**THE STATE OF SOUTH CAROLINA**

**IN THE COURT OF APPEALS**

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APPEAL FROM SALUDA COUNTY
COURT OF COMMON PLEAS

R. Knox McMahon, Circuit Court Judge

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Appellate Case No. 2018-001388

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Stephen Wilkinson, as Trustee of George B. Buchanan, Jr. Irrevocable Family Trust Dated the 15th day of July, 2001, .....Respondent,

v.

Redd Green Investments, LLC, Anderson North Augusta, LLC, Herbert Anderson, Jr., A. Bruce, Green, Herbert Keith Anderson, and L. Cliff Redd, ..... Defendants,

Of which Redd Green Investments, LLC, A. Bruce Green, and L. Cliff Redd are ..... Appellants.

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# INITIAL REPLY BRIEF OF APPELLANTS

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## ARGUMENT

This entire appeal is premised upon the fact—accepted by the Circuit Court for purposes of its ruling on directed verdict—that the Trust violated S.C. Code § 15-39-720 (the "Deficiency Statute") when it sent a representative to place an illegal bid at the upset sale. This blatant violation of law allowed the Trust not only to obtain a deficiency judgment (to which it was not entitled unless it complied with the Deficiency Statute), it also allowed it to place a lower initial bid on the real property subject to foreclosure sale than if it had not violated the statute, thereby artificially reducing the credit applied to the debt and artificially inflating the resulting deficiency. The Trust now unashamedly claims that this illegal act should have no impact on its ability to recover the inflated deficiency against the Guarantors, even though there may have been no deficiency whatsoever if the Trust had complied with the law and made only one bid, which necessarily would have been its highest and best bid.

In essence, the Trust contends that it can impair the collateral with impunity through an admitted violation of South Carolina law and that the Guarantors must pay the price for this violation through liability for a trumped up deficiency judgment. But the Trust's arguments must fail because they ignore decades of common law that a guaranty must be interpreted by its own terms and inherently includes an implied obligation of good faith and fair dealing, as with any other contract. Under the circumstances present here, the Trust had an obligation of good faith to comply with the law during the course of the foreclosure proceedings—and specifically to comply with the Deficiency Statute—by bidding only one time with its highest and best bid at the foreclosure sale. Its failure to do so, by sending a representative to bid at the upset sale, allowed it offer a minimal bid at the first sale, safe with the knowledge that its representative could protect the low bid at the upset sale.

In this manner, the Guarantors were deprived of a true high bid from the Trust at the foreclosure sale, and as a result deprived of having the debt fully satisfied by the collateral. The resulting deficiency, which sprang into existence when there never should have been one, is the result of a blatant violation of South Carolina law. As between the Trust, who carried out this violation, and the Guarantors, who were innocent of this wrongdoing and not even named in the underlying foreclosure suit, the cost of the wrongdoing should be borne by the Trust as the culpable party.

The Trust's violation must be deemed to preclude recovery on the guaranties, either as a matter of law or at the very least as an issue of fact to be determined by the jury.[1] In arguing otherwise, the Trust's Brief repeatedly misapprehends and misstates the arguments of the Guarantors, consistently focuses on irrelevant issues that are not germane to the appeal, and fails to point to any legal precedent that supports the grant of a directed verdict or that overcomes the Guarantors' position. Each of these faulty arguments is addressed in turn below.

## I. The language of the guaranties supports the assertion of the defense that the Trust violated the Deficiency Statute.

The Trust's first argument is that the plain language of the guaranty precludes the assertion of a prior violation of the Deficiency Statute as a defense, (Resp. Br. 10 Part I), and that "[t]he Guarantors ask this court to add implied terms that contradict the plain, express terms of the guaranty agreement," (Resp. Br. 11). This argument is demonstrably incorrect. The essence of the implied covenant of good faith is that the Trust cannot take any action that would "impair the other's rights to receive benefits under the contract." *Tadlock Painting Co. v. Maryland Cas. Co.*, 322 S.C. 498, 500, 473 S.E.2d 52, 53 (1996) (internal quotations omitted). And so the question becomes whether one of the benefits the Guarantors had a right

[1] Whether by breach of the implied covenant of good faith and fair dealing or the doctrines of unclean hands, waiver, or not being able to gain from an illegal act.

to receive under the guaranty agreements was compliance with South Carolina law governing foreclosure procedure, and particularly compliance with the Deficiency Statute that forbid the Trust from bidding a second time at the upset sale.

The position of the Trust is that it could act with impunity and blatantly violate the law at the foreclosure sale, even to the detriment of the Guarantors, because to require it to comply with the Deficiency Statute would be "add[ing] implied terms that contradict the plan, express terms of the guaranty agreement." (Resp. Br. 11.) As a general matter, without reference to the terms of the guaranty agreements, it is an outrageous proposition that compliance with South Carolina law is contradictory to the terms of those agreements. And when reference is made to the actual terms of the agreements, the proposition absolutely fails. In fact, the guaranty agreements make express reference to the bidding procedure at the foreclosure sale and manifestly indicate that the Guarantors were relying upon the high bid at any foreclosure sale to operate as an offset to the debt.

Specifically, the guaranties, in all caps and bold, state that "**THE HIGH BID AT THE JUDICIAL FORECLOSURE SALE WILL BE APPLIED TO THE DEBT REGARDLESS OF ANY APPRAISED VALUE OF THE MORTGAGED PROPERTY.**" (Pl. Exs. 8-9 at 3.) The import of this provision is that Guarantors bargained for the high bid at the foreclosure sale to be applied to the debt and to reduce any obligation under the guaranty. This reliance upon the high bid is even more pronounced because it is included within a provision whereby the Guarantors waived the additional protection of statutory appraisal rights.[2] And certainly it is a fair implication from this express provision in the guaranty that the

[2] In a foreclosure proceeding, a borrower or guarantor has the right to have the appraised value substituted for the high bid and applied to the debt if the appraised value is higher, S.C. Code Ann. § 29-3-740. This protection can be waived. *Id.* § 29-3-680(b).

