THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM FAIRFIELD COUNTY
Court of Common Pleas

Carol A. Tolen, Special Referee
Trial Court Case No. 2012-CP-20-00132

Appellate Case No. 2018-000230

ArrowPointe Federal Credit Union, Respondent,

v.

Jimmy Eugene Bailey; Laura Jean Bailey; and U.S. Bank National Association not in its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1, Defendants

Of which U.S. Bank National Association not in it individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1 is the Appellant.

INITIAL BRIEF OF RESPONDENT

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STATEMENT OF THE CASE

This appeal is from a foreclosure case, where two mortgage creditors are disputing the priority of two mortgage loans given to the Borrowers, Jimmy Eugene Bailey and Laura Jean Bailey (hereafter "Borrowers"). ArrowPointe Federal Credit Union (hereafter "Credit Union" or "Respondent") filed a Lis Pendens, Summons and Complaint for mortgage foreclosure on March 27, 2012. The Complaint alleged that the mortgage of Defendant JP Morgan Chase Bank (the predecessor-in-interest to Appellant) was subordinate to the Respondent's mortgage. As the Borrowers had previously received a discharge in bankruptcy, the Respondent expressly waived the right to a personal or deficiency judgment should the proceeds of sale not be sufficient to satisfy the judgment debt. Appellant filed an Answer disputing priority. The Borrowers never responded to the foreclosure complaint and were held to be in default.

Appellant filed a Motion for Summary Judgment, which was denied by Order entered April 2, 2015.

On October 12, 2016, the Respondent filed a Motion for Summary Judgment and Memorandum in Support of same. Appellant contested Respondent's motion with a Memorandum in Opposition, filed March 13, 2017.

The Special Referee heard arguments on the Respondent's Motion for Summary Judgment on March 13, 2017 and ruled in favor of the Respondent, finding that the Respondent's mortgage was recorded first and entitled to priority over Appellant's mortgage. The Special Referee declined to adopt the theory of replacement mortgage and found that even if such a theory were to be adopted, Appellant could not take advantage of it because of the material prejudice Respondent suffered as a result of the substantial additional funds Appellant advanced. The Special Referee granted the Respondent the right to sell the property at a foreclosure auction, with the first proceeds of the sale going to

satisfy the indebtedness to the Respondent, and the remaining proceeds going to satisfy the indebtedness to the Appellant. This appeal follows.

STATEMENT OF THE FACTS

Appellant and Respondent agree about the material facts of the case and filed a detailed Stipulation of Facts prior to the hearing on the Respondent's Motion for Summary Judgment. Appellant and Respondent agree to the sequence of the loans, and the recorded mortgages are of public record.

On September 29, 2009, Borrowers refinanced an existing mortgage on their real property, located at 247 Morninglow Drive, Winnsboro, SC. Joint Stipulation, Exhibit A. The lender was Quicken, Appellant's predecessor-in-interest. This loan is referred herein to as "Appellant Loan 1." The principal amount loaned to the Borrowers at this time was $256,500.00. Id. at Page 2.

The mortgage for Appellant Loan 1 was recorded on October 20, 2009. Id. at Page 1. ("Appellant Mortgage 1"). When Appellant Mortgage 1was recorded, it was in primary position.

On October 27, 2009, Respondent gave a loan to the Borrowers. This loan is referred to herein as "Respondent Loan." The principal amount Respondent loaned to the Borrowers at this time was $99,000.00. Joint Stipulation, Exhibit C.

In order to secure the payment of the Respondent Loan, the Borrowers gave to the Respondent a mortgage covering the same property. Joint Stipulation, Exhibit I. The mortgage for the Respondent Loan was recorded November 4, 2009. ("Respondent Mortgage").

Respondent was aware of Appellant Mortgage 1 at the closing of Respondent's Mortgage. Joint Stipulation 13. Based on South Carolina law, Respondent recognized that as of that time, its mortgage loan was in second position, junior and subordinate to the Appellant Mortgage 1. Thereafter, the priority of the mortgages changed as a result of Appellant's action.

On November 23, 2009, the Borrowers entered into a second, new loan transaction with Appellant's predecessor-in-interest, Quicken. Joint Stipulation, Exhibit J. This loan is referred to herein as "Appellant Loan 2." The principal amount of the new, second loan was $296,000.00, which was an increase in the amount borrowed from Appellant Loan 1 of $39,500.00. The new transaction also included Borrowers cashing out $26,235.11 in equity from the home. Joint Stipulation, Exhibit P. Appellant was on record notice of the Respondent Mortgage at this time, by virtue of Respondent's mortgage being properly recorded. There are no allegations that Respondent Mortgage was improperly filed, recorded, or indexed. Appellant Loan 2 has been subsequently assigned on numerous occasions (at least four times), and now is being held by Appellant. Joint Stipulation 19.

Appellant Loan 2 was not recorded until December 15, 2009. (Appellant Mortgage 2") Joint Stipulation, Exhibit J.

Payment due on the Note for Respondent's Mortgage was not made as provided in the Note, and Respondent elected to require immediate payment of the entire amount due, and filed a foreclosure action in Fairfield County. Respondent's Complaint.

