

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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APPEAL FROM FAIRFIELD COUNTY
Court of Common Pleas

S.C. SUPREME COURT

Carol A. Tolen, Special Referee

Opinion No. 5784 (S.C. Ct. App. filed Nov. 25, 2020)

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, Petitioner.

APPENDIX – VOLUME I OF II

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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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.

Appellate Case No. 2018-000230

Appeal From Fairfield County
Carol Ann Tolen, Special Referee

Opinion No. 5784
Heard October 15, 2020 – Filed November 25, 2020

AFFIRMED

Andrew Bryant Walker and Shaun C. Blake, both of Rogers Lewis Jackson Mann & Quinn, LLC, and Sean Matthew Foerster, of Rogers Townsend & Thomas, PC, all of Columbia, for Appellant.

Christy Curtis Jones, of Sherpy & Jones, PA, and Jonathan McKey Milling and Cydney McAdams Milling, both of Milling Law Firm, LLC, all of Columbia, for Respondent.

THOMAS, J: ArrowPointe Federal Credit Union filed this action against Jimmy Eugene Bailey, Laura Jean Bailey, and JPMorgan Chase Bank, seeking foreclosure of a mortgage and a declaration that its mortgage be declared a first lien.

Appellant¹ appeals the special referee's order granting ArrowPointe summary judgment and ordering foreclosure, arguing the referee erred in finding (1) South Carolina does not recognize the replacement mortgage doctrine, (2) ArrowPointe suffered material prejudice by the application of the replacement mortgage doctrine, and (3) the existence of material prejudice under the replacement mortgage doctrine defeats the priority of the replacement mortgage. We affirm.

FACTS

A. Stipulated Facts

The parties stipulated to the following facts:

The Baileys owned 247 Morninglow Drive in Winnsboro and mortgaged the property to Quicken, which secured a note in the principal amount of \$256,500. The Quicken Mortgage was recorded on October 20, 2009² (First Mortgage) and was in a senior lien priority position on the subject property. On October 27, 2009, the Baileys gave ArrowPointe a mortgage securing an equity line of credit (ArrowPointe LOC) in the principal amount of \$99,000. The ArrowPointe LOC was recorded on November 4, 2009. At the time, "the parties to that transaction intended the [ArrowPointe LOC] to be a junior mortgage on the Subject Property second in lien priority position behind the First Mortgage."

On November 23, 2009, the Baileys entered a subsequent mortgage and loan transaction with Quicken (Second Mortgage), obtaining a new loan in the principal amount of \$296,000, an increase from the First Mortgage of \$39,500. The proceeds of the Second Mortgage were used to pay off the loan secured by the First

¹ JPMorgan Chase Bank is one of numerous predecessors in interest to Appellant, U.S. Bank National Association not in its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1, including Quicken Loan, Inc. Regardless of the entity in interest at the time of a filing or hearing, we refer to it as Appellant.

² The Joint Stipulation states the First Mortgage was recorded on October 15, 2009. The mortgage reflects recording on October 20, 2009.

Mortgage in the amount of \$257,459.04.³ The First Mortgage was released of record, and the Second Mortgage was recorded on December 15, 2009. The Second Mortgage was assigned numerous times.

At the time of the Second Mortgage, Quicken did not have actual knowledge of the ArrowPointe Loan, but was on record notice of it. In addition, the Baileys executed an acknowledgment by affidavit that "there [were] no outstanding home improvement loans, mortgages, deeds of trust, or equity lines of credit, recorded or unrecorded."

The Baileys defaulted on the ArrowPointe LOC, and ArrowPointe filed this foreclosure action. At the time of the Joint Stipulation, the amount due on the ArrowPointe LOC was \$187,201.60.

B. Other Facts

Appellant and ArrowPointe filed competing motions for summary judgment, each claiming lien priority. At a hearing on September 19, 2013, Appellant abandoned its equitable subrogation argument and argued the replacement mortgage doctrine entitled it to priority. By order dated March 19, 2015, the special referee denied Appellant's motion for summary judgment, concluding "the replacement mortgage theory is not the law of the State of South Carolina and should not apply in this case. Therefore, as a matter of law, [the Second Mortgage] does not take priority over [the ArrowPointe LOC]." Appellant moved for reconsideration, the referee heard arguments, and the motion for reconsideration was orally denied.

At a subsequent hearing, the referee heard arguments on ArrowPointe's motion for summary judgment. Appellant argued it was entitled to first priority under the replacement mortgage doctrine, and even if ArrowPointe was prejudiced, it was only prejudiced to the extent the Second Mortgage was greater than the First Mortgage. Appellant argued it "was \$260,000 in already with these borrowers, and to the extent [it] raised it up into the 290s and the Court determines that's a material prejudice, . . . [it] should get up to 260."

By order dated January 18, 2018, the referee granted ArrowPointe's motion for summary judgment. The referee again found the doctrine of replacement mortgage was not part of the case or statutory law of South Carolina. The referee also found

³ Although not in the Joint Stipulation, the Settlement Statement reflects funds of \$26,235.11 were disbursed to the Baileys.

even if the doctrine was the law in South Carolina, ArrowPointe suffered material prejudice because the principal amount of the Second Mortgage was larger than the First Mortgage and "any material prejudice is fatal to Replacement Mortgage." The referee ordered foreclosure and sale of the subject property and awarded ArrowPointe first lien priority. This appeal follows.

STANDARD OF REVIEW

"When an appeal involves stipulated or undisputed facts, an appellate court is free to review whether the trial court properly applied the law to those facts." *WDW Props. v. City of Sumter*, 342 S.C. 6, 10, 535 S.E.2d 631, 632 (2000). "In such cases, the appellate court owes no particular deference to the trial court's legal conclusions." *J.K. Constr., Inc. v. W. Carolina Reg'l Sewer Auth.*, 336 S.C. 162, 166, 519 S.E.2d 561, 563 (1999).

LAW/ANALYSIS

A. Doctrine of Replacement Mortgage

Appellant argues the special referee erred in finding it was not entitled to lien priority under the replacement mortgage doctrine. We disagree.

South Carolina is a "race-notice" state in which our recording statute determines the priority of liens by the date of recording. *See* S.C. Code Ann. § 30–7–10 (2007) (codifying South Carolina's recording act); *Regions Bank v. Wingard Props., Inc.*, 394 S.C. 241, 255, 715 S.E.2d 348, 355 (Ct. App. 2011) ("The recording statute found in section 30–7–10 . . . provides that all mortgages are valid, without notice, from the day they are recorded in the register of deeds for the county where the real property is located."); *Leasing Enters., Inc. v. Livingston*, 294 S.C. 204, 208, 363 S.E.2d 410, 412 (Ct. App. 1987) ("Our reading of the current statute indicates the recording act is a race-notice act which will provide protection to the subsequent purchaser or creditor provided he records first.").

One exception to our race-notice statute is the doctrine of equitable subrogation. "Equitable subrogation allows a subsequent creditor to assume the rights and priority of a prior creditor." *What's New*, 13 Aug. S.C. Law. 47, 53 (2001). To be equitably subrogated to a prior mortgage, a party must meet the following elements: (1) the party claiming subrogation has paid the debt; (2) the party was not a volunteer but "had a direct interest in the discharge" of the debt or lien; (3) the party was secondarily liable for the debt or for the discharge of the lien; (4) no

injustice will be done to the other party by the allowance of the equity; and (5) the party asserting the doctrine must not have had actual notice of the prior mortgage. *Indep. Nat'l Bank v. Buncombe Prof'l Park, LLC*, 411 S.C. 605, 608, 769 S.E.2d 663, 665 (2015).

Like the doctrine of equitable subrogation, the doctrine of replacement mortgage is an exception to the race-notice statute. The doctrine of replacement mortgage urged by Appellant to be adopted is described as follows:

(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, or

(2) to the extent that one who is protected by the recording act acquires an interest in the real estate at a time that the senior mortgage is not of record.

Restatement (Third) of Property (Mortgages) § 7.3 (1997 & June 2020 Update).

"In recent years, a significant number of courts have adopted the Restatement or followed its logic." Grant S. Nelson & Dale A. Whitman, *Adopting Restatement Mortgage Subrogation Principles: Saving Billions of Dollars for Refinancing Homeowners*, 2006 BYU L. Rev. 305, 314 (2006). The state appellate courts have varying approaches to equitable subrogation:

Courts have adopted three different approaches to equitable subrogation, reflecting different apportionments of equity: (1) the majority position holds that a party with actual knowledge of an intervening lien cannot seek equitable subrogation; (2) the minority position holds that a party with actual or constructive knowledge of an intervening lien cannot seek equitable subrogation; and (3) the Third Restatement of Property approach states that actual or constructive knowledge of an intervening

lien is irrelevant and does not bar application of equitable subrogation.

Glenn R. McGillivray, *What's Your Priority?: Revitalizing Pennsylvania's Approach to Equitable Subrogation of Mortgages After First Commonwealth Bank v. Heller*, 58 Vill. L. Rev. 301, 310 (2013).

Appellant argues the common law in South Carolina supports the replacement mortgage doctrine. South Carolina has held that a party may assert the doctrine of equitable subrogation if the party did not have actual notice of an intervening mortgage even if the party had constructive notice. *Enter. Bank v. Fed. Land Bank of Columbia*, 139 S.C. 397, 401, 138 S.E. 146, 148 (1927). In *Enterprise Bank*, the Supreme Court allowed equitable subrogation where "[a] most elaborate and painstaking abstract was made of the title by . . . a reputable attorney of the Oconee bar" and the party seeking equitable subrogation met the elements thereof. *Id.* at 400, 138 S.E. at 147. The court noted the intervening mortgagee's "position was not in any wise altered to its prejudice by anything that the [party seeking equitable subrogation] did; its claim to priority rest[ed] solely upon . . . fortuitous circumstances" *Id.* at 401, 138 S.E. at 148.

More recently, in *Dedes v. Strickland*, 307 S.C. 155, 159, 414 S.E.2d 134, 136 (1992), the Supreme Court refused to invoke the doctrine of equitable subrogation for the benefit of a lender who paid and satisfied its own mortgage but did not discover an intervening mortgage. The court noted the importance of a proper search of the records by stating "we would not construe as a mistake the failure of First Federal, a commercial lender, to search the appropriate records and ascertain the existence of other liens." *Id.* at 159, 414 S.E.2d at 137; *see Bank of New York v. Nally*, 820 N.E.2d 644, 652 (Ind. 2005) (citing *Enterprise Bank* and South Carolina as in "[t]he majority of jurisdictions [that] continue to state that actual knowledge precludes the application of equitable subrogation, while constructive knowledge does not." (quoting *Osterman v. Baber*, 714 N.E.2d 735, 739 (Ind. Ct. App. 1999))).