Trust would comply with South Carolina law at any judicial foreclosure sale and that it would not take any action to undermine the high bid that would be applied against the debt amount. It is pure arrogance for the Trust to conclude not only that it was entitled to violate South Carolina law but also that any requirement for it to comply with the law would contradict the language in the guaranty agreement.

The Court must reject this argument of the Trust. The guaranty agreements expressly contemplate that the Guarantors will have the benefit of "the high bid." There could be no more direct assault on this benefit by the Trust than its illegal violation of the Deficiency Statute, which allowed it to avoid placing its highest and best bid. In so doing, the Trust breached its implied obligation of good faith and fair dealing that it would not do anything that would impair the Guarantors' rights to a high bid under South Carolina law. The reliance of the guarantors upon "the high bid" implies a reliance upon nothing less than a high bid in compliance with the law, not a counterfeit high bid that violates the law in order to manipulate the system and avoid making a true high bid.

### A. The fact that the guaranty agreements are guarantees of payment, and not guaranties of collection, is irrelevant.

The Trust fails to point to any language in the guaranty agreements that supports its primary argument that the plain language of the guaranty agreements precludes the Guarantors from asserting an alleged violation of the Deficiency Statute as a defense. Instead, the Trust makes a number of subordinate arguments that fail to prove its point. The first such argument is set forth at Part I.A of the Trust's brief and contends that the guaranty agreements are guaranties of payment, not guaranties of collection. This distinction is correct, but it is a distinction without a difference.

As correctly cited by the Trust, the difference between these types of guaranties is that a creditor may maintain an action immediately against a guarantor on an absolute guaranty of payment and does not require prosecution against the debtor first; whereas with a guaranty of collection, the lender must pursue the debtor and collateral first. *See Peoples Fed. Sav. & Loan Ass'n v. Myrtle Beach Ret. Grp., Inc.*, 300 S.C. 277, 281, 387 S.E.2d 672, 674 (1989). Here, the Trust chose to bring an action against the borrower and collateral first, and so it is irrelevant whether or not it could have pursued the Guarantors first.

Furthermore, nothing in the *Peoples* case or in the guaranty agreements suggests that the fact that the Trust could have brought an action against the Guarantors first in any way indicates that it has the unfettered right to impair the collateral by blatantly violating the Deficiency Statute. In fact, the absolute guaranty of payment at issue in *Peoples* was quoted by the court and contained an express recognition that if the bank chose to pursue a foreclosure first, then the proceeds must be applied to reduce the debt. *See id.* at 280, 387 S.E. 2d at 674 (quoting the guaranty of payment as providing: "If the Note is partially paid through foreclosure of the Mortgage, . . . or if the Note is otherwise partially paid, the undersigned shall remain liable for the balance thereof.").

Moreover, the *Peoples* case relied upon *Southern Bank & Trust Company v. Harley*, also involving an absolute guaranty of payment. However, in *Harley* the court expressly acknowledged that a guarantor under an absolute guaranty of payment is entitled to the benefit of the collateral if the lender pursues a foreclosure action first: "[A] guarantor of a secured debt is entitled to have the proceeds of the collateral applied to the liquidation of the debt if the creditor forecloses the security before proceeding on the guaranty. The purpose of this rule is to avoid a double recovery by the creditor". *S. Bank & Tr. Co. v. Harley*, 292 S.C. 340, 341–

43, 356 S.E.2d 410, 410–11 (Ct. App. 1987) (citation omitted), *aff'd as modified,* 295 S.C. 423, 368 S.E.2d 908 (1988).

Thus, the Trust's distinction between a guaranty of payment and a guaranty of collection is to no avail. To the contrary, the case law demonstrates that one who makes a guaranty of payment is entitled to the benefit of the collateral if the lender pursues the collateral first. It necessarily follows that the lender cannot undermine or impair this benefit by violating the statutes governing bidding at the foreclosure sale, as the Trust did here. Accordingly, the Trust's violation of the Deficiency Statute was a breach of the Trust's implied covenant of good faith and fair dealing under the guaranty agreement.

### B. The Trust's argument that the Guarantors have no right in the collateral because the debt has not been paid in full is irrelevant.

The Trust's next argument, that the Guarantors have no right in the collateral because the debt has not been paid in full, (Resp. Br. 12 Part I.A.i), is equally unavailing. The Guarantors of course do not contend that they have paid the debt and therefore have a right to the collateral. Rather, the Guarantors' position is that the guaranties indicate reliance upon the collateral and proper bidding at the foreclosure sale, and therefore there is an implied covenant of good faith and fair dealing not to violate the Deficiency Statute or otherwise impair the collateral.

### C. The Trust's discretion to pursue the collateral first does not authorize it to violate the Deficiency Statute.

The Trust's next argument is that it had discretion to foreclose on the property prior to pursuing the Guarantors. (Resp. Br. 12 Part I.A.ii.) The Guarantors agree that the Trust had this discretion. As noted above, however, the Guarantors are entitled under South Carolina law to the benefit of the collateral if the lender chooses to pursue it before it pursues the Guarantors.

And it follows that the Trust must not violate the foreclosure procedures to the detriment of the Guarantors in this process.