As determined by the Special Referee, the amount due and owing on the Note for Respondent's Loan at the time of the hearing on Summary Judgment totaled

$187,201.60. Order Granting Summary Judgment. The break-down of the amount due is as follows:

a.	Principal due	$ 100,105.00
b.	Interest from July 4, 2011, at 6% per annum	39,910.21
c.	Insurance premiums	5,880.00
d.	Costs of collection prior to hearing	804.76
e.	Taxes, insurance, etc. not included above	37,706.63
f.	Attorney's fees and collection costs	2,795.00
Total debt secured by Note and Mortgage		$187,201.60

There is no basis for vacating the decision of the Special Referee and the lower court should properly be affirmed.

Standard of Review

A mortgage foreclose action is an action in equity. Fibkins v. Fibkins, 303 S.C. 112, 115, 399 S.E.2d 158, 160 (Ct.App.1990). An action to determine the priority of liens is also an equitable action, and the standard of review is that the appellate court is entitled to its own view of the preponderance of the evidence. Williams v. Wilson, 349 S.C. 336, 339-40, 563 S.E.2d 320, 322 (2002). In the instant case, the facts are not disputed; rather it is the Special Referee's analysis and interpretation of the law that is being challenged. See Lewis v. Lewis, 392 S.C. 381, 709 S.E.2d 650 (2011).

ARGUMENTS

I. THE SPECIAL REFEREE PROPERLY FOUND THAT THE MORTGAGE THAT WAS RECORDED FIRST IS ENTITLED TO PRIORITY OVER ANY MORTGAGE THAT IS LATER RECORDED.

The instant dispute is over which mortgage loan has priority: Respondent Mortgage (as found by the lower court) or Appellant Mortgage 2 (as urged in this appeal).

The lower court concluded that Respondent Mortgage has priority over Appellant Mortgage 2 because the mortgage for the Respondent Mortgage was recorded before the mortgage for Appellant Mortgage 2. Statutory law holds that the priority of mortgages is determined by the time at which those mortgages are filed of record with the Register of Deeds or Clerk of Court. S.C. Code Ann. §30-7-10.

> All deeds of conveyance of lands, . . . all mortgages or instruments in writing in the nature of a mortgage of any real property, . . . all assignments, satisfactions, releases, and contracts in the nature of subordinations, waivers, . . . or other liens on real property created by law or by agreement of the parties and generally all instruments in writing conveying an interest in real estate required by law to be recorded in the office of the register of deeds or clerk of court in those counties where the office of the register of deeds has been abolished . . . are valid so as to affect the rights of subsequent creditors (whether lien creditors or simple contract creditors), . . . only from the day and hour when they are recorded in the office of the register of deeds or clerk of court of the county in which the real property affected is situated. In the case of a . . . subsequent lien creditor on real estate for valuable consideration without notice, the instrument evidencing the subsequent conveyance or subsequent lien must be filed for record in order for its holder to claim under this section as a subsequent creditor or purchaser for value without notice, and the priority is determined by the time of filing for record.
>
> S.C. CODE ANN. § 30-7-10 (1976) (emphasis added).

Thus South Carolina law clearly provides that the first mortgage creditor to record its interest puts others on notice of its interest in the real property as of the date and time the first mortgage creditor recorded the mortgage. Johnson v. Keel, 147 S.C. 259, 145 S.E. 113, 115 (1928). "This statute indicates our recording act is a race-notice act which will provide protection to a subsequent purchaser or creditor provided he records first." MI Co., Ltd. v. McLean, 325 S.C. 616, 626, 482 S.E.2d 597, 602 (Ct. App. 1996). Priority is determined by the time of filing for record, and competing creditors are said to race to the courthouse. Id.

Here, Respondent recorded its Mortgage on November 4, 2009. Appellant recorded Appellant Mortgage 2 on December 15, 2009. The Respondent was first in line, and based upon South Carolina law, first in right. The Appellant was on notice of Respondent's mortgage when it closed its Appellant Mortgage 2. See Leasing Enter. Inc. v. Livingston, 294 S.C. 204, 207, 363 S.E.2d 410, 412 (Ct. App. 1987). "[R]ecording is the method by which a third party without actual notice is alerted to the possible transfer of interests in real property." Id.

Respondent is entitled to priority over the Appellant Mortgage 2 because its mortgage is recorded first. When Appellant engaged in a new loan transaction with Borrowers, lending additional funds, cashing out equity, and satisfying Appellant Mortgage 1, it lost its priority and is now in second position. Appellant was on notice of the Respondent Mortgage through filing and cannot now complain about the result of its own actions.