Finally, in *Matrix Financial Services Corp. v. Frazer*, the court held Matrix was not entitled to priority lien status under the doctrine of equitable subrogation. 394 S.C. 134, 138, 714 S.E.2d 532, 534 (2011). Citing *Dedes*, 307 S.C. at 158-59, 414 S.E.2d at 138, the *Matrix* court stated that a lender "could not be subrogated to the rights of its own prior mortgage." *Id.* at 137-38, 714 S.E.2d at 534.

Although South Carolina has not adopted the Restatement doctrine of replacement mortgage, Appellant argues our supreme court indicated support of the doctrine in *Matrix*. In *Matrix*, a default judgment against the mortgagors was enrolled after their first mortgage was recorded and assigned to Matrix. *Id.* at 136, 714 S.E.2d at 533. The mortgagors refinanced and a replacement mortgage was then recorded. *Id.* The court held Matrix was not entitled to priority lien status under the doctrine of equitable subrogation and could not be subrogated to the rights of its own prior mortgage. *Id.* at 138, 714 S.E.2d at 534. However, the court also noted the following:

Matrix is not asserting priority under a theory of replacement and modification. Matrix expressly pled equitable subrogation in its reply to Appellant's counterclaim. Both *Dedes*, controlling South Carolina precedent, and section 7.6 of the Restatement [(Third) of Property (Mortgages)] stand for the proposition that a lender that refinances its own debt is not entitled to equitable subrogation. We do not decide whether a lender that refinances its own debt could attain priority under the theory of replacement and modification illustrated in section 7.3 of the Restatement

*Id.*⁴

Appellant argues the dicta in *Matrix* regarding the theory of replacement and modification indicates the court would have allowed Matrix priority under section 7.3 of the Restatement. Appellant also relies on the dissent in *Matrix*. *See id.* at 141, 714 S.E.2d at 535-36 (Pleicones, J., dissenting) ("It appears that the majority would agree with me that a refinancer has a right to lien priority, if that refinancer uses the theory of 'replacement and modification' rather than equitable subrogation.").

Appellant next cites an order from the Honorable Marvin H. Dukes, III, Master-in-Equity and Special Circuit Court Judge for Beaufort County. Appellant argues Judge Dukes "considered similar facts and legal arguments . . . and found [the doctrine of]. . . Replacement Mortgage should be applied to establish the priority

⁴ The *Matrix* court also noted "even if Matrix met the requirements for equitable subrogation, Matrix would be precluded from receiving that remedy because of its unauthorized practice of law." *Id.*

of the replacement mortgage at issue." ArrowPointe maintains there is no precedential value to Judge Duke's order, and the facts in that case are distinguishable because the replacement loan was for a smaller amount than the replaced mortgage. In addition, the intervening creditor in that case was a judgment creditor rather than a mortgage creditor that made a decision to approve a loan based on business ratios and a title search. Appellant provides no citation to authority to support this argument and acknowledges Judge Dukes' order is not "controlling authority." *See Plante v. State*, 315 S.C. 562, 563, 446 S.E.2d 437, 438 (1994) (stating the defendant improperly relied on an unpublished order).

Appellant also relies on the adoption of replacement mortgage in sister states, citing the rationale espoused in *Sovereign Bank v. Gillis*, in which the New Jersey Superior Court adopted the Restatement view stating:

We regard this as a sound approach. A proper judicial analysis of material prejudice will examine such aspects as the respective loan amounts involved, the interest rates, and, potentially the loan terms. Actual or constructive knowledge by the refinancing lender, if it is the same original lender or its corporate successor, should be irrelevant.

74 A.3d 1, 9–10 (N.J. Super Ct. App. Div. 2013) (footnote omitted).

ArrowPointe argues if "replacement and modification" is adopted, it "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." ArrowPointe also distinguishes *Sovereign Bank*, arguing New Jersey has statutory provisions specifically addressing the priority of mortgages after a modification. ArrowPointe urges this court to recognize our "legislature has not seen fit to [statutorily address the priority of mortgages after a modification] . . . and instead seems to be comfortable with the uncomplicated race-notice statute"

We are cognizant of the trend toward adopting some form of replacement mortgage doctrine in sister states and our supreme court's dicta in *Matrix*. However, we are also mindful that replacement mortgage is an equitable doctrine and the minority approach. "[A] black-letter-law approach of mechanically applying a Restatement test avoids the fact-specific inquiry characteristic of equitable subrogation historically" Gregg H. Mosson, Comment, *Equitable Subrogation in Maryland Mortgages and the Restatement of Property: A*

Historical Analysis for Contemporary Solutions, 41 U. Balt. L. Rev. 709, 736 (2012). "[S]ubstituting a black-letter test for a balancing of equities reduces a court's equitable inquiry, more likely excuses egregious conduct, and restricts others' equitable defenses against a party seeking subrogation [and] . . . replaces a court's abiding equitable powers for temporary fixes to evolving commercial problems." *Id.* (footnotes omitted). The adoption of the Restatement allows "subrogation to be an odd, judicial loophole . . . because without equity it loses its rationale [by excusing] . . . non-compliance with statutory law, . . . [promoting] a band-aid approach to subrogation to keep the mortgage market moving, and expand[ing] excusable negligence for a plaintiff seeking subrogation." *Id.* at 736-37 (footnotes omitted).

Because Appellant had constructive notice and under our race-notice statute ArrowPointe has priority, we agree with ArrowPointe that this matter is for our legislature. *See e.g.*, N.J. Stat. Ann. § 46:9–8.2 (1991) (statutorily providing for lien priority where a mortgage loan has undergone a modification to the extent "of the maximum specified principal amount which is secured by the mortgage"). Accordingly, we affirm the special referee's order declining to adopt the replacement mortgage doctrine.

B. Prejudice⁵

Appellant maintains the special referee erred in ruling ArrowPointe suffered material prejudice such as to avoid the replacement mortgage doctrine because ArrowPointe was on record notice that the amount secured by First Mortgage could increase. Because we decline to adopt the replacement mortgage doctrine, we need not address the remaining issues. *See Futch v. McAllister Towing of Georgetown, Inc.*, 335 S.C. 598, 613, 518 S.E.2d 591, 598 (1999) (noting an appellate court need not address remaining issues on appeal when the disposition of a prior issue is dispositive).

CONCLUSION

Based on the foregoing, the special referee's order declining to adopt the replacement mortgage doctrine is

AFFIRMED.

⁵ We combine Appellant's second and third arguments.

HILL and HEWITT, JJ., concur.

THE STATE OF SOUTH CAROLINA

In The Court of Appeals

APPEAL FROM FAIRFIELD COUNTY

Court of Common Pleas

Carol A. Tolen, Special Referee

Case No. 2012-CP-20-00132

Appellate Case No. 2018-000230

RECEIVED

Dec 09 2020

SC Court of Appeals

Arrowpointe Federal Credit Union, Respondent,

v.

Jimmy Eugene Bailey; Larua 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

PETITION FOR REHEARING

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PETITION FOR REHEARING & MEMORANDUM IN SUPPORT

Per Rule 221(a), Appellant asks the Court for a rehearing. Rule 221(a), SCACR. A Petition for Rehearing shall be in accordance with Rule 240. Id. Therefore, a Petition for Rehearing shall be written, state the grounds for the petition, and comply with Rule 267. See Rule 240(c), SCACR. All petitions shall have a certificate of service and a memorandum with citations of authority. See Rule 240(c)(1)-(2), SCACR.

“The purpose of [] a petition is to aid the court in deciding correctly a case heard by it.” Arnold v. Carolina Power & Light Co., 168 S.C. 163, 167 S.E. 234, 238 (1933). It would be improper to, and Appellant does not, submit this petition to have the case tried in this court a second time. Id. To prevail on this petition for rehearing, Appellant must demonstrate how the Court overlooked or misapprehended its argument. Kennedy v. S.C. Ret. Sys., 349 S.C. 531, 532, 564 S.E.2d 322, 322 (2001).

Appellant believes the Court overlooked or misapprehended five foundational points to Appellant’s argument. First, South Carolina’s definition of equitable subrogation prompts the need for an equitable remedy that applies to scenarios wherein equitable subrogation is unavailable. “Equitable subrogation is simply not a remedy available to a lender that refinances the original debt owed to it.” Matrix Financial Serv. Corp. v. Frazier, 394 S.C. 134, 138 714 S.E.2d 532, 534 (2011). “Equity owes its birth to the desire to look beneath the rigid rules of the law—to seek substantial justice.” State ex rel. Daniel v. Strong, 185 S.C. 27, 192 S.E. 671, 681 (1937). South Carolina courts recognize the doctrine of equitable subrogation in the context of a third-party refinancer when the third-party has constructive notice but not actual notice of an intervening lien. Matrix Financial Serv. Corp. v. Frazier, 394 S.C. 134, 137-38 714 S.E.2d 532, 533-34. Yet, the Court here denies lien priority to a first-party refinancer that had constructive notice, but not actual

notice, of Respondent's intervening lien. Arrowpointe Federal Credit Union v. Jimmy Eugene Bailey, Op. No. 5784 (S.C. Ct. App. filed Nov. 25, 2020) (Shearouse Adv. Sh. No. 46 at 8) (Quicken did not have actual notice). The Court does so without distinguishing why a first-party refinancer (Appellant "replacing" its own mortgage) should be dealt with more harshly than a third-party refinancer who can subrogate to its predecessor's lien priority position. Id. at 16 ("Because [1] Appellant had constructive notice and [2] under our race-notice statute [Respondent] has priority, we agree with [Respondent] that this matter is for our legislature."). Further, the Court's opinion did not analyze Enterprise Bank v. Fed. Land Bank, cited by the undersigned at oral argument, whereby our Supreme Court gave priority to a first-party refinancer over an intervening second mortgage lien. 139 S.C. 397, 138 S.E. 146 (1927); see also James v. Martin, 150 S.C. 75, 147 S.E. 752 (1929); see also Matrix, 394 S.C. 134, 141-42, 714 S.E.2d 532, 536 (Pleicones, J., dissenting). It is not clear why constructive notice is fatal to a first-party refinance (Replacement Mortgage), but not to a third-party refinance (Equitable Subrogation).

Second, the definitions of replacement and modification were muddled by Respondent, which in turn jumbled the distinctions between equitable subrogation, replacement, and modification. This confusion resulted in the Court misapprehending Respondent's slippery use of these concepts and overvaluing Respondent's rejoinders.