The Trust also relies upon the legal principle that a party does not breach the implied covenant of good faith and fair dealing when it has done what the contract expressly allows. This argument obviously assumes its own conclusion. As discussed above and further below, the contract does not allow the Trust to violate South Carolina's bidding statutes at the foreclosure sale. Nor does the fact that the contract allows the Trust to pursue the collateral first lead to the conclusion that it can violate the bidding statutes.

**D. The Guarantors did not receive the full benefit of their bargain..**

The Trust's next argument is that the Guarantors received the benefit of their bargain when their guaranties induced the Trust to loan money to the borrower and that the implied covenant of good faith and fair dealing could not be breached long after it performed this obligation of lending money. (Resp. Br. 14 Part I.A.iii.) But this argument begs the question of what the benefits of the bargain were and what the obligations of the Trust were. The Trust acknowledges that the implied covenant of good faith and fair dealing prohibits it from doing anything "to impair the [Guarantors'] rights to receive benefits under the contract," *Tadlock Painting Co. v. Maryland Cas. Co.*, 322 S.C. 498, 500, 473 S.E.2d 52, 53 (1996), and as discussed above, the Trust's violation of the Deficiency Statute was a direct impairment of one of the benefits to which the Guarantor was entitled, namely that the high bid at the foreclosure sale would be in accordance with South Carolina law. Thus, the Guarantors did not receive the full benefit of their bargain.

## E. The terms in the guaranty agreements do support the Guarantors' position that the Trust had an *implied* obligation not to violate the Deficiency Statute.

The Trust's next argument is that the terms of the guaranty agreements concerning recourse to the collateral do not support the Guarantors' position. (Resp. Br. 15 Part I.B.) This argument misstates the position of the Guarantors and misconstrues the guaranties. The Guarantors have not contended that the Trust breached the guaranty agreement by failing to give notice that it sought recourse to the collateral, and so there is no preservation issue. Nor have the Guarantors contended that they paid the debt and therefore have a right of recourse to the collateral. That is not the point. Instead, the Guarantors' position is that the guaranty agreements impose an implied obligation of good faith and fair dealing upon the Trust not to violate the statutory bidding procedures during the foreclosure sale, and that this implied obligation arises from express terms in the agreement. The Guarantors' position of an implied obligation is based upon two categories of express terms in the guaranty agreements, and each category independently supports the Guarantors' position.

The first category is that the guaranty agreements make express reference to the high bid during the foreclosure bidding process and therefore imply that the Trust had an obligation to act in good faith during the foreclosure bidding process and not make an illegal bid at the upset sale. How this implied obligation arises from the express language is discussed above and need not be repeated here. The Trust mistakenly contends that the "Guarantors ask this court to interpret that provision as an agreement that the Trust will insure the highest possible bid at a foreclosure sale," (Resp. Br. 16), and that the "plain language of the guaranty agreements does not include any requirement that the property sell for the full amount of the debt at a foreclosure sale or for fair market value before the Trust may pursue recovery from the Guarantor," (*id.* 17). But it is not the Guarantors' position that the Trust had an obligation

to ensure the highest possible bid or that the property must sell for fair market value or for the amount of the debt. Such a position would be unreasonable. Instead, the Guarantors' position is that the Trust was obligated to comply with the Deficiency Statute and related bidding procedures that were designed to incentivize the Trust to make its highest and best bid.

As detailed in the Guarantors' Initial Brief, these bidding procedures place a very heavy burden and incentive upon a mortgagee to make its highest and best bid at the opening foreclosure sale, because it is only allowed to bid one time and then its bid is subjected to an upset sale thirty days later where any third party has an opportunity to outbid the mortgagee. If a mortgagee could appear at the upset sale and bid again, then this incentive is destroyed, and the mortgagee is free to make a low bid at the first sale because it would know that it could bid again at the upset sale. Thus, if the Trust had complied with the bidding procedures and the Deficiency Statute, it effectively would have been forced to make a single bid that was its highest and best bid. But because it violated those statutory procedures, it avoided the entire intent of the statute. Accordingly, it breached the implied obligation of good faith and fair dealing[3] by violating South Carolina law and thereby avoiding the pressure of being forced to make its highest bid.

The second category of express terms in the guaranty agreements is that the guaranty agreements make express reference to the Guarantors' reliance upon the collateral, including the ability to have recourse to the collateral under certain circumstances. Therefore, the Trust has an implied obligation to act in good faith with respect to the collateral during the judicial foreclosure bidding process and not make an illegal bid at the upset sale. These express provisions include that the Trust must give notice to the Guarantors before it "may surrender,

[3] Alternatively, it is precluded from recovery on the guaranties by the doctrines of unclean hands, waiver, or not being able to gain from an illegal act.

compromise, exchange, and release" any collateral; that the Guarantors have a "right of subrogation, reimbursement or indemnity" and a "right of recourse to security for the debts" once the Trust has been paid in full; and that the Guarantors have "a right of subrogation in or under the Loan Documents" and a "right to participate . . . in the right, title or interest of [the Trust] in or to any collateral for the Loan" once the Trust has been paid in full. (Pl. Exs. 8-9 at 1, 2.)

The Trust's brief contends that a statement in the Guarantor's Initial Brief that the Guarantors have a "'right of recourse to security for the debts and obligations of the Borrower to the Lender' if and when they pay the Borrower's obligations" is not supported by the language of the guaranties, (Resp. Br. 16), but this argument is belied by the express language cited above. And because this express language contemplates a reliance upon the collateral, even if said reliance is contingent upon full payment that has not yet been made, it is fair to imply a good faith obligation upon the Trust that it will not act to impair the potential of the collateral to benefit the Guarantors.

