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 its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1 is the Appellant.

REPLY BRIEF OF APPELLANT

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ARGUMENT IN REPLY

The Appellant U.S. Bank offers the following points of clarification and rebuttal to the arguments raised by the Respondent ArrowPointe in its brief.

I. ARROWPOINTE WHOLLY MISINTERPRETS THE RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 7.3(a)(1), SOUTH CAROLINA'S RACE-NOTICE STATUTE, CASE LAW, AND EQUITABLE MAXIMS.

a. ARROWPOINTE'S INTERPRETATION OF THE LANGUAGE IN THE RESTATEMENT IS MISPLACED.

The Restatement (Third) of Property (Mortgages) § 7.3 ("Restatement") reads verbatim as follows in subsection (a)(1):

> (a) If a senior mortgage is released of record and, as part of the same transaction, is replaced with a new mortgage, the latter mortgage retains the same priority as its predecessor, except
> (1) to the extent that any change in the terms of the mortgage or the obligation it secures is materially prejudicial to the holder of a junior interest in the real estate.

See Restatement (Third) of Property (Mortgages) § 7.3 (1997). ArrowPointe fails to use this actual language of the Restatement in its Brief, but uses a misleading paraphrase that reads as follows:

> 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 is materially prejudicial to any existing subordinate lienholders. ("Incorrect Restatement Paraphrase").

See Respondent's Initial Brief, p. 12-13, 20-21. ArrowPointe's Incorrect Restatement Paraphrase further thwarts the Restatement drafters' intent by suggesting, first, that any changes to the terms between the replaced mortgage and the replacement mortgage causes the theory to fail. Id. This interpretation defies logic. The two different mortgages would not have identical terms. Second, ArrowPointe suggests that any material prejudice in the replacement mortgage causes it to fail. Id. Critically, ArrowPointe ignores the language in subsection (a)(1) that states "to the extent of". This "to the extent of" language gives rise to the mathematical analysis in Illustration 2 and 6 that

U.S. Bank points out in its brief, which shows the commentators efforts to keep the junior creditor in the same position as when it underwrote its loan – no better, no worse. See Footnote 6, p. 23, Appellant's Initial Brief.

ArrowPointe suggests U.S. Bank's "Adjusted U.S. Bank Total Debt" analysis as defined in its brief is an "attempt to engage in convulated calculations." See p. 23, Appellant's Initial Brief; p. 23, Respondent's Brief. Rather, such calculations are a critical component of preventing a windfall to ArrowPointe as shown in the Restatement's express language and Illustrations. If the Restatement is recognized in South Carolina, ArrowPointe's unsupported argument that any material prejudice prevents Replacement Mortgage must fail.

b. ARROWPOINTE'S STRICT APPLICATION OF SOUTH CAROLINA'S RACE-NOTICE STATUTE MISINTERPRETS CASE LAW, EQUITABLE MAXIMS AND THIS STATE'S LONGSTANDING EXCEPTIONS TO THE GENERAL RACE-NOTICE RULE.

Throughout its brief, ArrowPointe argues that its Revolving Credit Mortgage must hold senior lien position solely due to the operation of S.C. Code Ann. §30-7-10 ("Race-Notice Statute"). See Argument I in Respondent's Brief. ArrowPointe ignores South Carolina's common-law exceptions to the Race-Notice Statute such as Purchase Money Mortgages, and side-steps the exception of Equitable Subrogation. See Crystal Ice Co. of Columbia v. First Colonial Corp. 273 S.C. 306, 310-11, 257 S.E.2d 496, 498 (1979) (holding equities favor granting priorities to purchase money mortgages even when recorded subsequent-in-time); see also Matrix Financial Services Corp. v. Frazer, 394 S.C. 134, 137-38, 714 S.E.2d 532, 533-34 (2011) (outlining the elements of equitable subrogation and making findings pursuant to Restatement (Third) of Property (Mortgages) § 7.6). While ArrowPointe admits that equitable subrogation is part of South Carolina common law, it repeatedly suggests that application of the Race-Notice Statute is the only

way to arrive at the appropriate lien priority result. ArrowPointe's argument ignores well-known exceptions to the Race-Notice Statute.

Replacement Mortgage is a logical extension of the long-standing common law principle of equitable subrogation. The terminology differs for a lender refinancing another lender's loan (Subrogation) rather than a lender refinancing its own loan (Replacement). ArrowPointe takes great strides and leaps at thwarting the logic in Matrix and Crawford by suggesting that South Carolina would only recognize the Restatement for Modifications rather than refinances of new loans (Replacement). Id.; Crawford v. Central Mortgage Co., 404 S.C. 39, 744 S.E.2d 538 (2013). Neither opinion makes any sort of such suggestion. The Matrix court's use of the term "Replacement" shows that it is contemplating new, refinanced loans. To wit, South Carolina cases recognizing Equitable Subrogation solely deal with loans that have been refinanced into new loans. Crawford only addresses Unauthorized Practice of Law ("UPL") issues and makes no holdings concerning lien priority. Id. Crawford shows the Court's propensity to allow senior lienholders to work with their borrowers towards more flexible financing arrangements, including the increase of principal amounts due, interest and longer maturity periods. Id.