The Supreme Court of New Jersey made clear that the Third Restatement of Property (Mortgages) provides frameworks for assessing priority problems involving a "replacement" mortgage and priority problems involving a mortgage "modification". The term "replacement" refers to a refinance, which describes a satisfaction of the original loan and the replacement of that original loan with a new loan, all of which is part of the same transaction. Sovereign Bank v. Gillis, 432 N.J. Super. 36, 50, 74 A.3d 1, 9 (App. Div. 2013) (citing Third Restatement of Property

(Mortgages) §7.3(a)). The term “modification” refers to an amendment to the terms of the original loan rather than the scenario that accompanies a refinance. Id., 432 N.J. Super. 36, 51, 74 A.3d 1, 9 (citing Third Restatement of Property (Mortgages) § 7.3(b) and (c)). The case of Sovereign Bank v. Gillis was cited in a subsequent decision, wherein the Supreme Court of New Jersey underlined the fact that the two terms refer to two different principles: “In Gillis, we relied on principles of ‘replacement’ and ‘modification’ that are technically distinguishable from the traditional application of equitable subrogation.” Ocwen Loan Servs., LLC v. Quinn, 450 N.J. Super. 393, 399, 163 A.3d 349, 352 (App. Div. 2016). An appellate court in Arizona has also endeavored to make this distinction clear.

The practical differences between the two [principles and loans] are as follows: replacement occurs when a lender releases its original lien of record, discharging it with the proceeds of the second loan secured by a new mortgage that is recorded either immediately or shortly after releasing the initial loan as part of the same replacement loan transaction. Restatement § 7.3 cmt. a; Grant S. Nelson & Dale A. Whitman, *Real Estate Transfer, Finance, and Development*, 835–36 (7th ed. 2006). In contrast, modification occurs when the senior lienholder and the debtor agree to modify the terms of the senior mortgage or the obligation it secures. The original mortgage remains of record and the modifications are reflected in an amendment agreement that also is recorded. Restatement § 7.3 cmt. b; Nelson & Whitman, *supra*, at 837.

Cont'l Lighting & Contracting, Inc. v. Premier Grading & Utilities, LLC, 227 Ariz. 382, 387 n. 3, 258 P.3d 200, 205 n. 3 (Ct. App. 2011), as corrected (June 1, 2011).

Despite what is above, Respondent suggests that “replacement mortgage theory should only be used with regard to true loan modifications”. Respondent’s Brief, p. 11. This suggestion demonstrates Respondent’s failure to distinguish the principles of “replacement” from “modification”. The Matrix Court refers to, and the principles of Section 7.3 of the Third Restatement of Property (Mortgages) apply to, two distinct loan scenarios. Matrix 134 at 138, 714

S.E.2d 532, 534 (citing § 7.6 of the Restatement in support of its definition of equitable subrogation and indicating that § 7.3 of the Restatement applies to the distinct concepts of replacement and modification). Respondent also sought to undermine Appellant's citation of Sovereign Bank v. Gillis by pointing out that New Jersey has a statute that addresses the priority of mortgage modifications. Respondent's Brief, pp. 14-15. But the Gillis Court did not rely on, or even mention, this statute when it adopted "replacement" mortgage. And Respondent does not seem to realize that the loan under consideration in Gillis was a refinance, not a modification. Sovereign Bank v. Gillis, 432 N.J. Super. 36, 40, 74 A.3d 1, 3.

The misunderstanding that Respondent created led the Court to conflate equitable subrogation with replacement mortgage and mortgage modification. The conflation is shown by the Court's reliance on: (1) a University of Baltimore law review article and (2) the aforementioned New Jersey statute dealing with modifications, which this Court cites immediately following its once sentence holding rejecting replacement mortgage. The Court looked to this law review article for guidance about the Restatement's replacement mortgage doctrine, but the article attacked the Restatement's approach to equitable subrogation and a wholly distinguishable (junior lienholder not allowed to litigate priority issues prior to foreclosure sale) Maryland case concerning equitable subrogation, General Electric Capital Mortgage Services, Inc. v. Levenson, 338 Md. 227, 657 A.2d 1170 (MD. 1995); Gregg H. Mosson, Equitable Subrogation in Maryland Mortgages and the Restatement of Property: A Historical Analysis for Contemporary Solutions, 41 U. Balt. L. Rev. 709, 733 n. 13 (2012) (citing Restatement (Third) of Prop.: Mortgs. § 7.6(a) (1997)).

The scholarly—though inapt—law review article brings us to the third point overlooked or misapprehended by the Court. The Court states that "replacement mortgage is an equitable doctrine". Arrowpointe, supra, (Shearouse Adv. Sh. No. 46 at 16). Appellant agrees. But the Court

then suggests that the Restatement's rationale and approach is "without equity" when it cites such language from the Mosson law review article. *Id.* (citation omitted). These inconsistent sentences suggest the Court was swayed by the article's indication that the Restatement's approach is "without equity" and therefore is unjust. See Mosson, Equitable Subrogation in Maryland, 41 U. Balt. L. Rev. 709, 715 ("Equity is a 'positive jurisprudence' of 'important principles' founded upon 'eternal verities of right and justice.'") (footnote omitted). This idea that the Restatement's approach is "unjust" probably tainted the Court's view of replacement mortgage.

Appellant will demonstrate that the Restatement's replacement mortgage doctrine is not unjust. Although Appellant does not waive its arguments concerning the fact that Respondent was on notice that the amount secured by Appellant's replaced mortgage could increase, Appellant's Brief, pp. 18-21, Appellant will offer its Argument concerning the extent of priority to demonstrate the justice of the Restatement's approach. *Id.*, pp. 21-25. In this case, the replaced mortgage secured a note in the principal amount of \$256,500. Appellant's Brief, p. 5. The replacement mortgage secured a note in the principal amount of \$296,000. *Id.*, p. 6. At the time of the replacement mortgage, \$257,459.04 remained on the replaced mortgage and was paid off by the Appellant's replacement mortgage loan proceeds. *Id.* Section 7.3 indicates that "an increase in the principal amount will prejudice the holders of junior interests...[because] [u]nless the original mortgage validly secures future advances...it would be *unfair* to subordinate the intervening lienor to a replacement mortgage balance that it would have no reason to anticipate." Third Restatement of Property (Mortgages) §7.3(Comment b.) (emphasis added).¹ As Illustration 2 makes clear,

¹ "This result is consistent with the treatment afforded an intervening lienor under Subsection (b) of this section, where the principal amount of a senior mortgage obligation is increased by modification rather than as part of a replacement transaction." Third Restatement of Property (Mortgages) §7.3(Comment b.).

however, Appellant's replacement mortgage retains priority up to the amount of the difference between the principal amount of the replacement mortgage and the amount remaining on the principal of the replaced mortgage, plus interest accruing thereon. Third Restatement of Property (Mortgages) §7.3 (Comment b.) (Illustration 2). The difference in this case amounts to \$296,000 minus \$257,459.04, totaling \$38,540.96. Therefore, Appellant's replacement mortgage, at a minimum, is senior to Respondent's mortgage in the amount of \$257,459.04 (loan proceeds actually funded by Appellant), and Respondent is entitled to priority of the next \$38,540.96 and interest accruing thereon. Id.

This result is consistent with the aim of the Restatement, which is to resolve priority problems "in a manner that protects *the legitimate expectations* of the holders of junior interests, while at the same time denying them the ability to veto workouts or other flexible restructuring arrangements between mortgagors and senior lenders." Id. (Comment a.) (emphasis added). Respondent cannot claim to have legitimately expected to gain priority over the amount of the replaced mortgage. Respondent intended its mortgage to be behind the replaced mortgage, second in priority. (R. p. 166, Joint Stipulation 13). Respondent's Vice President even admits that the extent of the material prejudice is \$38,540.96 (referred to as the damage to Respondent's "equity position"). Appellant's Brief, p. 24 (citing R. p. 290).

The Restatement's approach does not favor either party. Replacement mortgage seeks to enforce a junior lien holder's legitimate expectation, "prevent[ing] a junior lien holder from converting the mistake of the lender into a magical gift for himself." Matrix Fin. Servs. Corp. v. Frazer, 394 S.C. 134, 141, 714 S.E.2d 532, 535 (Pleicones, J., dissenting) (discussing the purpose of equitable subrogation). One could argue that enforcing legitimate expectations fairly and preventing undeserved gifts is "doing justice." See Mosson, Equitable Subrogation in Maryland,

41 U. Balt. L. Rev. 709, 737 (“In terms of jurisprudential analysis, one can argue that subrogation has never been a tool of legislating fixes to statutory real-property laws, but of doing justice.”).

The fourth point overlooked or misapprehended by the Court is the source of its equitable powers. The Court suggests the Legislature must adopt an equitable remedy. Arrowpointe Federal Credit Union v. Jimmy Eugene Bailey, Op. No. 5784 (S.C. Ct. App. filed Nov. 25, 2020) (Shearouse Adv. Sh. No. 46 at 16) (citing a New Jersey statute concerning mortgage modifications as opposed to mortgage refinances). In fact, “Courts have the inherent power to do all things reasonably necessary to ensure that just results are reached to the fullest extent possible.” Regions Bank v. Wingard Properties, Inc., 394 S.C. 241, 252, 715 S.E.2d 348, 354 (Ct. App. 2011). Equitable subrogation, for example, is a judicially created exception to the legislatively adopted race-notice statute. Arrowpointe Federal Credit Union v. Jimmy Eugene Bailey, Op. No. 5784 (S.C. Ct. App. filed Nov. 25, 2020) (Shearouse Adv. Sh. No. 46 at 12). Our Courts have not deferred to the legislature in their common law recognition of equitable subrogation of a third-party refinancer. This Court’s deference to the legislature involving a first-party refinancer indicates a misapprehension of the similarities between the doctrines of equitable subrogation and replacement mortgage.

Fifth and finally, like equitable subrogation, replacement mortgage should be recognized as part of this Court’s common law as a judicially created exception to the race notice statute in order to promote justice. While the Court could adopt the Restatement 7.3 wholesale, it does not have to “substitute a black letter test” to balance equities and reach justice. Id., Op. No. 5784 (S.C. Ct. App. filed Nov. 25, 2020) (Shearouse Adv. Sh. No. 46 at 16) (citation omitted). The Court could hold that actual knowledge is fatal to the application of replacement mortgage, which would be consistent with this Court’s common law of equitable subrogation and a departure from

Restatement 7.3 of Property. To hold, as the Court does, that constructive knowledge of an intervening lien is fatal to replacement mortgage seems to be a misapprehension by the Court and a departure from its common law jurisprudence concerning lien priority and equitable subrogation. Id., Op. No. 5784 (S.C. Ct. App. filed Nov. 25, 2020) (Shearouse Adv. Sh. No. 46 at 16) (“Because Appellant had constructive notice...we agree with [Respondent] that this matter is for our legislature.”).

To conclude, the Court overlooked and misapprehended Appellant’s argument. The Court conflated the separate scenarios in which equitable subrogation, replacement mortgage, and mortgage modification apply. This ultimately resulted in the Court declining to adopt replacement mortgage while relying on an inapplicable New Jersey statute concerning modifications and a University of Baltimore law review article concerning equitable subrogation. Replacement mortgage is not unjust; it seeks an equitable and therefore just result between a first-party refinancer that would be senior but for a mistake and an intervening lien holder who only leapfrogged to a prior-in-time position because of the refinance.