**F. <u>There is ample law supporting the relief sought by the Guarantors.</u>**

The Trust's next argument is that no law supports the relief the Guarantors seek. (Resp. Br. 17 Part I.C.) The Trust first contends that *Commercial Credit Corp. v. Nelson Motors, Inc.*, 247 S.C. 360, 362–70, 147 S.E.2d 481, 481–85 (1966), does not support the Guarantors' position because it involved a guaranty of collection rather than a guaranty of payment. But as noted above, this distinction is irrelevant because it only impacts whether the Trust must pursue the borrower and collateral first. Moreover, a guaranty of payment nonetheless entitles the guarantor "to have the proceeds of the collateral applied to the liquidation of the debt if the creditor forecloses the security before proceeding on the guaranty." *Harley*, 292 S.C. at 340, 342, 356 S.E.2d 411. Thus, the Trust's attempt to distinguish *Nelson Motors* is ineffectual.

In addition, *Nelson Motors* directly supports the relief sought by the Guarantors because it held that breach of the implied covenant of good faith and fair dealing is a valid defense to a guaranty agreement. *Id.* The Guarantors' Initial Brief also cites to ten cases from other jurisdictions holding that a guarantor may defend against an action on the guaranty on the basis that the lender breached the implied obligation of good faith and fair dealing as a result of the lender's impairment of the collateral or other wrongdoing. (App. Br. 16-17 & n.6.) Accordingly, the Trust's contention that no law supports the Guarantors' position is incorrect.

The Trust next contends that the UCC prohibitions on impairment of collateral do not apply because the guaranties here are not negotiable instruments and therefore S.C. Code Ann. § 36-3-605 is not controlling. The Guarantors do not contend that the guaranties are negotiable instruments controlled by the UCC, but as noted in Comment 2, the Guarantors' rights are governed by the general law of suretyship and guaranty as set forth in the Restatement (Third) of Suretyship and Guaranty (1996) sections 39-44. S.C. Code Ann. § 36-3-605 cmt. 2. And in turn the rules set forth in section 36-3-605 "essentially parallel modern interpretations of the law of suretyship and guaranty that apply when a secondary obligor is not a party to an instrument [as set forth in the Restatement]. *Id.* cmt. 1. Indeed, section 36-3-605(d) is based upon section 42 of the Restatement. *Id.* cmt. 7. So, even though S.C. Code Ann. § 36-3-605 may not be controlling *per se*, it is based upon principles of law that are controlling.

And those principles mandate that a lender not impair the collateral by its "failure to comply with applicable law in disposing of collateral." Restatement (Third) of Suretyship & Guaranty § 42(2)(d) (1996). As further noted in comment f, the reason that noncompliance with the law constitutes impairment of the collateral is because "it is likely that the proceeds will be smaller and, therefore, the deficiency owed by the secondary obligor will likely be

greater." *Id.* cmt. f. This is exactly the situation in the instant case, where the Trust's failure to comply with South Carolina law deprived the Guarantors of an opportunity for the deficiency to be eliminated entirely or at least reduced dramatically.

These principles, which apply generally as set forth in the Restatement and which have been adopted by statute in South Carolina with respect to negotiable instruments, are persuasive with respect to whether the Trust breached its implied covenant of good faith and fair dealing when it failed to comply with the Deficiency Statute during the foreclosure process. In addition, although the Trust disputes that the court in *CoastalStates Bank v. Hanover Homes of S.C., LLC*, 408 S.C. 510, 520, 759 S.E.2d 152, 158 (Ct. App. 2014), agreed with the guarantors' arguments in that case that the principles of the UCC and Restatement apply to guarantors in South Carolina, the *CoastalStates* court did rule in accordance with the guarantors' position in that case. Accordingly, the case is fairly read as supporting the application of those principles to the guaranties at issue here to find that the Guarantors are not precluded as a matter of law from defending against the enforcement of the guaranties (whether by application of the implied covenant of good faith and fair dealing or by the doctrines of unclean hands, waiver, or not being able to gain from an illegal act).

## II. The trial judge assumed that the Trust violated the Deficiency Statute for the purposes of granting a directed verdict, and in any event there is ample evidence of a violation such that it would be error if the Court's ruling was premised upon there being no violation of the Deficiency Statute.

### A. The trial court's granting of a directed verdict assumed that the Trust violated the Deficiency Statute.

The Trust next argues that the trial court should be affirmed in its finding that there was no violation of the Deficiency Statute. (Resp. Br. 20 Part II.A). This argument is confounding, as the Court plainly stated that it assumed there was a violation of section 15-39-720 for purposes of its ruling:

> If we're looking at the evidence in the light most favorable to the Defendants, there was a violation of Section 15-39-720, upset bid within thirty days on foreclosure or execution sale. That's an inference that can be drawn. To this Court that makes not a whit of difference. Not a whit of difference. I look at Plaintiff's Exhibit Number 8, Plaintiff's Exhibit Number 9, which [are] the guaranty agreements that are the documents upon which this lawsuit has been brought. I do not think a violation of the statute that I just cited is a defense on a guaranty of a debt.

(Tr. 134.)

Although the judge did state that he did not think the Trust violated the statute, he was clear that "there is more than one inference that can be drawn from parts of the testimony" but that "following the standard of directed verdict," he was "drawing that inference . . . in the light most favorable to the Defendant." (Id. 132-33.) When asked for clarification for the record concerning the ruling, the judge clarified: "I assume there was a violation of the statute for purposes of my ruling." (Id. 133 (emphasis added).) This statement could not be clearer, and so the Trust is incorrect that the Court also ruled that Second Avenue Holdings is not a representative of the Trust.