Replacement Mortgage

Realizing the loss of priority with the new transaction, Appellant argues that Appellant Mortgage 2 replaced Appellant Mortgage 1, and that it should assume the recording date of Appellant Mortgage 1. Appellant urges that Appellant Mortgage 2 is a replacement mortgage, and that intervening lienholders such as Respondent are not entitled to the statutory priority granted according to the date that the competing mortgages are recorded. This is not the law of South Carolina.

a. SOUTH CAROLINA LAW DOES NOT SUPPORT THE DOCTRINE OF REPLACEMENT MORTGAGE

Attempting to cobble together support in South Carolina case law for the novel theory advanced, Appellant argues that dicta in the majority opinion Matrix as well as the

dissent support the replacement mortgage theory. Matrix Financial Serv. Corp.. v. Frazer, 394 S.C. 134, 714 S.E.2d 532 (2011). On the contrary, the only reference to the concept of replacement mortgage in Matrix is that such theory was not advanced before the trial court. Id. at 138, 714 S.E.2d at 534. Conversely, Matrix stands for the proposition that a creditor claiming refinance of its own debt cannot be equitably subrogated. Id. When reviewing the context of Matrix's tangential mention of replacement mortgage, it becomes clear that the case does not stand for the proposition that the theory of replacement mortgage has been, or should be, adopted in South Carolina.

In fact, the main focus of Matrix is to emphasize the importance of lenders hiring South Carolina lawyers to properly oversee the mortgage loan closing process so that disputes such as the instant dispute will be avoided, and the Court warns lenders to take seriously the steps outlined in a real estate closing and properly search title for prior liens. Id. at 139, 714 S.E.2d at 534. Errors made by Appellant, or Appellant's counsel, should not give rise to new legal theories in South Carolina that erode established statutory authority.

The Court in Matrix does not rely on the Restatement (Third) of Property (Mortgages) § 7.6 in deciding against applying equitable subrogation to those facts. The Matrix Court relied on prior case law, specifically Dedes v. Strickland to apply the elements of equitable subrogation. Dedes v. Strickland, 307 S.C. 155, 414 S.E.2d 134 (1992). Indeed, equitable subrogation is part of South Carolina's commons law and is discussed in numerous cases in South Carolina involving mortgages. Independence Nat'l Bank v. Buncombe Prof'l Park, LLC, 411 S.C. 605, 769 S.E.2d 663 (2015); Langehans v.

Smith, 347 S.C. 348, 554 S.E.2d 681 (Ct. App. 2001); United Carolina Bank v. Caroprop, Ltd., 311 S.C. 376, 429 S.E.2d 197 (Ct. App. 1987); Dodge City of Spartanburg, Inc. v. Jones, 317 S.C. 491, 454 S.E.2d 918 (Ct. App. 1994). Matrix does not demonstrate the Court's willingness to adopt the Restatement; rather it demonstrates the Court's deference to the common law.

In both the majority and the dissent of Matrix, the phrase "replacement and modification" is repeated five separate times. Matrix Financial Serv. Corp.. v. Frazer, 394 S.C. 134, 714 S.E.2d 532 (2011). In fact, the term "replacement" is not used anywhere in the case without "and modification" being used right after. Id. Placing these two terms together constantly is important, especially to the real estate practitioner in South Carolina. A modification is different than a refinance, as a modification does not advance cash out to the borrower. See Crawford v. Cent. Mortg. Co., 404 S.C. 39, 41, 744 S.E.2d 538, 539 (2013).

When creditors and borrowers enter into a modification, it is commonly as a result of foreclosure intervention. See Crawford v. Cent. Mortg. Co., 404 S.C. 39, 744 S.E.2d 538 (2013). A new loan is not closed, and the existing debt is not extinguished. Id. An attorney is not required to be present at the "closing" of a modification, but an attorney must be present at the closing of a refinance. Id. Doe v. McMaster, 355 S.C. 306, 585 S.E.2d 773 (2003). The prior loan is not satisfied with a modification. It retains its original priority because there is no change in terms that would materially prejudice intervening lenders. Nothing in Crawford or Matrix supports the position we have here where a new loan obligation, with a cash out payment to the borrower, should take the priority of an earlier, satisfied mortgage.

For the Special Referee to ignore this State's race-notice statute and fashion a new remedy out of the Restatement would be have been error. "It is well known that equity follows the law." Regions Bank v. Wingard Props. Inc., 394 S.C. 241, 249, 715 S.E.2d 348, 353 (Ct. App. 2011) quoting Smith v. Barr, 375 S.C. 157, 164, 650 S.E.2d 486, 490 (Ct. App. 2007). "When providing an equitable remedy, the court may not ignore statutes, rules, and other precedent." Regions at 254, at 715 S.E.2d at 355. South Carolina's race-notice statute applies and settles this issue; therefore it would have been error for the Special Referee to craft an equitable relief based on secondary sources.

Equity will not protect a party that did not take the time to protect itself. See O'Keefe v. Rice, 8 S.C. Eq. 179 (1831). Equitable relief will not be employed when a party fails to properly do what ought to be done. See Kennerty v. Etiwan Phosphate Co., 21 S.C. 226 (1884). Here, the Appellant failed to conduct a thorough, accurate title examination and act accordingly to protect its interests.