In addition, Appellant asks the Court to rule upon Appellant’s second and third arguments concerning prejudice, which the Court declined to do in its initial opinion. Arrowpointe Federal Credit Union v. Jimmy Eugene Bailey, Op. No. 5784 (S.C. Ct. App. filed Nov. 25, 2020) (Shearouse Adv. Sh. No. 46 at 17); Linda Mc Co. v. Shore, 390 S.C. 543, 558, 703 S.E.2d 499, 506–07 (2010) (“An argument not made to an intermediate appellate court *and ruled on by that court* is not preserved for review in this Court.”) (emphasis added), overruled on other grounds by Gordon v. Lancaster, 425 S.C. 386, 823 S.E.2d 173 (2018).

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Appellant petitions the Court to rehear the argument.

Respectfully submitted,



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Attorneys for Appellant

December 9, 2020

THE STATE OF SOUTH CAROLINA

In The Court of Appeals

APPEAL FROM FAIRFIELD COUNTY

Court of Common Pleas

Carol A. Tolen, Special Referee

Case No. 2012-CP-20-00132

Appellate Case No. 2018-000230

Arrowpointe Federal Credit Union, Respondent,

v.

Jimmy Eugene Bailey; Larua 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

CERTIFICATE OF SERVICE

I hereby certify that I served a copy of Appellant's Petition for Rehearing upon Respondent by depositing a copy of the document in the U.S. mail, postage prepaid, on November 30, 2020 and addressed to:

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The South Carolina Court of Appeals

Arrowpointe Federal Credit Union, Respondent,

v.

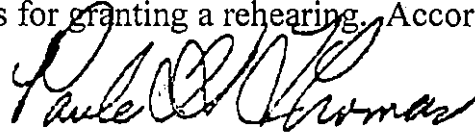
Jimmy Eugene Bailey; Laura Jean Bailey; and U.S. Bank National Association not in its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1, Defendants,

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.

Appellate Case No. 2018-000230

ORDER

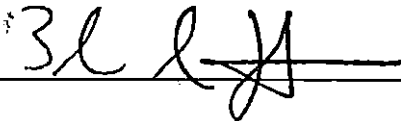
After careful consideration of the petition for rehearing, the Court is unable to discover that any material fact or principle of law has been either overlooked or disregarded, and hence, there is no basis for granting a rehearing. Accordingly, the petition for rehearing is denied.



J.



J.



J.

Columbia, South Carolina

FILED
Jan 13 2021

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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

RECEIVED
JUL 18 2018
SC Court of Appeals

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.

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STATEMENT OF ISSUES ON APPEAL

I. WHETHER THE SPECIAL REFEREE ERRED IN HOLDING THAT SOUTH CAROLINA DOES NOT AND SHOULD NOT RECOGNIZE THE DOCTRINE OF REPLACEMENT MORTGAGE AS FORECASTED IN THE SUPREME COURT'S MATRIX FINANCIAL SERVICES, CORP. V. FRAZER OPINION AND AS ESPOUSED IN THE RESTATEMENT THIRD OF PROPERTY.

II. WHETHER THE SPECIAL REFEREE ERRED IN HOLDING THAT RESPONDENT WAS MATERIALLY PREJUDICED BY THE APPELLANT'S MORTGAGE WHEN RESPONDENT WAS ON RECORD NOTICE THAT THE AMOUNT SECURED BY APPELLANT'S MORTGAGE COULD INCREASE.

III. WHETHER THE SPECIAL REFEREE ERRED IN HOLDING THAT THE EXISTENCE OF SOME MATERIAL PREJUDICE NECESSARILY DEFEATS THE PRIORITY OF THE REPLACEMENT MORTGAGE AND CANNOT BE CURED BY A REDUCTION OF THE EXTENT OF THE REPLACEMENT MORTGAGE'S LIEN PRIORITY.

STATEMENT OF THE CASE

This appeal arises from the Special Referee's Order Granting Plaintiff's Motion for Summary Judgment and Order of Foreclosure ("Order") dated January 18, 2018 in favor of ArrowPointe Federal Credit Union ("ArrowPointe"). The basis of the appeal of U.S. Bank National Association not in its individual capacity but solely in its capacity as Indenture Trustee for WVUE 2015-1 ("U.S. Bank") involves the Special Referee's grant of lien priority in favor of ArrowPointe in the Order.

The underlying civil action commenced on March 27, 2012 in the Fairfield County Court of Common Pleas, Case No. 2012-CP-20-00132. ArrowPointe filed a Lis Pendens, Summons and Complaint seeking to foreclose a Revolving Credit Mortgage ("Revolving Credit Mortgage") given by Jimmy E. Bailey and Laura Jean Bailey ("Baileys") to ArrowPointe. The real property subject to the foreclosure action is commonly known as 247 Morninglow Drive, Winnsboro, South Carolina ("Subject Property").

ArrowPointe named the Baileys and JPMorgan Chase Bank ("Chase") as Defendants. Chase held a mortgage given by the Baileys to Quicken Loans ("Replacement Mortgage") when ArrowPointe filed the underlying action. On May 14, 2012, Chase filed an Answer and Counterclaim, alleging, in part, that the Replacement Mortgage held a senior lien priority position ahead of the Revolving Credit Mortgage. On September 5, 2012, a Consent Order of Reference was entered into by Chase and ArrowPointe referring the action to Carol A. Tolen, as Special Referee for Fairfield County.

The Replacement Mortgage and the loan it secures have been assigned to several different lenders during the course of the underlying lawsuit and this appeal. Chase assigned the Replacement Mortgage back to its original holder Quicken Loans, Inc. ("Quicken"), and the

Circuit Court entered a Consent Order Substituting Real Party in Interest and Amending Caption on October 17, 2013.

Chase filed a Notice of Motion and Motion for Summary Judgment with supporting affidavits concerning the lien priority issue on July 24, 2013. ArrowPointe filed a Memorandum in Opposition on September 17, 2013. The Special Referee heard oral arguments on September 19, 2013, and allowed the parties additional time to submit written memorandum for her consideration after the hearing. Chase filed a Memorandum in Support of its Motion for Summary Judgment on October 2, 2013.

After an unusually-long period between oral arguments and ruling, the Court denied Chase's Motion for Summary Judgment by order dated March 19, 2015 and filed on April 2, 2015. Quicken, who held the Replacement Mortgage by the time of the decision in 2015, served a Motion for Reconsideration on April 10, 2015. The Court heard oral arguments on the Motion for Reconsideration on May 26, 2015. Though a written order does not appear to have been filed, the Special Referee denied the Motion at the hearing and after arguments. (R. p. 83, lines 11-12 on p. 17).

Quicken assigned the Replacement Mortgage to DLJ Mortgage Capital, Inc., ("DLJ"), and the court entered an Order Substituting Defendant, Amending Caption, and Permitting Amendment on January 21, 2016. On January 29, 2016, DLJ filed a Lis Pendens, Amended Answer, Counterclaim, and Cross-Claim, seeking foreclosure of the Replacement Mortgage and a declaration that its Replacement Mortgage was senior in priority under the replacement mortgage doctrine or, alternatively, equitable subrogation. DLJ assigned the Replacement Mortgage to U.S. Bank, and on March 16, 2018, the Court entered the Order substituting U.S. Bank for DLJ.

The Baileys did not appear in the action and were held in default. Neither U.S. Bank nor ArrowPointe sought a deficiency judgment.

ArrowPointe served a Motion for Summary Judgment concerning the lien priority issue on October 12, 2016 along with supporting memorandum. DLJ filed a Memorandum in Opposition to Plaintiff's Motion for Summary Judgment on March 13, 2017.

DLJ and ArrowPointe filed a Joint Stipulation on March 13, 2017. The Special Referee heard oral arguments on ArrowPointe's summary judgment motion on that same day. The Joint Stipulation and its exhibits were entered into the record at the hearing and recorded that same day. At the same hearing, the Special Referee also heard an uncontested motion to substitute U.S. Bank as the real party in interest for DLJ, as well as uncontested testimony from both U.S. Bank and ArrowPointe on the respective debt of their loans, as well as their rights to foreclose their mortgages.

The Special Referee signed the Order on January 18, 2018. The Order held, among other things, that ArrowPointe's Revolving Credit Mortgage held priority over U.S. Bank's Replacement Mortgage and that the Revolving Credit Mortgage could be foreclosed. The Order also substituted U.S. Bank¹ as the real party in interest and established debt figures for both the ArrowPointe loan and the U.S. Bank loan. U.S. Bank's counsel received notice of the Order on January 22, 2018, and filed and served its Notice of Appeal on February 16, 2018. On March 16, 2018, Appellant served a Motion for Superseadas seeking the stay of the sale of the Subject Property during pendency of the instant appeal².

¹ It has come to U.S. Bank's counsel's attention that the Replacement Mortgage and the loan it secures has recently been assigned to a new lender, the particular details of which are still forthcoming.

² As of the filing of this Brief, the lower court has not set a hearing or ruled on U.S. Bank's Motion for Superseadas.

STATEMENT OF THE FACTS

U.S. Bank and ArrowPointe agree on the facts in the underlying case as illustrated in the Joint Stipulation.

The Baileys hold title to the Subject Property and have owned it during all relevant times in this matter. (Joint Stipulation 1) (R. pp. 164-165). The Baileys gave a mortgage to Quicken that was recorded on October 15, 2009 (the “Replaced Mortgage”). (Joint Stipulation 2 and Exhibit A of the Joint Stipulation) (R. p. 165; pp. 311-316). The Replaced Mortgage was in a senior lien priority position on the Subject Property at the time of its recording. Id.

The Replaced Mortgage secured a Note in the principal amount of \$256,500.00, plus interest (“Replaced Note”). (Id. and Joint Stipulation 3) (R. p. 165). Additionally, the “Transfer of Rights in the Property” section of the recorded First Mortgage, states “This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note . . .”. Id.

Subsequently, the Baileys gave ArrowPointe the Revolving Credit Mortgage securing an Open-End Home Equity Credit Agreement in the principal amount of \$99,000.00 to make improvements and additions to their home on the Subject Property. (Joint Stipulation 5, 6 and Exhibits C – I) (R. p. 165; pp. 319-361). The Revolving Credit Mortgage was duly recorded on November 4, 2009. Id.

When ArrowPointe obtained the Revolving Credit Mortgage from the Baileys, the parties to the transaction intended that the Revolving Credit Mortgage be a junior mortgage on the Subject Property second in lien priority position behind the Replaced Mortgage. (Joint Stipulation 13) (R. p. 166).