The confusion apparently arises from the trial judge's remarks that he did not think that Second Avenue Holdings was the same as the Trust and that they were distinct entities, as well

as a reference to a "ruling" that there wasn't a violation. (*Id.*) But the overall context of the judge's statements demonstrate that the granting of the directed verdict was not based upon any determination that the Deficiency Statute was not violated, particularly given that the judge's final statement is that he assumed a violation for purposes of his ruling:

> And I understand and I cited the statute. As I say, I don't want to weigh the evidence and say it's -- based on my ruling that there wasn't a violation; I assume there was a violation of the statute for purposes of my ruling.

(*Id.*)

### B. The trial court erred in granting a directed verdict because there is evidence in the record from which a jury could find that the Trust violated the Deficiency Statute.

Alternatively, any ruling that the Trust did not violate the Deficiency Statute would plainly violate the standard for granting a directed verdict, where the trial court is concerned only with the existence of evidence, not its weight, and where "the trial court should view the evidence and all reasonable inferences in the light most favorable to the non-moving party." *S.C. Fed. Credit Union v. Higgins*, 394 S.C. 189, 193-94, 714 S.E.2d 550, 552 (2011). "If more than one reasonable inference can be drawn ... the case should be submitted to the jury." *Id.* at 194, 714 S.E.2d at 552 (internal quotations omitted). There is ample evidence in the Record that supports a reasonable inference in favor of the Guarantors' position that there was a violation of the Deficiency Statute based upon Second Avenue Holdings acting on behalf of the Trust. If and to the extent the Circuit Court made such a ruling, the Court of Appeals would be compelled to reverse it.

The Deficiency Statute, Section 15-39-720, prohibits a mortgagee or his "representative" or "all persons acting in his behalf" from entering any kind of bid in any amount at any other time except at the initial foreclosure sale. *Id.* (emphasis added). Thus, the trial court's focus on Second Avenue Holdings being a distinct legal entity from the Trust is

completely irrelevant. The relevant inquiry under the provisions of the statute is whether Mr. Buchanan, acting through his wholly owned company Second Avenue Holdings, was acting as a representative of the Trust or acting on behalf of the Trust.

In the instant case, there is ample evidence that Mr. Buchanan and/or his wholly owned subsidiary Second Avenue Holdings was acting as a representative of the Trust (or otherwise acting on behalf of the Trust) when they made their bid at the second sale on October 4, 2012:

- Mr. Buchanan was the sole owner of Second Avenue Holdings. (*Id.* p. 111.) Mr. Buchanan, acting on behalf of his wholly owned Second Avenue Holdings, "went to the second sale and there were other bidders there and multiple bids were put in" and "[i]n the end, Second Avenue Holdings, LLC, won the bid and held the property." (*Id.* p. 52.) *Given that this was a single member LLC solely owned and controlled by Mr. Buchanan, Second Avenue Holdings should not be viewed as having interests distinct from Mr. Buchanan's interests. Thus, to the extent he was operating as a representative of the Trust, so was Second Avenue Holdings.*

- Mr. Buchanan falsely testified that Second Avenue Holdings was created three or four years prior to the foreclosure sale, when the Articles of Organization revealed that they were signed on September 4, 2012, and filed on September 6, 2012,[4] only a few days following the first sale. (Tr. p. 97 & Green Ex. 1.) *A reasonable inference from the creation of the entity immediately following the first sale indicates that it was created to be used as an instrumentality in carrying out the unlawful violation of the bidding statute. His false testimony impeaches any testimony he may have given contrary to the Guarantors' position.*

- Both the Trustee, Stephen Wilkinson, and Mr. Buchanan testified concerning Mr. Buchanan's keen interest and active role as a participant and advisor with respect to the Trust. Mr. Wilkinson testified that all of the assets held by the Trust have "all been put in there by Mr. Buchanan" for the benefit of "Mr. Buchanan's children." (*Id.* p. 65-66.). He further explained that as Trustee he makes "distributions for the health, education and welfare" of the children and that the establishment of the Trust allows Mr. Buchanan to avoid estate taxes. (*Id.* p. 46, 74.) *This testimony shows that Mr. Buchanan often acted on behalf of the Trust, playing an active role as a participant and advisor with respect to the business of the Trust. This is evidence that he acted at the upset sale as a representative.*

- Additionally, Mr. Buchanan testified that he set up the Trust and funded it out of his own assets, (Tr. pp. 93-94); that he holds the title of "financial advisor" in the current

[4] "Unless a delayed effective date is specified, the existence of a limited liability company begins when the articles of organization are filed." S.C. Code Ann. § 33-44-202(b).

structure of the Trust, (*Id.* p. 111); and that he routinely identifies properties to be put into the trust, (id. p. 110). He further conceded that he was the one who identified the loan opportunity at issue in this action and met with the Appellants on behalf of the Trust, without the Trustee, to initiate the transaction. (*Id.* p. 110.) The Trustee also obtained Mr. Buchanan's consent before proceeding with the foreclosure action. (Id. p. 95.) *This testimony shows that Mr. Buchanan often acted on behalf of the Trust, playing an active role as a participant and advisor with respect to the business of the Trust.*

- The Trustee, Mr. Wilkinson, agreed that Mr. Buchanan gives financial advice as needed, (*id.* p. 76), and that Mr. Buchanan makes recommendations about either buying property or selling property and brings most of the Trust's investments to the table. (*Id.* p. 78.) Mr. Wilkinson agreed that he listens to Mr. Buchanan's advice and has never turned down one of his recommendations. (*Id.* p. 79.) He testified that the genesis of the loan at issue was when "Mr. Buchanan was contacted by someone . . . [who] told him there was an opportunity" and that "if he wanted to loan some money, you know, there was an opportunity to make some money and we had done this on -- or they had done this on a previous property in Wyoming and it worked out well." (*Id.* pp. 66-67 (emphasis added).) *This testimony shows that Mr. Buchanan often acted on behalf of the trust, playing an active role as a participant and advisor with respect to the business of the Trust. And the Trust's own Trustee referred to Mr. Buchanan himself loaning the money that was being loaned by the Trust.*