In light of South Carolina's recognition of Equitable Subrogation, ArrowPointe's argument that Replacement Mortgage obviates the need for title searches in loan closings holds no weight. As Equitable Subrogation prevents turning a mistake into a magical gift for a junior lienholder, so does Replacement Mortgage. ArrowPointe's discussion of UPL progeny distracts attention away from the Restatement commentator's intended result of placing the lienholders in the same position as they were when they closed their loans. See Respondent's Brief at p. 10-11 discussing State v. Buyer's Serv. Co. and Doe v. McMaster opinions concerning UPL. U.S. Bank admits that its Replacement Mortgage was part of a new loan that refinanced a senior loan, and that its closing

required a title search as part of South Carolina law. ArrowPointe stipulates that U.S. Bank's predecessor used a South Carolina licensed attorney to close its loan and that U.S. Bank did not have actual knowledge of the Revolving Credit Mortgage. See Joint Stipulation 16-17. However, its suggestion that the adoption of Replacement Mortgage would negate the need for a title search is misplaced and is inconsistent with the existing doctrine of Equitable Subrogation.

ArrowPointe argues that certain equitable maxims prevent the Court from adopting Replacement Mortgage. See Respondent's Brief, p. 10. However, if ArrowPointe's argument were true, South Carolina could not recognize any exception to the Race-Notice Statute. South Carolina courts have declined the strict Race-Notice rule advanced by ArrowPointe. South Carolina courts recognize exceptions to the Race-Notice Statute such Equitable Subrogation, as well Purchase Money Mortgages that are senior to prior-in-time lienholders whose debt arose through the mortgagor. Replacement Mortgage as discussed in the Restatement is consistent with South Carolina common law and equitable maxims.

In its analysis of other cases raised by U.S. Bank from other jurisdictions that support Replacement Mortgage, ArrowPointe's analysis should be distinguished. While pointing to a statute concerning modifications in New Jersey, ArrowPointe ignores that the Sovereign Bank v. Gillis court recognized the doctrine of replacement in the context of a new loan that refinanced a prior loan, as opposed to a modification of an existing loan. 432 N.J. Super. 36, 74 A.3d 1 (N.J. Supr. Ct. App. Div. 2013). In CitiMortgage, Inc. v. MERS, the court reaches the same equitable result that U.S. Bank asks of this Court, though U.S. Bank asks this Court to recognize the term "Replacement Mortgage" in this instance rather than Equitable Subrogation in light of the Matrix decision. 295 Mich. App. 72, 77 (Mich. Ct. App. 2011). Addressing ArrowPointe's discussion of Arizona's recognition of Replacement Mortgage, the Markham Contracting Co., Inc. v. FDIC

court clearly recognizes that a replacement mortgage can hold priority *to the extent* that it does not materially prejudice an intervening lienholder. 240 Ariz. 360, 379 P.3d 257 (Ariz. Ct. App. 2016) (emphasis added).

Along with existing doctrines that represent exceptions to the Race-Notice Statute, Replacement Mortgage as discussed in the Restatement should be recognized as the common law of South Carolina.

II. ARROWPOINTE FAILED TO RAISE PRIORITY ARGUMENTS IN THE LOWER COURT CONCERNING AD VALOREM TAXES AND S.C. CODE ANN. § 29-3-40 (1976), WHICH IS AN ISSUE THAT WAS NOT REVIEWED OR RULED UPON BY THE LOWER COURT

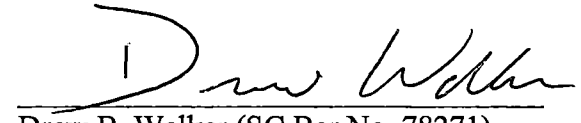
ArrowPointe and U.S. Bank based their lien priority arguments in the lower court solely on whether Replacement Mortgage applied in South Carolina courts. ArrowPointe raises S.C. Code Ann. § 29-3-40 concerning *ad valorem* taxes for the first time in its brief. See Respondent's Brief, p. 24. Because the issue was not plead or raised at a hearing in the lower court, the issue was neither ruled upon nor preserved for the instant appeal. Queen's Grant II Horizontal Property Regime v. Greenwood Development Corp., 368 S.C. 342, 372-73, 628 S.E.2d 902, 919 (Ct. App. 2006). Factually, the record indicates that U.S. Bank has Escrow Advances, which include taxes, in the amount of $30,050.87 as of March 13, 2017. Exhibit V of the Joint Stipulation. ArrowPointe has "Taxes, insurance, etc. not included above" in the amount of $37,706.63. See Order p. 3. The record is neither clear on what "etc." means, nor does it itemize or chronologize taxes, insurance, escrow advances, etc. because the parties stipulated to each other's debt and itemization was not necessary because the priority argument under the aforementioned statute was not raised. "Issue preservation rules are designed to give the trial court a fair opportunity to rule on the issues, and thus provide us with the platform for meaning appellate review." Queen's Grant, 368 S.C. at 372-

73, 628 S.E.2d at 920. The trial court did not review the tax priority argument advanced for the first time in ArrowPointe's brief, and the issue cannot receive appellate review.

CONCLUSION

Based on the foregoing, and in addition to the arguments made in its Initial Brief, U.S. Bank respectfully requests the lower court be reversed by adopting the doctrine of Replacement Mortgage, applying such decision retroactively, and further finding that ArrowPointe suffered no material prejudice. In the alternative that the court determines there was material prejudice under the doctrine of Replacement Mortgage, this matter should be remanded to determine the Adjusted U.S. Bank Total Debt.

Respectfully Submitted,



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May 29, 2018

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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 *Reply Brief of Appellant* by depositing a copy of the same in United States Mail, postage prepaid, on May 29th, 2018, to Attorneys of record, listed herein:

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RE: Arrowpointe Federal Credit Union v. Jimmy Eugene Bailey, et al.
Case No. 2018-000230

Dear Ms. Kitchings:

Enclosed please find an original and one copy of the Reply Brief of Appellant for filing in the above referenced matter.

Should you have any questions, please contact my office.

Sincerely,

Drew B. Walker

DBW/pdb

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