The Baileys then entered into a subsequent loan transaction with Quicken, its successors and assigns, on November 23, 2009. (Joint Stipulation 14 and Exhibit J, K, L and P of the Joint Stipulation) (R. p. 166; pp. 362-387; pp. 398-399). The Baileys obtained a new loan from Quicken through a Note in the principal amount of \$296,000.00 plus interest in this transaction (“Replacement Note”). Id. The proceeds from the Replacement Note were used to pay off the loan secured by the Replaced Mortgage in the amount of \$257,459.04. Id. As part of the same transaction, the senior Replaced Mortgage was released of record, and then a new mortgage in favor of Quicken was recorded, the Replacement Mortgage. Id. The Replaced Mortgage was of record at all times until the Replacement Mortgage was recorded on December 15, 2009. Id. Quicken intended that the Replacement Mortgage replace the Mortgage and retain Quicken’s senior lien position. Id.

A licensed South Carolina attorney, Stacey E Besser f/k/a Stacey Pope Gardner, supervised the loan closing for the Replacement Mortgage. (Joint Stipulation 16) (R. p. 167). Attorney Besser witnessed and notarized the Replacement Mortgage. Id. Attorney Besser remains licensed and in good standing with the South Carolina Bar in the present day. Id.

Quicken did not have actual knowledge that the Revolving Credit Mortgage existed at the time it conducted the Replacement Mortgage transaction. (Joint Stipulation 17) (R. p. 167). Quicken was on record notice of the Revolving Credit Mortgage at the time it conducted the Replacement Mortgage transaction. Id. During the Replacement Mortgage transaction, the Baileys executed a Title Company Client Acknowledgment that represented by affidavit that “there are no outstanding home improvement loans, mortgages, deeds of trust, or equity lines of credit, recorded or unrecorded” other than the Replaced Mortgage. (Joint Stipulation 17 and Exhibit K of Joint Stipulation) (R. p. 167; pp. 369-370). The Baileys misrepresented the truth when they told Quicken

that there are no equity lines of credit secured by the Subject Property. (Joint Stipulation 17) (R. p. 167).

Thereafter, the Replacement Mortgage went through a series of assignments. (Statement of the Case, supra, and Joint Stipulation 19 and Exhibits M-O in Joint Stipulation) (R. p. 168; pp. 388-397). U.S. Bank's debt on the Replacement Note secured by the Replacement Mortgage was \$436,609.23, as of March 13, 2017, with amounts of the debt continuing to accrue as stated in the Order. (Order at ¶9 and Joint Stipulation 27 and Exhibit V to the Joint Stipulation) (R. p. 4; p. 169; pp. 414-420). ArrowPointe's debt on its note secured by the Revolving Credit Mortgage is \$187,201.60 as of March 13, 2017 with amounts of the debt continuing to accrue as stated in the Order. (Order at ¶5 and Joint Stipulation 29 and Exhibit X to the Joint Stipulation) (R. p. 3; p. 169; pp. 424-425).

ArrowPointe continued to believe that it was in junior lien position until July 2011 when it discovered the Replacement Mortgage had replaced the Replaced Mortgage. (Joint Stipulation 13 and Rule 30(b)(6) ArrowPointe Deposition Transcript of James R. Price) (R. p. 166; p. 132, lines 20-23).

Standard of Review

"An action to establish lien priorities is an action in equity." Friarsgate, Inc. v. First Federal Sav. & Loan Ass'n, 317 S.C. 452, 456, 454 S.E.2d 901, 904 (Ct. App. 1995). In an action in equity referred to a master or special referee for final judgment with direct appeal to the Court of Appeals, the appellate court may view the evidence to determine facts in accordance with its own view of the preponderance of the evidence, though it is not required to disregard the findings of the master or special referee. Id.

ARGUMENTS

I. THE LOWER COURT ERRED IN HOLDING THAT SOUTH CAROLINA DOES NOT AND SHOULD NOT RECOGNIZE THE DOCTRINE OF REPLACEMENT MORTGAGE.

The doctrine of Replacement Mortgage presents a legal issue that South Carolina appellate courts have not yet ruled upon. See Matrix Financial Services Corp. v. Frazer, 394 S.C. 134, 138, 714 S.E.2d 532, 534 (2011) (holding “We do not decide whether a lender that refinances its own debt could attain priority under the theory of replacement and modification illustrated in section 7.3 of the Restatement (Third) of Property (Mortgages)”). The underlying case presents an opportunity to make such a determination.

The Baileys entered into three successive financing transactions. Quicken recorded the Replaced Mortgage on October 15, 2009. ArrowPointe recorded the Revolving Credit Mortgage on November 4, 2009. Quicken recorded the Replacement Mortgage on December 15, 2009. U.S. Bank now holds the Replacement Mortgage. Applying the stipulated facts to the legal principles espoused in the Restatement (Third) of Property (Mortgages), in South Carolina case law and common law, and in other jurisdictions, this Court should reverse the trial court by applying the doctrine of Replacement Mortgage and ordering foreclosure and sale of the Subject Property in favor of U.S. Bank.

a. THE RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) SUPPORTS THE DOCTRINE OF REPLACEMENT MORTGAGE.

The Restatement (Third) of Property recognizes the Replacement of Senior Mortgages and its effect on intervening interests as follows:

- (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, or

(2) to the extent that one who is protected by the recording act acquires an interest in the real estate at a time that the senior mortgage is not of record.

See Restatement (Third) of Property (Mortgages) § 7.3 (1997).

The Comments to this Restatement section acknowledge that the replacement of senior mortgages is commonplace in lending transactions involving real property. See Id. at cmt. a. Further, the commentators state that “[r]equiring the consent of junior interests for such transactions might deny the parties needed flexibility in dealing with changing economic and business conditions. This section aims at resolving those problems in a manner that protects the legitimate expectations of the holders of junior interests, while at the same time denying them the ability to veto workouts or other flexible restructuring arrangements between mortgagors and senior lenders.” See Id. Simply put, junior mortgagees do not have veto authority on a financing transaction between a senior mortgagee and its borrower. The junior mortgagee’s position should not materially worsen due to the transaction, but the senior mortgagee will retain priority to the extent of the replaced mortgage.

Additionally, if the original mortgage puts language in the public record that demonstrates the senior mortgagor’s ability to increase the amount secured by its current or future loans, then the intervening lienholder is on notice that the senior debt can increase and should temper its lending decisions accordingly. See Reporters’ Note, cmt. d, Restatement (Third) of Property (Mortgages) § 7.3 (1997).

b. SOUTH CAROLINA LAW SUPPORTS THE DOCTRINE OF REPLACEMENT MORTGAGE.

South Carolina case law and common law support the doctrine of Replacement Mortgage. Additionally, Replacement Mortgage has been favored and ordered in the Circuit Courts of this State.

1. South Carolina Appellate Court holdings support the doctrine of Replacement Mortgage.

The South Carolina Supreme Court applied the Restatement (Third) of Property (Mortgages) Section 7.6 in its majority opinion in Matrix. This Restatement section recognizes an equitable doctrine known as equitable subrogation, which is an exception to the race-notice statute that typically determines priority by the earlier date of recording. Restatement (Third) of Property (Mortgages) § 7.6 (1997). Much like Replacement Mortgage, Section 7.6 allows a refinancing lender that is different from the original senior mortgagee to retain its priority to the extent the subrogee pays off the prior mortgage. See Id.

Prior to the Restatement (Third), many states allowed the same lender to refinance its own mortgage, including South Carolina, and retain priority through the doctrine of equitable subrogation. The Restatement opines that, for practical purposes and by definition, a lender cannot be subrogated to itself. Therefore, the commentators conclude that Replacement Mortgage is the more appropriate doctrine for a mortgagee to retain priority through a new loan that pays off its own prior loan. Restatement (Third) of Property (Mortgages) § 7.6 (1997).

Seeing no practical difference other than the titles of these two theories, some states still allow a lender to refinance its own mortgage and retain priority over junior mortgagees under the title of equitable subrogation. However, following the guidance of the Restatement (Third) commentators, South Carolina's Supreme Court in Matrix opted to follow the Restatement (Third) of Property (Mortgages) § 7.6 while acknowledging the Restatement (Third) of Property (Mortgages) § 7.3 that discusses Replacement Mortgage. The Matrix majority alludes to the Replacement Mortgage theory in dicta but does not make a ruling based on the principle because "Matrix is not asserting priority under a theory of replacement and modification." See Id. 394 S.C at 138, 714 S.E.2d at 534.

In discerning the logic of the majority with regard to Replacement Mortgage, the dissenting opinion of Justice Pleicones sheds light on the majority's seeming propensity to favor Replacement Mortgage in South Carolina. "It appears that the majority would agree with me that a refinancer has a right to lien priority, if that refinancer uses the theory of 'replacement and modification' rather than equitable subrogation. Heretofore, South Carolina has used the doctrine of equitable subrogation to restore a refinancer's lien to priority, and I would not reverse this because (Matrix) used this theory rather than the newly announced 'replacement and modification' rule." Matrix, 394 S.C. at 141, 714 S.E.2d at 535-36 (emphasis added). While the majority did not, admittedly, specifically announce a new rule in its opinion, Justice Pleicones clearly received the impression that the majority favors Replacement Mortgage and would adopt it with the appropriate procedural backdrop.

Recognizing U.S. Bank's priority here: (a) reduces foreclosures and facilitates refinancing, (b) reduces title insurances premiums, (c) establishes that our Courts do, in fact, recognize replacement mortgage theory, and (d) accomplishes the equitable maxim that no one (ArrowPointe) should be enriched by another's loss. See Matrix, 394 S.C. 134, 714 S.E.2d 532; see also, Sovereign Bank v. Gillis, 432 N.J. Super. 36, 48, 74 A.3d 1, 8 (N.J. Supr. Ct. App. Div. 2013).

"The purpose of subrogation (replacement here) is to prevent a junior lien holder from converting the mistake of the lender into a magical gift for himself." Matrix, (Pleicones, J., dissenting) (citing United States v. Baran, 996 F.2d 25 (2nd Cir. 1993) (parenthetical added)). Here, the mistake would seemingly be Quicken's failure to locate the publicly recorded Revolving Credit Mortgage and ask ArrowPointe for a legal subordination document. Restatement § 7.3 does not require, and actually denounces, such a request from a junior lienholder. Further, equitable

principles excuse a title abstracting oversight and allow the senior mortgagee to retain its priority. Quicken did obtain a sworn affidavit from the Baileys that no lien such as the Revolving Credit Mortgage existed. (Joint Stipulation 17 and Exhibit K of the Joint Stipulation) (R. p. 167; pp. 369-370). Even if Quicken had actual knowledge of the Revolving Credit Mortgage, which it did not (Joint Stipulation 17) (R. p. 167), the Restatement (Third) of Property (Mortgages) § 7.3 does not require ArrowPointe's permission or allow ArrowPointe "the ability to veto workouts or other flexible restructuring arrangements between mortgagors and senior lenders." See Restatement (Third) of Property (Mortgages) § 7.3 (1997), cmt. a; see also, Sovereign Bank, 966 F.2d 25.