- In the opening statement, the Trust's counsel noted that the Trust bid $6.6 Million at the first sale but that afterwards Mr. Buchanan "was concerned that someone else might come in and take this property and leave the trust in a bad position, losing some money." (Tr. p. 52.) *Mr. Buchanan's concern for the Trust losing money indicates that he was operating on its behalf in connection with the bidding.*

- Mr. Buchanan "decided that it would be better for one of his companies to own it rather than the -- rather than somebody other than the trust." (*Id.*) *This statement implicitly acknowledges that the interests of Mr. Buchanan and Second Avenue Holdings effectively were the same as the Trust and that they were operating for the benefit of the Trust in the bidding; and it further acknowledges that Second Avenue Holdings did not fall into the category of "somebody other than the trust."*

- Second Avenue Holdings assigned the bid to the Trust because "Mr. Buchanan after consulting with some others and the trustee decided that it would be better from a tax perspective and from his children's perspective for the trust to hold onto that property rather than Second Avenue Holdings, LLC." (*Id.* p. 53.) *Mr. Buchanan's concern for taxes and for his children's interests demonstrates that he was acting on behalf of the Trust, which was established to avoid estate taxes and to benefit his children. Mr. Buchanan need not be acting for his own personal benefit in order to be a representative of the Trust.*

- Second Avenue Holdings deposited $500,000 toward its bid and, on October 24, 2012, assigned its bid to the Trust, with the deposit to be returned less the Master in Equity's commission and other court costs. (*Id.* p. 100 & Green Ex. 2.) There was no consideration for the assignment other than a reimbursement of costs. (*Id.* p. 101.) *An arm's length transaction necessarily would require substantial consideration for such a transaction, and the lack of consideration indicates that Mr. Buchanan was operating on behalf of the Trust.*

- The property was deeded from the Master in Equity to the Trust following Second Avenue Holdings' assignment of bid back to the Trust, and the Trust claimed an exemption from the deed recording fee on the basis that the mortgagee obtained the property pursuant to foreclosure proceedings. (Tr. pp. 72-73 & Pl. Ex. 3.) *The fact that Second Avenue Holdings assigned its bid to the Trust is irrefutable evidence that it acted on behalf of the Trust. Further, the Trust could only claim the exemption if Second Avenue Holdings were deemed to be acting on its behalf.*

- An order in the foreclosure proceeding amending the interest amount of the Deficiency Judgment to 15% noted that Second Avenue Holdings "paid interest on its bid at the rate of $3,587.05 per day through the compliance date." (Tr. p. 72 & Pl. Ex. 4.) *Second Avenue Holdings paid interest on a bid that it ultimately assigned to the Trust, and this payment of interest benefitted only the Trust, which indicates that Second Avenue Holdings was acting on behalf of the Trust.*

Under the standard for a directed verdict, the question is whether there was the existence of *any* evidence and/or inferences that a jury might reasonably construe as establishing that Mr. Buchanan, through his wholly owned Second Avenue Holdings, acted on behalf of the Trust at the upset sale. The evidence recited above establishes that there was ample proof for a jury to conclude that he acted on behalf of the Trust at the upset sale. Indeed, given that the bid was assigned the Trust without consideration, the court could have so concluded as a matter of law. Accordingly, this Court must reverse the ruling of the trial court granting the directed verdict and remand for a new trial or entry of judgment for Appellants.

### C. The Guarantors were prejudiced by the Trust's violation of the Deficiency Statute.

The Trust next argues that the Guarantors cannot show prejudice from the Trust's violation of the Deficiency Statute. (Resp. Br. 21 Part B.) This argument demonstrates that the

Trust does not understand the design and purpose of the Deficiency Statute. As detailed in the Guarantor's Initial Brief and above, the bidding procedure is designed to incentivize the mortgagee to give its highest and best bid because, in order to claim a deficiency to pursue against the borrower and Guarantors, the Deficiency Statute mandates that the mortgagee may bid only at the opening sale and not bid again (either on its own or through a representative) at the upset sale. Instead, at the upset sale the public may outbid the mortgagee and take the property, applying the highest bid to the debt. In this manner, the mortgagee has every reason to make its best and highest bid at the first sale so as not to risk a third party taking property at the second "upset sale" that has a value above the mortgagee's bid at first sale. This statutory structure is completely undermined if the mortgagee could bid at the upset sale (and indeed there would be no need for an upset sale) because it would no longer have an incentive to make its best bid.

Accordingly, the Guarantors have been deprived of the Trust's best bid. It is this deprivation that violated the implied covenant of good faith and fair dealing and now precludes the Trust from pursuing its Guaranty because it is in material breach of the contract. Alternatively, the Trust is precluded from recovery by the doctrine of unclean hands, the doctrine that it cannot benefit from its illegal act, and/or the doctrine of waiver, namely that it waived its right to pursue the deficiency against the Guarantors because a mortgagee is only allowed to obtain a deficiency if it complies with the Deficiency Statute.

