationship between the transferor and the transferee, the pendency or threat of litigation, secrecy or concealment, departure from the usual method of business, the transfer of the debtor's entire estate, the reservation of benefit to the transferor, and the retention by the debtor of possession of the property. 'Although it has been said that a single badge of fraud may stamp a transaction as fraudulent, it is more generally held that while one circumstance recognized as a badge of fraud may not alone prove fraud, where there is a concurrence of several such badges of fraud an inference of fraud may be warranted.'

261 S.C. at 209-10, 199 S.E.2d 74, 79 (emphasis added).

In *Coleman*, the Court was concerned with numerous badges of fraud including an intra-family transfer of the transferee's entire estate, a secret agreement for the transferee to stay on the property rent free the rest of his life, the transferors' lack of due diligence in investigating their family member transferee's financial condition, the transferee and transferor's admissions

at trial that the transferee was insolvent at the time of the transfer, and the transferee's failure to disclose the Coleman debts to the transferors. The *Coleman* Court ultimately looked at whether the transferors acted reasonably and determined, with clear and convincing evidence proving almost every badge of fraud, that the transferors "failed to **adequately explain** their not making a more detailed inquiry . . . when the circumstances demanded such inquiry and such inquiry would have most probably led to the discovery of the subject debts." *Id.* at 211, 199 S.E.2d 74, 80 (emphasis added).

To the extent this Court needs to revisit its Opinion, *Coleman* instructs the Court need only answer two questions: (1) did Kennedy have notice of badges of fraud?; and (2) if sufficient badges were present, has Kennedy adequately explained its conduct?. As to the first question, other than the existence of a lawsuit, there were no badges of fraud, much less badges proven by clear and convincing evidence. Sapp failed to prove badges of fraud, relying almost exclusively on two pre-closing emails amongst lawyers. What Kennedy proved at trial, however, is:

- Kennedy participated in an arms-length transaction with a stranger (Wheeler) (R. pp. 178–79, 772);
- Kennedy paid valuable consideration supporting the mortgage transaction (R. pp. 228–29);
- Kennedy conducted the transaction in the ordinary course of business and in compliance with its standard business practices (R. pp. 228–500);
- No secret agreement was made to allow Wheeler or Pawleys perpetual use of the mortgaged property (R. pp. 24–59, 663–65);
- Wheeler did not transfer the property to a family member or friend (R. pp. 750–55);
- Wheeler did not transfer his entire estate to Pawleys (R. pp. 228–29);
- Wheeler was not insolvent at the time of the transfer (R. pp. 228–29, 663–65);
- Kennedy did not know of or participate in any secret or fraudulent deal to help Wheeler evade Sapp's alleged claim; (R. pp. 645, 663–69); and
- Kennedy was not on notice of a claim from Sapp affecting title (R. pp. 457–89, 498–500).

Under these circumstances, this Court was clearly within in its discretion to find badges of fraud were not present which would necessitate voiding or subordinating Kennedy's lien.

Even if the Court accepts Sapp's argument that numerous badges of fraud were proven by clear and convincing evidence, Kennedy adequately explained its conduct in that it left Wheeler with the assets necessary to cover the contingent liability to Sapp. The only evidence presented at trial of Wheeler's net worth or financial condition was that when the Kennedy loan closed, Wheeler, via his interest in Pawleys, had at least \$1,317,000.00. Nothing about this transaction would put a reasonable lender on notice that Wheeler was trying to evade Sapp's alleged claim, and this Court correctly found that Kennedy adequately explained its conduct.

On this point, Sapp repeatedly argues Kennedy should have investigated Sapp's claim further or contacted Sapp directly. Had Kennedy contacted Sapp, Sapp would have told Kennedy he thought he was owed \$300,000 by Wheeler, a claim already disclosed by Wheeler and unrelated to the property. Hearing about the claim from Sapp would not have changed the outcome in this case because Kennedy would not be suspicious of an alleged \$300,000 claim in light of Wheeler's assets totaling at least \$1,317,000.00. Moreover, and as previously discussed, the claim was immaterial because it did not affect title. In sum, Kennedy offers an "adequate explanation" of its conduct, and the Court should affirm its finding that Kennedy was a bona fide purchaser without notice and is entitled to a first lien position.

II. AS AN ADDITIONAL SUSTAINING GROUND, THE COURT SHOULD FIND THAT EQUITY DICTATES THAT KENNEDY'S MORTGAGE LIEN BE FOUND SUPERIOR TO SAPP'S LIEN.

While the Court need not look further, were the Court to conduct an equity analysis, equity weighs in favor of Kennedy and dictates that Kennedy's mortgage lien be found superior to Sapp's lien. "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.” *Hooper v. Ebenezer Sr. Servs. & Rehab. Ctr.*, 386 S.C. 108, 687 S.E.2d 29, 33 (2009) (quotation and citation omitted); *see also Regions Bank v. Wingard Props., Inc.*, 394 S.C. 241, 715 S.E.2d 348, 355 (2011) (“[W]here a substantive right exists, an equitable remedy may be fashioned to give effect to that right.”); *Ex parte Dibble*, 279 S.C. 592, 310 S.E.2d 440, 442 (1983) (“Courts have the inherent power to do all things reasonably necessary to insure that just results are reached to the fullest extent possible.”). South Carolina courts have the equitable power to reform written instruments. *Crew v. Blackmon*, 289 S.C. 229, 234, 345 S.E.2d 754, 756 (Ct. App. 1986).