If the advanced replacement mortgage theory is adopted as it relates to refinances, with cash payouts, a title search becomes unnecessary. If the replacement mortgage theory is adopted, the major steps an attorney must take in a mortgage loan closing in South Carolina would not have been set out in Buyers Services, and reiterated time and again in other cases. State v. Buyers Serv. Co., 292 S.C. 426, 357 S.E.2d 15 (1987); Wachovia Bank v. Coffey, 389 S.C. 68, 698 S.E.2d 244 (Ct. App. 2010); Doe v. McMaster, 355 S.C. 306, 585 S.E.2d 773 (2003). If the replacement mortgage theory advanced is adopted, South Carolina Code Annotated Section 30-7-10 becomes meaningless. This cannot be the case.

Buyers Services states that one of the things that an attorney does when closing a mortgage loan secured by real property is search the title of the real property. Buyers Services at 429, at 357 S.E.2d at 17. This would not be a requirement if Appellant's replacement mortgage theory is adopted. Using Appellant's argument, lenders with closed-end mortgages could advance additional funds without the need for a title examination, to the detriment of intervening lienholders. If the Court accepts the theory of replacement mortgage, especially as it would apply to cash-out refinances, such a holding would not only eliminate customary procedures of real estate practitioners such as title examinations, but it would also erode the holdings of the Buyers Services line of cases.

The use in Matrix of the phrase "replacement and modification" together, in conjunction with the Crawford Court's definition of modification, show that if adopted, replacement mortgage theory should only be used with regard to true loan modifications, which by definition do not satisfy or cancel the original mortgage or cash-out funds to borrowers. Long-standing equitable maxims show that equity will not fashion a remedy when a statute such as the race-notice statute already addresses the dispute. Further, the Buyers Services line of cases show the importance of a title search in South Carolina, which would be completely undermined if replacement mortgage theory is adopted.

b. SOUTH CAROLINA'S CIRCUIT COURT DECISION IS UNDER DIFFERENT FACTS

Appellant cites to a single Circuit Court case in South Carolina as support for the theory of replacement mortgage, CBC Nat. Bank v. Miller, 2015-CP-07-02081 (January 19, 2017), which shows the lack of authority for the proposition. Furthermore, "unpublished orders [from the Appellate Courts] have no precedential value and should

not be cited except in proceedings in which they are directly involved." South Carolina Appellate Court Rules: Rule 268(d)(2), SCACR. The referenced case, however, is not from an Appellate Court, it is from a lower court and bears no guidance in the instant matter. Beyond this, however, the one trial court case Appellant relies upon has different facts than the instant case. In the case out of Beaufort County cited by Appellant, the replacement loan actually was for a smaller loan amount than the replaced mortgage. CBC Nat. Bank v. Miller, 2015-CP-07-02081 (January 19, 2017). In the instant case, the loan is for $39,500.00 more, and the Borrowers took cash out in the amount of $26,235.11.

Also, in the Beaufort case, the intervening creditor was a judgment creditor, not a mortgage creditor. Id. Mortgage creditors, as opposed to judgment creditors, make decisions to approve or deny second mortgage loans based on loan-to-value ratios determined by a thorough title search. The Beaufort intervening creditor being a judgment lien holder was not influenced in its decision to obtain a judgment against the borrower according to the amount of an existing mortgage loan. If anything, the case out of Beaufort County shows that Appellant's predecessor-in-interest, Quicken, is not in the habit of conducting thorough title searches, or more troubling, does not address intervening lienholders at all.

c. RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) IS INAPPLICABLE TO THE FACTS OF THIS CASE

The theory of replacement mortgage is espoused not in the case law or statutory law of South Carolina, but in the Restatement (Third) of Property (Mortgages). According to the Restatement, a replacement mortgage can retain the original priority of the mortgage that is being replaced, except to the extent that the replacement mortgage

changes the terms of the original mortgage or if the replacement mortgage is materially prejudicial to any existing subordinate lienholders. Restatement (Third) of Property; Mortgages § 7.3.

According to the secondary source that Appellant is urging the Court to adopt, there are two instances in which the replacement mortgage theory must fail. First, to the extent that the terms of the second mortgage are different than the terms of the first mortgage, the replacement mortgage cannot retain the priority of the first mortgage. Id. Second, if the replacement mortgage is materially prejudicial to intervening lienholders, the prejudicial replacement mortgage cannot retain the priority of the first mortgage. Id. These two exceptions will be addressed in Argument III, infra.

The commentary to this provision suggests that public policy favors workouts and flexible restructuring to benefit current borrowers. Restatement (Third) of Property; Mortgages § 7.3. However, in this case, Appellant Mortgage 2 did not result in more favorable terms to the Borrowers. On the contrary, the Borrowers cashed out supposed equity in the amount of $26,235.11, paid closing costs in excess of $12,000.00, which only served to increase the amount that they owed by $39,500.00 and made their eventual default more likely. These are not the hallmarks of a workout loan.