The Trust also contends that the Guarantors have the burden to establish that the sale price would have been higher but for the violation of the Deficiency Statute. But the Trust was the party who violated South Carolina law at the foreclosure sale, not the Guarantors, and so the Trust should bear any burden, not the innocent Guarantors. The Trust does not cite to any

legal authority for its position other than a footnote in a concurring opinion in a matter involving appraisal rights. This opinion has no application here, nor does the footnote, because it involved the lack of third party bidders at an upset sale. This situation is distinguishable from the instant case, where there were bidders at the upset sale, (Tr. p. 52), demonstrating that the Trust's initial bid was below fair value. And it is a reasonable inference that the Trust would have bid the amount of the debt if it had made only a single bid and not sent its representative to the upset sale to protect it from losing the property. It also is a reasonable inference that Mr. Buchanan's presence had a chilling impact upon other bidders, and the Guarantors indeed understood that it in fact had a chilling impact upon the bidding. (Affidavits of Cliff Redd and Bruce Green in Opposition to Plaintiff's Motion for Summary Judgment pp. 1-2.) Indeed, the Trust's counsel admitted at trial that the sale amount was below the value of the property: "[T]he property is worth an awful lot more than what was paid at the foreclosure sale. I think we all know it was. It's not a big secret." (Tr. p. 33 (emphasis added).)

Further, there is evidence in the record that the value of the property far exceeded the amount of the debt of $9.5 Million. The Guarantors testified that it had a value of $30 Million when they acquired it. (Tr. p. 85). The Guarantors also testified that the value of the property was "several times" the amount of the loan. (*Id.* p. 84.) There also is evidence that the Trust valued the Property immediately following foreclosure at $15 Million and that the property maintained a $15 Million value thereafter. (*Id.* p. 32.) At a value of $15 Million, it is reasonable to conclude that the Trust would have bid the full debt amount of $9.5 Million if it had acted in compliance with the Deficiency Statute and bid only one time rather than circumventing the statute to bid again at the upset sale.

Finally, the Trust argues that the Guarantors "ask the courts to extinguish their debt on the purely hypothetical ground that a third party would have bid either the full amount of the debt or fair market value—or that the Guarantors would have done so—if 2nd Avenue Holdings had not bid." (Resp. Br. 22.)[5] This contention completely misstates the Guarantors' position. Appellants never have argued that third parties or the Guarantors would have bid the debt amount at the upset sale but for Second Avenue Holdings. Instead, the Guarantors have argued that if the Trust had complied with the Deficiency Statute, then it would have had every incentive to bid the full debt amount of $9.5 Million at the first sale. But instead it made a low bid at that sale, safe with the knowledge that its representative could bid higher later. And this violation resulted in the Trust never being forced to make its highest and best bid at the first sale.

## III. The Guarantors are not precluded from arguing that the violation of the Deficiency Statute in the prior foreclosure action may serve as a defense in this subsequent action on the guaranties.

The Trust next argues that this case is not a proper vehicle for challenging the foreclosure proceedings. (Resp. Br. p. 22. Part III.) The Trust contends that the implication of the Guarantors' argument that they were not named in the foreclosure action is that the Trust's decision not to name them was unlawful or inequitable. This contention simply misapprehends the Guarantors' position. The Guarantors fully recognize and agree that the Trust had the right to pursue the borrower and the collateral first and not to include the Guarantors in the foreclosure action. The reason that the Guarantors stressed in their Initial Brief that they were not included in the foreclosure action, and even included this fact in the Statement of Issues on Appeal, is that if the Guarantors had been named in the foreclosure action, then they could have

[5] The Trust makes one additional argument that the foreclosure sale price could not be set aside on the basis that it would shock the conscience, but the standard for shocking the conscience is a different standard that is not relevant to any of the issues on appeal.

addressed the issues raised in this appeal at that time. But they were not involved in the action, and the Trust obtained a judgment for foreclosure by default. But because the Trust violated the Deficiency Statute during the bidding process, the Guarantors are entitled to raise that violation as a defense in this separate action, now that they have been named as parties.

### A. The Guarantors are not barred by *res judicata.*

The Trust next argues that the Guarantors are barred by *res judicata* from challenging the amount of the deficiency judgment in a subsequent suit. (Resp. Br. p. 23 Part III.A). The Trust's argument is based upon a faulty premise, as the Guarantors do not seek to challenge the amount of the judgment in the foreclosure suit. This judgment was entered against the Borrower, and the Guarantors are not seeking to undo it. Instead, the Guarantors are contending that they have a defense to the Trust's enforcement of the guaranties because the Trust violated South Carolina law when it obtained the deficiency.

The Trust cites to *Duckett v. Goforth*, which notes that "[t]he doctrine flows from the principle that public interest requires an end to litigation and no one should be sued twice for the same cause of action." 374 S.C. 446, 465, 649 S.E.2d 72, 82 (Ct. App. 2007). Similarly, the doctrine of *res judicata* potentially "bars a second suit," and not the assertion of an affirmative defense, because its "fundamental purpose is "to ensure that no one should be twice sued for the same cause of action." *Yelsen Land Co. v. State*, 397 S.C. 15, 22, 723 S.E.2d 592, 596 (2012) (emphasis added; internal quotations omitted). Here, no one has been sued twice, and so the fundamental principle underlying the doctrine is inapplicable. The Guarantors have not asserted any claims against the Trust but only seek to interpose affirmative defenses. The Trust cites to no authority holding that a guarantor is precluded from asserting an affirmative defense on the basis of *res judicata.* The Trust is asking this Court to adopt a novel theory with no prior basis in the case law.