ArrowPointe should not receive a magical gift. The equitable principles espoused in the Restatement (Third) of Property regarding Replacement Mortgages should be applied here in order to establish the priority of the Replacement Mortgage.

2. Common law principles in South Carolina support the doctrine of Replacement Mortgage.

The lower court, when issuing the Order, stated that "[t]he theory of replacement mortgage is espoused not in the case law or statutory law of South Carolina, but in the Restatement Third of Property." (Order at Page 5, ¶1, 1st Sentence) (R. p. 5). The lower court went on to hold that US Bank's "argument is based on the Restatement and not existing precedent. The Restatement is not the law of South Carolina, and no appellate court has *yet* adopted the concept of replacement mortgages. Therefore, DLJ (now, U.S. Bank) cannot use this principal [sic] to claim priority over an earlier mortgage lien." (Order at Page 6, Section 1) (R. p. 6) (emphasis and parenthetical added). The lower court erred in its reasoning that South Carolina's common law cannot espouse Replacement Mortgage simply because it has never been ruled upon by our appellate courts.

As an initial matter, U.S. Bank contends that the lower court mistakenly focused on whether the South Carolina Supreme Court has adopted a cause of action or theory *entitled*

“Replacement Mortgage.” However, the Restatement’s (or the common law’s) current title for a parties’ theory of recovery is irrelevant. “The facts alleged, not just the name of the cause of action used, should be examined in assessing whether a valid claim has been asserted.” Gignilliat v. Gignilliat, Savitz & Bettis, L.L.P., 385 S.C. 452, 459-60, 684 S.E.2d 756, 760 (2009). South Carolina has long recognized that equity provides a lender, such as U.S. Bank, relief when it claims a right to subordinate another, such as ArrowPointe, after paying off a first position mortgage over a lender who knowingly took a second position mortgage, and has otherwise done nothing to advance its priority. See United Carolina Bank v. Caroprop, Ltd., 316 S.C. 1, 4, 446 S.E.2d 415, 417 (1994) (“Finally, our holding imposes no injustice upon [the second mortgage holder], it having knowingly taken a *second* mortgage from [a co-tenant]. [The other co-tenant’s] payment of the [first] mortgage in no way disadvantages [the second mortgage holder], which has done nothing to advance its priority.”). Thus, although South Carolina courts have not explicitly entitled certain relief granted as “replacement mortgage”, there is nothing to indicate that this Court would not recognize the theory of “replacement mortgage”, now articulated in Restatement (Third) of Property (Mortgages) § 7.3 (1997).

Regarding South Carolina courts’ adoption of the rationale provided by the Restatements, it is clear from prior decisions that South Carolina’s common law is broader than simply the causes of action explicitly named in prior decisions. Indeed, South Carolina has previously recognized that its common law is often “rooted” in the Restatements. See, e.g., Johnson v. Robert E. Lee Acad., Inc., 401 S.C. 500, 504, 737 S.E.2d 512, 514 (Ct. App. 2012) (“The recognition of a voluntarily assumed duty in South Carolina jurisprudence is rooted in the Restatement of Torts . . .”) (footnote omitted); see also, Kolstad v. Am. Dental Ass’n, 527 U.S. 526, 527, 119 S. Ct. 2118,

2121, 144 L. Ed. 2d 494 (1999) (“The Court’s discussion of this question is informed by the general common law of agency, as codified in the Restatement (Second) of Agency . . .”).

In fact, and as discussed above, the Supreme Court of South Carolina has specifically relied on provisions of the Restatement (Third) of Property in recent opinions in the context of mortgages, thereby using the same to articulate, clarify, and refine South Carolina’s common law. See Matrix at 138, 714 S.E.2d at 534 (2011) (using the Restatement (Third) of Property (Mortgages) in support of the Court’s decision). The Supreme Court’s—and this Court’s—reliance on the Restatement appears in a variety of contexts. See Matthews v. Dennis, 365 S.C. 245, 249, 616 S.E.2d 437, 439 (Ct. App. 2005) (the Supreme Court citing to the Restatement (Third) Property to discuss the different types of implied easements); Howard v. Nasser, 364 S.C. 279, 288, 613 S.E.2d 64, 68 (Ct. App. 2005) (discussing the Restatement when seeking authority in support of the application of presumption to contested will cases); Goodwin v. Johnson, 357 S.C. 49, 55, 591 S.E.2d 34, 37 (Ct. App. 2003) (using the factors articulated by the Restatement for guidance in determining what to consider when establishing an easement by necessity).

Finally, in the event that this Court is persuaded that the principle now referred to as “replacement mortgage” is not currently a part of the common law of South Carolina, then this court should take the opportunity to recognize “replacement mortgage.” The South Carolina Supreme Court has stated: “The common law changes when necessary to serve the needs of the people and we have not hesitated to act in the past when it has become apparent that the public policy of this State is offended by outdated rules of law.” Marcum v. Bowden, 372 S.C. 452, 458, 643 S.E.2d 85, 88 (2007) (quoting Russo v. Sutton, 310 S.C. 200, 422 S.E.2d 750 (1992)). Similarly, “equity exists to correct mistakes and prevent windfalls.” Wachovia Bank, N.A. v. Coffey, 404 S.C. 421, 427, 746 S.E.2d 35, 39 (2013) (Pleicones, J. dissenting); e.g. McNair v.

Rainsford, 330 S.C. 332, 499 S.E.2d 488 (Ct. App. 1998) (unjust enrichment/constructive trust used to recover money from innocent third party where third party would be unjustly enriched by a windfall actually owed to plaintiff).

It would be an inequitable windfall for this Court to construe our common law to allow ArrowPointe, who knowingly took a second position mortgage, to become a senior lienholder through a technicality when Quicken refinanced its senior mortgage. “[S]uch crude application of the principles of the common law must yield to common sense.” State v. Langford, 55 S.C. 322, 33 S.E. 370, 371 (1899). Allowing ArrowPointe to obtain a windfall and a first priority position under these circumstances is a result that must yield to common sense.

If the Court considers this case as the formal recognition of “replacement mortgage”, this recognition is not “a break from precedent” and therefore should be given retroactive application because of the Court’s long-standing practice of providing equitable relief to subrogate lenders who otherwise would obtain an inequitable windfall by advancing priority upon the payoff of a first priority lien. Miranda C. v. Nissan Motor Co., 402 S.C. 577, 588, 741 S.E.2d 34, 40 (Ct. App. 2013); see also Carolina Chloride, Inc. v. S.C. Dept. Trans., 391 S.C. 429, 433–34, 706 S.E.2d 501, 503 (2011) (finding judicial decision should be applied retroactively when it created no new right or cause of action; rather, it abandoned former test and restated the focus for what a landowner must prove to entitle him to damages in an inverse condemnation action); Osborne v. Adams, 346 S.C. 4, 12–13, 550 S.E.2d 319, 323–24 (2001) (finding retroactive application of case law clarifying which professional relationships created a non-delegable duty in common law negligence cases was appropriate because case law neither created a new cause of action nor abolished any existing immunities).

In sum, the courts of this State often look to the Restatement to establish and refine the common law of South Carolina. In the instant case, the trial court's failure to apply such guidance resulted in an error that should be reversed.

3. South Carolina's Circuit Courts have supported Replacement Mortgage Doctrine.

Recently, and in accord with the rationale described herein, the Master-in-Equity for Beaufort County, the Honorable Marvin H. Dukes, III, considered similar facts and legal arguments in a motion for summary judgment and found that the equitable principles of Replacement Mortgage should be applied to establish the priority of the replacement mortgage at issue. (Ex. Z to Defendant DLJ's Memo in Opp. to Plaintiff's Motion for Summary Judgment) (R. pp. 431-442). While not controlling law, it appears that South Carolina's equity courts are willing to apply the equitable principles espoused in the Restatement regarding Replacement Mortgage.

c. SISTER JURISDICTIONS SUPPORT AND ESPOUSE THE DOCTRINE OF REPLACEMENT MORTGAGE.

Since the Restatement (Third's) publication in 1997, numerous jurisdictions have adopted Restatement (Third) of Property (Mortgages) § 7.3.

In Sovereign Bank v. Gillis, the Superior Court of New Jersey's Appellate Division adopts Restatement (Third) of Property (Mortgages) § 7.3 on Replacement and Modification in the context of a refinancer of its own loan to replace priority. 432 N.J. Super. at 39, 74 A.3d at 2. The court notes that there are certain equitable considerations to be taken into account when looking at the general propositions of a race-notice state, like New Jersey (and South Carolina). Id. at 43, 74 A.3d at 5. "An exception to the normal 'race-notice' determination of mortgage priorities can sometimes occur when a third-party advances money to pay off a mortgage." Id. at 44, 74 A.3d at 6. In adopting the Replacement Mortgage doctrine, the Sovereign Bank court takes the third-party

analysis a step further by granting priority to a refinancer of its own loan under the principles of Replacement Mortgage. Id. at 46-48, 74 A.3d at 6-8. The court also opines that a replacement mortgagee's actual knowledge of the intervening lien is not detrimental to replacement priority so long as the intervening junior mortgagee is not materially prejudiced. Id. In the instant case, ArrowPointe and U.S. Bank agree that Quicken did not have actual knowledge of the Revolving Credit Mortgage when it recorded the Replacement Mortgage. (Joint Stipulation 13) (R. p. 166). In fact, ArrowPointe continued to believe that it was in junior lien position until a short sale was suggested in July 2011, which led to its discovery that the Replacement Mortgage had replaced the Replaced Mortgage. (Joint Stipulation 17 and Rule 30(b)(6) ArrowPointe Deposition of James R. Price) (R. p. 167; p. 132, lines 20-23). One of the stated purposes for the adoption of Replacement Mortgage theory was to avoid the junior mortgagee from "reap[ing] an undeserved windfall" by virtue of the senior mortgage being paid off by the new mortgagee. Sovereign Bank, 432 N.J. Super. at 51.

Appellate courts from Michigan and Arizona have also adopted Replacement Mortgage theory, and specifically § 7.3. See CitiMortgage, Inc. v. MERS, 295 Mich. App. 72, 77 (Mich. Ct. App. 2011) (holding ". . . because § 7.3 of the Restatement reflects the present law in Michigan, we hereby adopt it."); see also Markham Contracting Co., Inc. v. FDIC, 240 Ariz. 360, 379 P.3d 257 (Ariz. Ct. App. 2016); Brimet II, LLC v. Destiny Homes Marketing, LLC, 231 Ariz. App. 457, 460, 296 P.3d 993 (Ariz. Ct. App. 2013) (holding that "[w]hen the lenders are of the same identity, priorities are determined under replacement and not equitable subrogation."); BAC Home Loans Servicing, LP v. Semper Invs. L.L.C., 230 Ariz. 587, 277 P.3d 784 (Ariz. Ct. App. 2012).