This Court can encourage lenders to work with delinquent borrowers and continue to decline to adopt the theory of replacement mortgage. If replacement mortgage theory is not adopted, lenders will continue to have at their disposal the ability to modify mortgage loans with delinquent borrowers without worrying about preserving priority or needing approval of subsequent lienholders. Lenders will simply need to modify existing mortgage loans in such a way to avoid materially prejudicing subsequent lienholders'

interests. Lenders will continue to be able to reduce the interest rate, reduce payment amounts, and reduce principal amounts. See Crawford v. Cent. Mortg. Co., 404 S.C. 39, 744 S.E.2d 538 (2013). The advanced theory does not advance public policy in South Carolina.

d. OTHER JURISDICTIONS HAVE DIFFERENT STATUTES AND A DIFFERENT DEVELOPMENT OF COMMON LAW

Appellant urges the Court to extend the current state of the law by listing other jurisdictions that would favor Appellant's desired result. Sovereign Bank v. Gillis, 432 N.J. Super 36, 74 A.3d 1 (N.J. Super. Ct. App. Div. 2013). The case out of New Jersey is distinguishable in that New Jersey has statutory provisions specifically addressing the priority of mortgages after a modification. The South Carolina legislature has not seen fit to do so and instead seems to be comfortable with the uncomplicated race-notice statute, with exception only by equitable subrogation, as espoused in a long line of cases.

> [T]he priority of the lien of a mortgage loan which has undergone a modification, as defined by this act, shall relate back to and remain as it was at the time of recording of the original mortgage as if the modification was included in the original mortgage or as if the modification occurred at the time of recording of the original mortgage. The priority granted by this section shall not apply to any balance due in excess of the maximum specified principal amount which is secured by the mortgage . . . .
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> N.J. STAT. ANN. § 46:9-8.2 (1991)

New Jersey statute also defines a modification as any change except an advance of principal amount due. "Modification means . . . [w]ith respect to a mortgage loan other than a line of credit, a change in the interest rate, due date or other terms and conditions of a mortgage loan except an advance of principal . . . ." N.J. STAT. ANN. § 46:9-8.1(d)(1) (1991). Thus, the facts of the present situation, with the advance of

additional funds, would exempt the scenario from the definition of "modification" under New Jersey law.

Another important fact in Sovereign Bank v. Gillis is that the lender arguing for replacement mortgage paid off the junior lienholder's intervening mortgage loan. Sovereign Bank v. Gillis, 432 N.J. Super 36, 38, 74 A.3d 1, 2 (N.J. Super. Ct. App. Div. 2013). Appellant did not pay off Respondent Mortgage loan with Appellant Mortgage 2; instead it disregarded Respondent's Mortgage.

Appellant also offers up a Michigan case as an example for the Court. CitiMortgage, Inc. vs. MERS, 295 Mich. App. 72, 813 N.W.2d 332 (Mich. Ct. App. 2011). However, Michigan takes a different approach to the entire issue, and equates replacement mortgage theory with equitable subrogation, which South Carolina Court has specifically refused to do.

> We caution, however, that the lending mortgagee seeking subrogation and priority over an intervening interest relative to its newly recorded mortgage *must be the same lender* that held the original mortgage before the intervening interest arose; and, furthermore, any application of equitable subrogation is subject to a careful examination of the equities of all parties and potential prejudice to the intervening lienholder."
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> Id. at 77.

The Michigan Court specifically approves of the use of equitable subrogation when the replaced mortgage and replacement mortgage creditor is the same lender. South Carolina courts specifically reject this line of thinking, and should likewise reject the replacement mortgage theory. See Matrix Financial Serv. Corp.. v. Frazer, 394 S.C. 134, 714 S.E.2d 532 (2011).

Even though Arizona elected to adopt the reasoning of replacement mortgage theory, the court in Brimet stated "[r]eplacement is not available when the terms of the

new loan change the terms of the underlying debt such that it is materially prejudicial to a junior lienholder's interest in the real property." Brimet II, LLC v. Destiny Homes Marketing, LLC, 231 Ariz. App. 457, 296 P.3d 993, 996 (Ariz. Ct. App. 2012).

Appellant urges the Court to not only adopt the replacement mortgage theory, to adopt it as it relates to cash-out refinances, but to also adopt a special solution (apportionment) to the exception of material prejudice to an intervening lienholder. Respondent has not been able to locate a jurisdiction that has adopted all of these provisions without at least part of the Restatement being codified. While other jurisdictions' interpretation and analysis of the theory of replacement mortgage may be interesting, it is not instructive or precedential in South Carolina where the Restatement has not been codified, and where South Carolina law specifically provides for the priority of the filing dates. See S.C. CODE ANN. § 30-7-10 (1976). Certainly, what other jurisdictions do is important to a national lender such as Quicken (Appellant's predecessor-in-interest), which is hoping to impose nationwide standards in order to close mortgages at a high volume and at high speed (and without the need or costs of title examinations). Local, small creditors such as Respondent, which close and service mortgage loans within the State, continue to honor the clear race-notice statute that is in place.

When it comes to real estate closings, South Carolina has a tendency to demand a more rigid, formal process than many other jurisdictions. Not all states require that an attorney oversee the process. See State v. Buyers Service Co., Inc., 292 S.C. 426, 357 S.E.2d 15 (1987). Following these requirements, closing counsel can and should advise the lender of the necessity of a title examination and the impact of intervening liens. A

failure to so affords the lender of a remedy without prejudicing the innocent, intervening lienholder.