As for the elements of *res judicata*, there must be "(1) identity of the parties; (2) identity of the subject matter; and (3) adjudication of the issue on the merits in the former suit by a court of competent jurisdiction." *Id.* None of these elements exist here, just as they did not exist in *Duckett*:

> *Res judicata* does not bar the present litigation. The parties to the Australian litigation were Duckett and Greenhough; Goforth and Duckett are parties in the present litigation. The subject of the Australian proceeding was adjudication of custody, child support, visitation, and other related issues between Duckett and Greenhough. The action here is for determination of paternity, an award of custody, and child support between Duckett and Goforth. The issues of custody and child support have never been litigated between Duckett and Goforth. Moreover, the issue of paternity was not fully and finally adjudicated by the Australian tribunal.

*Id.*

The same is true here. First, there is no identity of parties, as the Guarantors were not included in the foreclosure action. The Trust contends that the Guarantors and borrower are privies but cite to no legal authority establishing that a guarantor and borrower are privies. As a result, the first element is not met.

Second, the subject matter is different, as the foreclosure was brought on the loan documents against the borrower, whereas the instant action is brought on the guaranty agreements against the Guarantors. "The general rule in South Carolina . . . is that a guaranty of payment is an obligation separate and distinct from the original note," and "'the responsibilities which are imposed by the contract of guaranty differ from those which are created by the contract to which the guaranty is collateral.'" *CoastalStates Bank v. Hanover Homes of S.C., LLC*, 408 S.C. 510, 519, 759 S.E.2d 152, 157 (Ct. App. 2014) (quoting *Citizens & S. Nat'l Bank of S.C. v. Lanford*, 313 S.C. 540, 544, 443 S.E.2d 549, 551 (1994), and quoting 38 Am.Jur.2d Guaranty § 4). As a result, the second element is not satisfied.

And third, there was no adjudication on the merits in the foreclosure action with respect to the issue of whether the Trust breached the Deficiency Statute. This issue was not litigated because the Trust was proceeding against a party in default, and so there was no opposition to the Trust's illegal second bid. The Trust contends that the Master was aware of and approved the assignment of the bid from Second Avenue Holdings to the Trust, but there is no evidence that the Master had any knowledge or approval of the violation of the Deficiency Statute. As a result, the third element is not satisfied.

### B. The Guarantors did not waive their affirmative defenses by not voluntarily appearing in the foreclosure action.

The Trust's final argument is that the Guarantors' waived their defenses by not voluntarily appearing in the foreclosure action. The Trust cites to no authority for this argument other than the generic proposition that waiver is the intentional relinquishment of a known right. But it defies logic to contend that the Guarantors intentionally relinquished their rights to defend against enforcement of the guaranties by not appearing in a lawsuit in which they were not named. The argument should be rejected out of hand.

## CONCLUSION

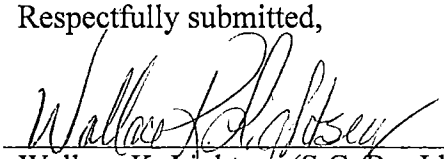
In the Trust's conclusory paragraph, it contends that the Guarantors are illogical to assert that the debt would have been extinguished if Second Avenue Holdings did not bid at the upset sale. Again, this is not what the Guarantors contend. The Guarantors' focus is not upon whether or not Second Avenue Holdings bid at the upset sale but upon whether the Trust complied with South Carolina's carefully crafted statutory scheme that the Trust admitted is designed "to encourage the party who is owed the money to put in the highest bid possible." (Tr. p. 52.) But if the party who is owed the money, in this case the Trust, were allowed to bid at the second sale, then this encouragement to make the highest bid possible at the first sale

evaporates. If a mortgagee could gain a deficiency by violating the very statute that gives it a right to the deficiency, then the statute is meaningless. The Guarantors had every right to believe that the Trust would comply with the law when it entered the bidding process, and the guaranty agreement specifically noted their reliance upon the high bid at the foreclosure sale.

The violation of the Deficiency Statute is presumed for the purpose of this appeal, and at the very least the jury should be able to determine whether this violation constituted either (1) a breach of the Trust's implied covenant of good faith and fair dealing not to impair the Guarantors' benefits under the guaranty agreements, (2) a waiver of its right to enforce a deficiency when a deficiency could be lawfully obtained only through compliance with the Deficiency Statute, (3) an illegal act through which the Trust cannot benefit, and/or (4) evidence of unclean hands precluding recovery.

In conclusion, the Court of Appeals should reverse the trial court's directed verdict and at the very least allow these factual issues to be determined by a jury. In the alternative, the Court of Appeals, for purposes of efficiency, should recognize that the Guarantors' affirmative defenses are established as a matter of law and that the violation of the Deficiency Statute is established as a matter of law and therefore instruct the trial court to enter judgment in favor of the Guarantors.

Respectfully submitted,



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Date: January 2, 2019

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**THE STATE OF SOUTH CAROLINA**

**IN THE COURT OF APPEALS**

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APPEAL FROM SALUDA COUNTY
Court of Common Pleas
R. Knox McMahon, Circuit Court Judge

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Lower Case No. 2015-CP-41-00172

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Stephen Wilkinson, as Trustee of George B. Buchanan, Jr. Irrevocable Family Trust Dated the 15th day of July, 2001, .....Respondent,

v.

Redd Green Investments, LLC, Anderson North Augusta, LLC, Herbert Anderson, Jr., A. Bruce, Green, Herbert Keith Anderson, and L. Cliff Redd, ..... Defendants,

of Whom

Redd Green Investments, LLC, A. Bruce Green, and L. Cliff Redd are..... Appellants.

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**PROOF OF SERVICE**

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The undersigned certifies that the foregoing **INITIAL REPLY BRIEF OF APPELLANTS** was served upon all counsel of record by causing a copy of the same to be deposited in the United States mail, postage prepaid, addressed as follows:

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This 2nd day of January, 2019.

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