Additionally, Illinois courts have espoused the principles of replacement mortgage for over 100 years.

Indeed, the legal doctrine [the replacement mortgage party] invoked has existed in Illinois case law for over 100 years, and it is not limited to the third-party situation described by Union. In Shaver, the supreme court held that a lender's refinancing of a debt secured by a mortgage, coupled with a simultaneous release of the original mortgage held by the lender, did not disturb the previous priority of liens on the land, where an intervening lienor took his lien with knowledge of the original mortgage.

UnionBank v. Thrall, 374 Ill. App. 3d 785, 790 (Ill. App. Ct. 2007).

The UnionBank court further stated that “[t]he authors of the Restatement (Third) of Property prefer the term ‘replacement of senior mortgages’ rather than ‘conventional subrogation’ . . .” and that, “[r]egardless of the label, however, it is clear that the doctrine remains valid under Illinois law and that [the replacement mortgage party] properly raised it before the trial court.” UnionBank, 374 Ill. App. 3d at 791.

Finally, Restatement § 7.3 has case citations from the following state and federal jurisdictions that apply the Restatement of Replacement Mortgage in determining the holdings of their decisions: California; Hawaii; Massachusetts; Missouri; New Hampshire; Connecticut; Florida; Kentucky; Nevada; Ohio; Oklahoma; Texas; Utah; Vermont; and Washington. Restatement (Third) of Property (Mortgages) § 7.3 (1997). U.S. Bank is unaware of a jurisdiction that has outright rejected Restatement (Third) of Property (Mortgages) § 7.3. In sum, the doctrine of Replacement Mortgage priority as provided in the Restatement is widely-recognized and favored in courts across the country.

II. THE LOWER COURT ERRED IN RULING THAT ARROWPOINTE SUFFERED MATERIAL PREJUDICE BY REPLACEMENT MORTGAGE WHEN ARROWPOINTE WAS ON RECORD NOTICE THAT THE AMOUNT SECURED BY QUICKEN'S MORTGAGE COULD INCREASE.

The Replacement Mortgage doctrine lists two exceptions: (1) material prejudice and (2) the replaced mortgage not being of record when the intervening lien is recorded. Restatement (Third) of Property (Mortgages) § 7.3 (a) (1997). The second exception is not at issue here because

ArrowPoint agrees that the Replaced Mortgage was recorded at the time it recorded its Revolving Credit Mortgage and that it had the expectation of being in a junior lien position. (Joint Stipulation 2 and 13) (R. p. 165-166).

As to the first exception concerning material prejudice, the Special Referee erroneously held that the "...language in the [Replaced] Mortgage would not allow DLJ to increase the balance secured by its [Replaced] Mortgage in a subsequent replacement mortgage. (Order Page 6, Section 2) (R. p. 6). Further, the Special Referee held that the increase in the principal owed in the Replaced Mortgage of \$256,550.00 to \$296,000.00 in the Replaced Mortgage (a difference of \$39,500.00) constituted material prejudice. The Restatement commentators and sister jurisdictions disagree.

The first exception of material prejudice requires analysis. The Replaced Mortgage, which irrefutably held priority, contained language that put ArrowPointe on notice that "This Security Instrument secures to Lender: (i) the repayment of the Loan, **and all renewals, extensions and modifications of the Note;...**" (Joint Stipulation Exhibit A, Third Page, Transfer of Rights in the Property Section) (R. p. 314) (emphasis added). Under the Restatement §7.3, ArrowPointe should have tempered (and likely did) its lending decision by acknowledging that the amount secured by the senior mortgagee could increase. Essentially, ArrowPointe knew or should have known during its underwriting by virtue of the publicly recorded Replacement Mortgage that additional sums of money could be advanced by Quicken to the Baileys and given priority. While ArrowPointe argues that this unilateral ability between the senior mortgagee and its borrower is penal, the Restatement disagrees. If the original mortgage validly secures future loans or monetary advances in its recorded mortgage, then the intervening lienholder is on notice that the senior debt can increase

and should temper its lending decisions accordingly. See Reporters' Note, cmt. d, Restatement (Third) of Property (Mortgages) § 7.3 (1997).

ArrowPointe makes a semantic argument that the Replacement Mortgage was not a "renewal, extension or modification". However, the Restatement aims to arrive at the equitably appropriate result. If the junior mortgagee had notice that future loans or monetary advances could be made in any fashion, the fact that it was a new loan is immaterial. A noteworthy treatise and case law support this theory on post-mortgage transactions affecting priority.

As a general rule, entering satisfaction of a mortgage and taking a new one, when designated by the parties to be merely a continuation of the first mortgage and when the two acts are practically simultaneous or parts of the same transaction, is not an extinguishment of the mortgage but merely a renewal and does not give priority to an intervening judgment or mortgage creditor of the mortgagor, especially where it is done in good faith, in ignorance of the existence of the intervening lien, and without any intention to release the lien of the mortgage.

59 C.J.S. Section 320, Renewal or Substitution of Mortgages (emphasis added). The Corpus Juris Secundum commentators view the Quicken transaction as a mere renewal, which places it under the gambit of the language in the Replacement Mortgage, and certainly under the spirit of Restatement (Third) of Property (Mortgages) § 7.3. A New Jersey court has applied similar rationale: "This "new loan" was in effect a "modification" as well as a "renewal" ... the court finds that the proceeds of the (Replacement) mortgage were used to take the place of the original (replaced) mortgage, which was a superior lien by recordation and by agreement to plaintiff's mortgages." See UPS Capital Business Credit v. Abbey, 975 A.2d 548, 551 (N.J. Super. Ct. Ch. Div. 2009). The Restatement's Illustration 5 outlines a similar scenario regarding priority

when language discussing additional amounts to be secured in the future is present in the replaced mortgage.³

“For purposes of equitable subrogation, prejudice is determined by evaluating the risk undertaken by the intervening lienholder *at the time it made the loan.*” Markham Contracting, 379 P.3d 257, 261-62 (also holding that they are assigning the title “equitable subrogation” interchangeably with “replacement mortgage” for purposes of that opinion due to the similar analysis). Because ArrowPointe had notice at the time of its underwriting that the secured debt could increase, the Replacement Mortgage should be given full priority because the expectations of ArrowPointe did not change and it has not been materially prejudiced. For these reasons, U.S. Bank should be granted priority and any potential foreclosure sale of the Subject Property should be subject to the Replacement Mortgage.

III. THE LOWER COURT ERRED IN HOLDING THAT THE EXISTENCE OF SOME MATERIAL PREJUDICE NECESSARILY DEFEATS THE PRIORITY OF THE REPLACEMENT MORTGAGE AND CANNOT BE CURED BY A REDUCTION OF THE EXTENT OF THE REPLACEMENT MORTGAGE’S LIEN PRIORITY.

In the alternative that this Court disagrees with the Second Argument, *supra*, and holds that ArrowPointe did suffer material prejudice even in light of the language in the Replaced Mortgage that allows amounts secured by the replacing party to increase, then further analysis is required to determine the extent of the prejudice. The Special Referee’s holding that any ounce of material

³ Illustration 5: Mortgagor borrows \$15,000 from Mortgagee-1 and gives Mortgagee-1 a promissory note for that amount secured by a mortgage on Blackacre. The mortgage states “this mortgage shall also secure all future loans or advances made by Mortgagee to Mortgagor.” The obligation is due and payable in five years. The mortgage is immediately recorded. Two months later, Mortgagor borrows \$10,000 from Mortgagee-2 and gives Mortgagee-2 a promissory note for that amount secured by a mortgage on Blackacre. The latter mortgage is promptly recorded. A year later, Mortgagor and Mortgagee-1 agree to restructure their loan agreement. As a result of this agreement, Mortgagee-1 lends an additional \$20,000 to Mortgagor. Mortgagee-1 then releases its original mortgage of record and, a few days later, Mortgagor delivers to Mortgagee-1 a \$35,000 promissory note secured by a mortgage on Blackacre. The latter mortgage obligation carries the same interest rate and the full \$35,000 is due and payable five years thereafter. It does not secure future advances. The mortgage is promptly recorded. Mortgagee-1’s \$35,000 mortgage is senior to Mortgagee-2’s.

prejudice is fatal to U.S. Bank's replacement mortgage position is erroneous and inconsistent with the law and the Restatement (Third) of Property (Mortgages) § 7.3(a). The Special Referee incorrectly held "I have considered whether South Carolina courts would interpret the Replacement Mortgage to hold priority over the (Revolving) Credit Mortgage, but only to the extent of the debt secured by the Replaced Mortgage. I believe and hold that South Carolina courts would reject this interpretation and, rather, would hold that *any material prejudice is fatal to Replacement Mortgage.*" (Order 6, § 3) (R. p. 6) (emphasis added). Further, the holdings in the final paragraph of § 3 of the Order on Page 6 that follows onto Page 7 represent an incomplete and incorrect interpretation of the Restatement (Third) of Property (Mortgages) § 7.3(a). (R. pp. 6-7).

Under the Restatement, the extent of the prejudice affects the priority determination. First, as to the principal amount due, there is an increase of \$39,500.00 from the Replaced Mortgage to the Replacement Mortgage. As to the increased time of maturity⁴, it is an inconsequential, immaterial month (November 1, 2039 in the Replaced Mortgage and December 1, 2039 in the Replacement Mortgage), which was not raised as an issue of prejudice by ArrowPointe in the lower court. Finally, ArrowPointe did not raise interest as a prejudicial element in the lower court, and for good reason. Neither the Replaced Mortgage nor the Replacement Mortgage stated an interest rate on its face, and ArrowPointe decided to move forward with its junior Revolving Credit Mortgage without any regard for the interest in the Replaced Mortgage. The face of the documents clearly show that the Replaced Mortgage interest was an adjustable rate, which put ArrowPointe on further notice that Quicken's secured debt could increase, and that the Replacement Mortgage

⁴ "The drafters suggest that a mere extension of time resulting from the refinancing is generally not regarded as seriously prejudicial to holders of intervening interest. *Third Restatement 7.6 cmt. e.* In fact, such an extension of time on the senior loan is often advantageous to junior lien creditors because the extension can forestall what otherwise would be a foreclosure on the senior debt that would extinguish the junior lien." Sovereign Bank, 74 A.3d 1, 7. Here, the month is practically inconsequential due to the fact that both loans are in foreclosure in the underlying matter.

had a fixed interest rate. (Exhibit A, Page 2, §H and Exhibit L, Page 2, §H of Joint Stipulation) (R. p. 313; p. 373). The Replacement Note shows a fixed interest rate of 4.875%. (Exhibit J, Page 1, §2 of Joint Stipulation) (R. p. 363).⁵ Given ArrowPointe's disregard for Quicken's interest rate in its underwriting of the Revolving Credit Agreement transaction, U.S. Bank believes an application of the 4.875% interest rate affords an equitable result. Finally, ArrowPointe did not challenge U.S. Bank's right to collect unpaid late fees, escrow advances and attorney's fees as ruled upon and awarded in the Order. See also (Exhibits V, AA and BB from the March 13, 2017 Hearing Transcript) (R. pp. 414-420; pp. 443-450).