Appellant's argument is based on the Restatement and not existing precedent. The Restatement is not the law of South Carolina, and no appellate court in South Carolina has adopted the concept of replacement mortgage. As noted herein, this legal theory runs contrary to established authority in this State and should not be adopted. Even if South Carolina were to adopt this theory, it would not apply here since there was a substantial amount of money taken out and cash given to the Borrowers in the Appellant Mortgage 2, thereby materially prejudicing Respondent, as will be addressed in Argument III.

II. THE SPECIAL REFEREE PROPERLY FOUND THAT APPELLANT'S MORTGAGE WAS NOT A REVOLVING CREDIT MORTGAGE OR LINE OF CREDIT, AND THAT APPELLANT WAS NOT FREE TO MAKE CASH-OUT ADVANCES OF PRINCIPAL TO BORROWERS.

Appellant argues that Respondent was on notice that the principal balance of the Appellant Mortgage 1 could increase under the terms of the Appellate Mortgage 1 mortgage. The Special Referee, being a real estate practitioner, did not agree with Appellant. The pertinent part of the Appellant Mortgage 1 states that it secures the instant Note and "any renewal, extension or modification." Appellant contends that this language is a Future Advance Clause or somehow works to convert a closed-end mortgage loan to an open-end mortgage loan or a line of credit or revolving credit mortgage. A future advance clause is located in Revolving Credit Mortgages and Home Equity Lines of Credit, not in the instant, closed-end Appellant Mortgage 1 mortgage. Appellant's argument is without merit.

a. APPELLANT MORTGAGE 2 IS NOT A RENEWAL OF APPELLANT MORTGAGE 1

A contract renewal occurs when a contract is extended for an additional period of time with the same terms and obligations as an existing contract, and a renewal usually happens at the time the existing contract is expiring. See First S. Bank v. S. Causeway, LLC (Ct. App. 2015) Appellate Case No. 2012-213524 Opinion No. 5357. In the instant situation, there is a new note, a new mortgage, a new loan amount, and a new interest rate. Appellant Mortgage 2 was not a renewal.

b. APPELLANT MORTGAGE 2 IS NOT AN EXTENSION OF APPELLANT MORTGAGE 1

An extension is defined as "an increase in the date of expiration or due date for a term or obligation." Barron's Law Dictionary, 187-88 (1996). It is a specific type of modification and is the agreement to delay the maturity date of a loan. A loan usually can be extended without the consent of intervening lienholders because it is highly unlikely to materially prejudice intervening lienholders. It does not advance new funds and does not increase the likelihood of default. On the contrary, it increases the likelihood of performance of the first loan, thereby making it more beneficial for all lien creditors. As is readily apparent from a comparison of the two different notes at issue in this matter, Appellant Mortgage 2 is not an extension of Appellant Mortgage 1. They are two separate and distinct obligations.

c. APPELLANT MORTGAGE 2 IS NOT A MODIFICATION OF APPELLANT MORTGAGE 1

The Court in Crawford addressed two fact patterns simultaneously; the borrowers in each fact pattern received mortgage modifications. Crawford v. Cent. Mortg. Co., 404 S.C. 39, 744 S.E.2d 538 (2013). The first modification that borrower Crawford received

reduced the interest rate, extended the maturity date, and added missed loan payments, escrow shortages, and attorneys' fees to the end of the loan. Id. at 41 – 42, 744 S.E.2d at 539. The Crawford Court took the time to note that the increase in principal was not a cash-out scenario. The changes accomplished by the modification are designed to aid the borrower and prevent future repayment defaults.

The second borrower, Warrington, received three modifications that extended the maturity date, and two of the modifications provided for interest-only payments. Id. at 43, 744 S.E.2d at 540. Again, these measures are in an attempt to assist a defaulting borrower and are made as an attempt to avoid foreclosures. "A loan modification is an adjustment to an existing loan to accommodate borrowers who have defaulted. In contrast, refinancing is the issuance of an entirely new loan, often used by home owners to take advantage of lower interest rates." Id. at 47, 744 S.E.2d at 542.

South Carolina statutory law also addresses future advance mortgages.

> Any mortgage or other instrument conveying an interest in or creating a lien on any real estate, securing existing indebtedness or future advances to be made . . . are valid from the day and hour when recorded so as to affect the rights of subsequent creditors . . . to the same extent as if the advances were made as of the date of the execution of the mortgage or other instrument for the total amount of advances made thereunder, together with all other indebtedness and sums secured thereby, the total amount of existing indebtedness and future advances outstanding at any one time may not exceed the maximum principal amount stated therein, plus interest thereon, attorney's fees and court costs. . . .

S.C. CODE ANN. § 29-3-50(A) (1976).