As previously argued to this Court, Sapp relies on decisions involving intra-family transfers in which the grantor transferred virtually his entire estate to a friend or family member and made a secret agreement for some perpetual use of the property. This Court correctly judged the Kennedy transaction for what it was, an arms-length transaction in which the lender (Kennedy) advanced \$960,000 to a borrower with more than sufficient assets to pay his alleged debts. Having properly recorded its lien and paid off an existing \$300,000 lien held by First South Bank, equity dictates Kennedy be declared superior to Sapp.

If the Court uses its equitable powers to unwind the Wheeler transfer to Pawleys and reforms the Kennedy mortgage to be with Wheeler, instead of Pawleys, Kennedy still wins in equity and under the Recording Statute. If Kennedy had entered into a mortgage with Wheeler, it would have recorded its mortgage lien fourteen months before Sapp obtained his judgment and there is no set of facts Sapp could have pled, much less proved by clear and convincing evidence, that would have allowed him to jump Kennedy. In fact, the Court found the Kennedy loan to

Pawleys was not a fraudulent conveyance and the same finding would be true if Kennedy had loaned directly to Wheeler. Sapp argues in his supplemental brief that under this scenario Kennedy would have been subordinated to Sapp because Kennedy would not have been refinancing a pre-existing debt. This argument is not based on legal authority or logic. If a mortgagor in South Carolina were subordinated to every known pre-judgment creditor at the time the mortgagor recorded its lien, mortgagors would likely decide to conduct their business in forty-nine other states. Sapp's argument also disregards the Recording Statute and the common law interpreting the Recording Statute. *See Spence* 368 S.C. 106, 628 S.E.2d 869; *Kirton*, 137 S.C. 11, 134 S.E. 859.

III. MORTGAGE LENDING IN SOUTH CAROLINA WOULD BE IRREPARABLY HARMED IF THE KENNEDY LIEN IS VOIDED OR SUBORDINATED.

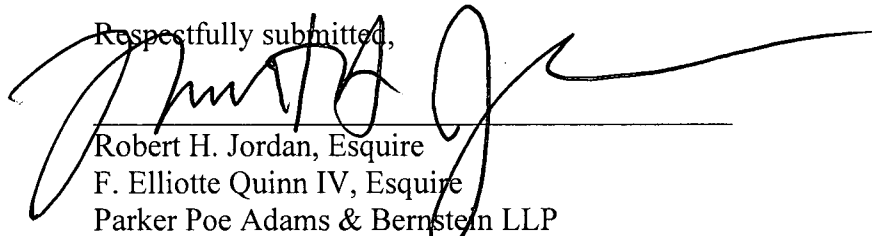
Sapp requested supplemental briefing, in part, to address public policy concerns. Sapp clearly understands the relief he is seeking is unprecedented in South Carolina. What Sapp is seeking is for this Court to make mortgage lenders guarantors of all borrower debts, including pre-judgment debts, which are disclosed before a mortgage is recorded. In South Carolina, a mortgagor becomes the owner of the land when the mortgage is recorded. *See Stephens v. Jenkins*, 312 S.C. 233, 439 S.E.2d 849 (1994). Kennedy became the owner of the subject property fourteen months before Sapp obtained his judgment. According to Sapp, however, if a borrower discloses any lawsuit, credit card debt, car loan, medical bill, consumer debt, or any other alleged or actual debt—no matter how small the debt relative to the borrower's net worth and no matter whether the debt affects title to the property—a mortgage lender must be subordinated to the disclosed creditor if the creditor later obtains a judgment and borrower is unwilling or unable to pay the judgment. The mortgagor would, in essence, be forced to pay out the creditor from the property the mortgagor owns.

Under Sapp's view of mortgage lending, it would not matter when the subsequent creditor obtained the judgment—*e.g.*, one year later or ten years later—because as long as the mortgage lender was informed of the debt prior to recording the mortgage lien, the subsequent judgment creditor's claim would be given priority to the mortgage lien. Sapp wants this Court to rule that a mortgage lender with knowledge of a borrower's debt, even if it is four times smaller than the amount of the borrower's known net worth, is a knowing participant in a fraudulent transaction and assumes all risk that the borrower may one day lose a lawsuit, default on a disclosed debt, or simply refuse to pay a creditor. This is an absurd construction of South Carolina law, and it is why the Recording Statute protects lenders like Kennedy from subsequent judgment creditors. Sapp is right to be concerned about the impact a ruling in his favor would have on mortgage lending in South Carolina as the relief he is seeking would turn mortgage lending on its head and effectively nullify the Recording Statute.

CONCLUSION

Based on the foregoing arguments of law, the Respondents' original briefs, the record on appeal, and applicable laws and statutes, Respondents request this Court affirm the Opinion.

Respectfully submitted,



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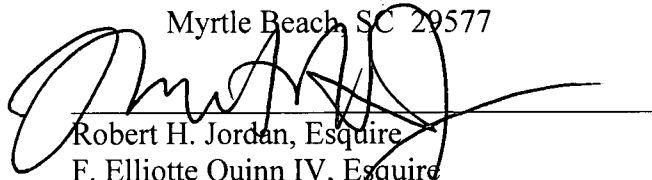
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PROOF OF SERVICE

I certify that I have served Respondents' Supplemental Brief on opposing counsel by
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