A Future Advance Mortgage must state the maximum amount that can be advanced under the mortgage loan. Id. This is to notify potential subsequent creditors as to the extent of probable indebtedness. This allows parties such as the Respondent to make a reasonable decision about whether to grant a subsequent mortgage. Appellant

Mortgage 1 does not contain a reference to the maximum amount that can be advanced. Joint Stipulation Exhibit A, Page 2. It merely mentions the amount already advanced at closing, which is consistent with a closed-end mortgage. Id. The language upon which Appellant relies does not establish a Future Advance clause.

III. THE SPECIAL REFEREE PROPERLY FOUND THAT THE RESPONDENT WAS MATERIALLY PREJUDICED BY THE APPELLANT'S MORTGAGE WHEN APPELLANT ADVANCED NEW FUNDS IN THE AMOUNT OF $39,500.00 AND PROPERLY FOUND THAT THIS MATERIAL PREJUDICE SHOULD BAR ANY THEORY OF REPLACEMENT MORTGAGE.

Appellant argues that not only should the Court extend the law to include replacement mortgage theory, and that replacement mortgage theory should apply to cash-out refinances, but also that the so-called replacement mortgage in question was not materially prejudicial to the Respondent, despite advancing significant funds. Further, Appellant argues that if the Court should agree with the Special Referee's findings that the replacement mortgage was materially prejudicial to the Respondent, the Court should nevertheless create a new formula to carve out the materially prejudicial parts of Appellant's replacement mortgage, essentially redrafting the offending mortgage.

According to the Restatement, a replacement mortgage can retain the original priority of the mortgage that is being replaced, except to the extent that the replacement mortgage changes the terms of the original mortgage or if the replacement mortgage is materially prejudicial to any existing lienholders. Restatement (Third) of Property; Mortgages § 7.3.

Even where this theory is advanced, the Restatement outlines two instances in which the replacement mortgage theory must fail. First, to the extent that the terms of the

second mortgage are different than the terms of the first mortgage, the replacement mortgage cannot retain the priority of the first mortgage. Id. Second, if the replacement mortgage is materially prejudicial to intervening lienholders, the prejudicial replacement mortgage cannot retain the priority of the first mortgage. Id.

In the instant case, the terms of the Appellant Mortgage 2 are different than the terms of Appellant Mortgage 1. The principal balance is $39,500.00 greater. The Borrowers walked away from the transaction with $26,235.11 in additional cash. Joint Stipulation, Exhibit P. The Borrowers cashed out supposed equity, apparently using a loan-to-value ratio that did not include the balance of the Respondent Mortgage loan. There were substantial closing costs in excess of $12,000.00 associated with the Appellant Mortgage 2. Joint Stipulation, Exhibit P.

Appellant Mortgage 2 also contains terms that are materially prejudicial to intervening lienholders. Because Appellant advanced significant additional money to the Borrowers in its mortgage for the Appellant Mortgage 2, the Respondent was substantially and materially prejudiced. An increase in the principal amount secured by a replacement mortgage is generally deemed to be materially prejudicial to an intervening lienholder such as the Respondent. Restatement (Third) of Property; Mortgages § 7.3(a)(2), comment b. When the "replacement" mortgage has materially prejudiced an intervening lienholder, the "replacement" mortgage is not entitled to the priority of the mortgage it is hoping to replace. Restatement (Third) of Property; Mortgages § 7.3. The Matrix dissent considers the idea of replacement mortgage, "except to the extent this priority would materially prejudice a junior lienholder. Material prejudice may exist

where the principal amount is increased . . . ." Matrix Fin. Servs. Corp. v. Frazer, No. 26859 (2010).

The law affords consideration to the intervening lienholders because intervening lienholders make decisions about whether to grant loan applications based on equity to support the entire proposed loan. The junior lender must make considerations about the potential future of loan, which could include a bankruptcy. If the borrower files for bankruptcy, the borrower can avoid second mortgage liens (and avoid payment) if there is no equity over and above what is owed to the superior creditor. 11 U.S.C § 1322(b)(2). In other words, there must be some equity to support the granting of a second mortgage if it is to be paid in bankruptcy. Id. If superior creditors are allowed to close cash-out refinance loans that increase the amounts due to borrowers without having to worry about the priority of the accompanying mortgage, creditors such as credit unions who routinely grant second mortgages will have no way of knowing how much equity is in any proposed parcel of collateral at any given time. This would make second mortgages undesirable loan products for many creditors, and thereby eliminate homeowners' access to them.

Advancing these additional funds would extremely prejudice the Respondent's ability to receive payment if the real property is sold, foreclosed, or destroyed. Respondent's mortgage was in the amount of $99,000. It is no small thing that Appellant would deny the Respondent of at least $39,500.00 in equity by unilaterally increasing the amount due to Appellant. Policy considerations such as reducing foreclosures are not accomplished by increasing the amount owed to the first mortgagee by $39,500.00, allowing cash-out of $26,235.11 and charging closing costs in excess of $12,000.00.

Appellant's Appellant Mortgage 2 created a substantial disadvantage to Respondent's interests and left Respondent in a far worse position, due to the additional funds advanced to the Borrowers. This additional amount advanced after the Respondent's mortgage closed is almost 40% of Respondent's total original loan amount.

Appellant argues that the Special Referee's finding that any material prejudice to an intervening lienholder should be fatal to the theory of replacement mortgage is an "incomplete and incorrect interpretation of the Restatement (Third) of Property (Mortgages) § 7.3(a)." Appellant complains that "any ounce of material prejudice" should not be fatal to the application of the concept of replacement mortgage. There is no such thing as an ounce of material prejudice. For prejudice to arise to a material amount, it is by definition more than an ounce. To small community creditors such as the Respondent, $39,500.00 is material prejudice, not an ounce.

Respondent agrees that extending the maturity of a note and mortgage by one month is not materially prejudicial. Similarly, reducing interest rates would not be materially prejudicial, as interest rates are not included in recorded Mortgages; interest rates are found in Notes, which are not recorded. These are the hallmarks of true modifications, not what he have in the instant situation.

Appellant attempts to engage in convoluted calculations to determine to what extent the Respondent was not materially prejudiced by the advance of new funds. However, the manner in which Appellant closed the Appellant Mortgage 2 denied Respondent the opportunity to properly evaluate Borrowers' request to Respondent for a mortgage loan at all. The parties cannot argue this in hindsight with credibility. At a minimum, this dialogue engaged in by Appellant confirms the material prejudice suffered by Respondent.

Appellant suggested, as one possible alternative, that the sales proceeds from the foreclosure sale first go to Appellant except to the extent that the Respondent was materially prejudiced. This fails to take into account the fact that Respondent has paid real property taxes that have come due in the amount of $37,706.63 on the property in question, during the litigation. By statute, the creditor paying real property taxes has the right to first sales proceeds. Section 29-3-40 of the South Carolina Code of Laws addresses the priority of advancements by creditors:

> Advancements made for taxes by any such mortgage holder shall be a first lien on the mortgaged real property to the extent of the taxes so paid with interest from the date of payment, regardless of the rank and priority of the mortgage under which such taxes are advanced.

S.C. CODE ANN. § 29-3-40 (1976).

That Respondent, not Appellant, has taken the step to protect its lien by paying real property taxes, a step traditionally taken by the first mortgage creditor, reveals Respondent is the party properly in first position, advancing funds to pay taxes and avoid a tax sale. Appellant's failure to do so reflects their true understanding and position.

Respondent makes mortgage loans and then services them, which motivates Respondent to completely search title, make loans more likely to perform, and refrain from advancing new money without conducting a proper closing, complete with a thorough title examination. By contrast, Appellant's mortgage has been sold and assigned repeatedly during the litigation and the appeal, and Appellant has not paid the real property taxes, both of which are signs of a creditor abandoning a botched loan.

CONCLUSION

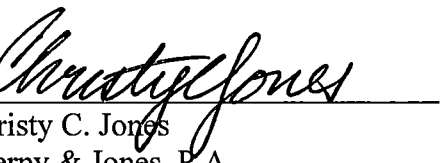
The trial court correctly ruled that Summary Judgment was appropriate because there was no genuine issue of material fact, such that Respondent was entitled to

judgment as a matter of law. The parties both agree to the timing of the various mortgages. The Court should uphold the Special Referee's finding that Respondent's mortgage is entitled to priority over Appellant's Appellant Mortgage 2 as a matter of law, as set forth in South Carolina statute.

Respondent has hardly received a magical gift in this matter, as suggested by Appellant. The situation, confusion and dispute has been created by the Appellant through their actions and inactions, all to the detriment of Respondent. The Appellant was in the better position to prevent this dispute by employing the time-honored procedures of a traditional real estate closing, including a thorough title search.

This Court should decline to extend the current law to create an exception to South Carolina's clear race-notice statute. The Court should not adopt replacement mortgage theory. If this Court decides to advance the replacement mortgage theory, it should be limited to situations involving modifications of mortgages. If this Court decides to adopt replacement mortgage theory as it applies to refinanced mortgage loans, it should determine that material prejudice to intervening lienholders will entirely negate a refinancing creditor's right to assert replacement mortgage. The Court should not create and exception to the race-notice statute, apply it to cash-out refinances, and hold that material prejudice can exist to allow a creditor to claim a priority not concurrent with recording date. Therefore, the Court should affirm the Special Referee's Order granting Respondent foreclosure and priority.

Respectfully submitted,



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THE STATE OF SOUTH CAROLINA

In the Court of Appeals

APPEAL FROM FAIRFIELD COUNTY
Court of Common Pleas

Carol A. Tolen, Special Referee
Trial Court Case No. 2012-CP-20-00132

Appellate Case No. 2018-000230

ArrowPointe Federal Credit Union, Plaintiff,

v.

Jimmy Eugene Bailey; Laura Jean Bailey; and U.S. Bank National Association not in its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1, Defendants,

Of Whom U.S. Bank National Association not in its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1 is the Appellant,

And of Whom ArrowPointe Federal Credit Union is the Respondent.

CERTIFICATE OF SERVICE

I certify that I have served a copy of *Initial Brief of Respondent* by depositing a copy of the same in United States Mail, postage prepaid, on May 17th, 2018, to Appellants' Attorney of record, listed herein:

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May 17, 2018