U.S. Bank's debt on the Replacement Note secured by the Replacement Mortgage was \$436,609.23 as of March 13, 2017 with amounts of the debt continuing to accrue as stated in the Order. ("U.S. Bank's Total Debt") (Order at ¶9 and Joint Stipulation 27 and Exhibit V to the Joint Stipulation of Facts) (R. p. 4; p. 169; pp. 414-420). U.S. Bank's Total Debt includes \$289,175.07 in principal due and \$81,550.23 in interest from June 1, 2011 through March 13, 2017 at 4.875%. Id. If this Court finds that ArrowPointe suffered material prejudice, which U.S. Bank denies, then it should remand the matter to the Special Referee to adjust the Replacement Note principal down to \$256,500.00 (amount of principal in the Replaced Note) and make a new determination of Principal and Interest (applied at 4.875%) by adjusting for payments from the inception of the loan as if the original principal amount was \$256,500.00. The Special Referee could then reduce U.S. Bank's Total Debt by the new Principal and Interest Amount that was calculated ("Adjusted U.S. Bank Total Debt"). ArrowPointe would be entitled to any surplus sale proceeds in excess of the Adjusted U.S. Bank Total Debt, and U.S. Bank would be entitled to the balance between U.S.

⁵ BAC Home Loans, provides strong analysis on why a move from an adjustable interest rate to a fixed interest rate (a modest rate of 4.875% in the Bailey's case) is typically a favorable position for intervening parties such as ArrowPointe, and not materially prejudicial. 230 Ariz. 587, 277 P.3d 784 (Ariz. Ct. App. 2012).

Bank's Total Debt and the Adjusted U.S. Bank Total Debt in the unlikely event that there are additional surplus proceeds in excess of ArrowPointe's Debt as reflected in the Order. Under this alternative argument, such a determination affords an equitable result to both U.S. Bank and ArrowPointe as shown in Comment B, Illustration 2⁶ of the Restatement (Third) of Property (Mortgages) § 7.3 (a).

In Paragraph 20 of Exhibit A to ArrowPointe's Memorandum in Support of its Motion for Summary Judgment, ArrowPointe's Vice President admits that the extent of its prejudice is \$38,540.96. This amount reflects the difference between the principal amount of the Replacement Mortgage and the payoff of the Replaced Mortgage (\$296,000 - \$257,459.04 = \$38,540.96). (R. p. 399, line 1501). Relevantly, Mr. Price quantifies the extent of his perceived, alleged damages from the Replacement Mortgage transaction: "The refinance damaged the Credit Union's equity position by \$38,540.96." (Exhibit A to ArrowPointe's Memorandum in Support of Plaintiff's Motion for Summary Judgment, Para. 20) (R. p. 290). Under no circumstance could ArrowPointe argue that it was damaged to an extent greater than \$38,540.96 under the Restatement analysis, which would minimally grant U.S. Bank priority up to \$257,459.04 in the alternative to the Adjusted U.S. Bank Total Debt analysis.

⁶ **Illustration 1, with the caveat of Illustration 2, below:** Mortgagor borrows \$50,000 from Mortgagee-1 and gives Mortgagee-1 a promissory note for that amount secured by a mortgage on Blackacre. The mortgage obligation carries a fixed rate of interest and is to be amortized by fixed payments over 15 years. The mortgage is immediately recorded. Thereafter, Mortgagor borrows \$10,000 from Mortgagee-2 and gives Mortgagee-2 a promissory note for that amount secured by a mortgage on Blackacre. The latter mortgage is promptly recorded. Two years later, when the balance on Mortgagee-1's mortgage is \$49,000, Mortgagor and Mortgagee-1 agree to a replacement mortgage. Mortgagee-1 releases its original mortgage of record and Mortgagor delivers to Mortgagee-1 a new promissory note for \$49,000 secured by a mortgage on Blackacre. The mortgage obligation carries the same fixed rate of interest as its predecessor and is evenly amortized over 20 years. A few days later, Mortgagee-1 records the replacement mortgage. The latter mortgage is senior to Mortgagee-2's mortgage. **Illustration 2:** The facts are the same as Illustration 1, except that the replacement mortgage delivered to Mortgagee-1 secures a \$60,000 obligation. Mortgagee-1's replacement mortgage is senior to Mortgagee-2's mortgage except to the extent of \$11,000 and accruing interest thereon.

For the reasons stated above, the Special Referee erred when she ruled that any material prejudice is fatal to the priority of replacement mortgages. In the alternative that this Court believes ArrowPointe suffered material prejudice, which U.S. Bank denies for the reasons stated in the Second Argument, then this matter should be remanded for a determination of the Adjusted U.S. Bank Total Debt.

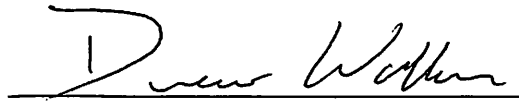
CONCLUSION

ArrowPointe should not receive a magical gift. The equitable principles espoused in the Restatement (Third) of Property regarding Replacement Mortgages should be applied here in order to establish the priority of the Replacement Mortgage.

This Court should reverse the findings made by the lower court and establish that South Carolina courts have adopted the doctrine of replacement mortgage, applying such decision retroactively, and should further find that ArrowPointe suffered no material prejudice by the Replacement Mortgage. In the alternative, this matter should be remanded to determine the Adjusted U.S. Bank Total Debt.

[Signature Page Follows]

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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, 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.

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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”).

(Respondent’s 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. (Footnote 6, p. 24, Appellant’s 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 convoluted calculations.” (p. 23, Appellant’s 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”). (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. (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. (Joint Stipulation 16-17) (R. p. 167). 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. (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

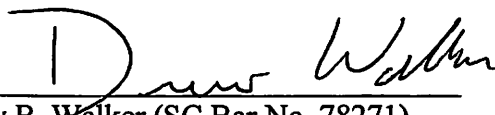
ArrowPointe and U.S. Bank based their lien priority arguments in the lower court solely on whether Replacement Mortgage applied in South Carolina courts. ArrowPointe raises S.C. Code Ann. § 29-3-40 concerning *ad valorem* taxes for the first time in its brief. (Respondent's Brief, p. 24). Because the 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) (R. p. 414). ArrowPointe has "Taxes, insurance, etc. not included above" in the amount of \$37,706.63. (R. 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 Brief of Appellant, 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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South Carolina Appellate Court Rules: Rule 268(d)(2), SCACR 12

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. (R. pp. 16-24). 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. (R. p. 22, ¶ 19.a.). 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. (R. p. 21, ¶ 16). Appellant filed an Answer disputing priority. (R. pp. 25-36). The Borrowers never responded to the foreclosure complaint and were held to be in default. (R. p. 2).

Appellant filed a Motion for Summary Judgment (R. pp. 171-175), which was denied by Order entered April 2, 2015. (R. pp. 12-15).

On October 12, 2016, the Respondent filed a Motion for Summary Judgment and Memorandum in Support of same. (R. pp. 276-285). Appellant contested Respondent’s motion with a Memorandum in Opposition, filed March 13, 2017. (R. pp. 295-310).

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. (R. pp. 1-11). 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. (R. pp. 5-7). 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. (R. pp. 8-9). 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. (R. pp. 164-170). Appellant and Respondent agree to the sequence of the loans, and the recorded mortgages are of public record. (R. pp. 165-168).

On September 29, 2009, Borrowers refinanced an existing mortgage on their real property, located at 247 Morninglow Drive, Winnsboro, South Carolina. Joint Stipulation, Exhibit A. (R. pp. 312-315). The lender was Quicken, Appellant's predecessor-in-interest. (R. p. 313, ¶ D). 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. (R. p. 313, ¶ E).

The mortgage for Appellant Loan 1 was recorded on October 20, 2009. ("Appellant Mortgage 1"). Id. at Page 1. (R. p. 312). When Appellant Mortgage 1 was recorded, it was in primary position. (R. p. 165, ¶ 2).

On October 27, 2009, Respondent gave a loan to the Borrowers. (R. p. 320). 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. (R. p. 355, ¶ 1).

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. (R. p.

355). The mortgage for the Respondent Loan was recorded November 4, 2009. (“Respondent Mortgage”). (R. p. 355).

Respondent was aware of Appellant Mortgage 1 at the closing of Respondent’s Mortgage. Joint Stipulation 13. (R. p. 211, lines 20-23). 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. (R. p. 205, lines 16-20). Thereafter, the priority of the mortgages changed as a result of Appellant’s action. (R. pp. 212-213).

On November 23, 2009, the Borrowers entered into a second, new loan transaction with Appellant’s predecessor-in-interest, Quicken. Joint Stipulation, Exhibit J. (R. pp. 363-365). This loan is referred to herein as “Appellant Loan 2.” The principal amount of the new, second loan was \$296,000.00 (R. p. 363), which was an increase in the amount borrowed from Appellant Loan 1 of \$39,500.00. (R. p. 313, ¶ E). The new transaction also included Borrowers cashing out \$26,235.11 in equity from the home. Joint Stipulation, Exhibit P. (R. p. 399, line 1604). Appellant was on record notice of the Respondent Mortgage at this time, by virtue of Respondent’s mortgage being properly recorded. (R. p. 298, ¶ 17). 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. (R. pp. 389-397).

Appellant Loan 2 was not recorded until December 15, 2009. (Appellant Mortgage 2”) Joint Stipulation, Exhibit J. (R. p. 167, ¶ 18).

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. (R. p. 21, ¶ 14).

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. (R. p. 3). 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 foreclosure 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. (R. pp. 5-7). 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. (R. p. 297, ¶ 12). Appellant recorded Appellant Mortgage 2 on December 15, 2009. (R. p. 299, ¶ 18). 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. (R. 298, ¶ 17). 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 (R. p. 399, line 1600), cashing out equity (R. p. 399, line 1604), and satisfying Appellant Mortgage 1 (R. p. 399, line 1520), 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. (R. 298, ¶ 17).

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. (R. p. 298, ¶ 17).

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 common 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. (R. p. 298, ¶ 17).

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 (R. p. 313, ¶ E- p. 373, ¶ E), and the Borrowers took cash out in the amount of \$26,235.11. (R. p. 399, line 1604).

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. (R. p. 212, lines 11-14). 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 (R. p. 399, line 1604), paid closing costs in excess of \$12,000.00 (R. p. 399, line 1400), which only served to increase the amount that they owed by \$39,500.00 (R. p. 313, ¶ E- p. 373, ¶ E) 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

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. (R. p. 399, line 1604).

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. (R. p. 399, line 1501).

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.”

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. (R. pp. 405-406).

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 do 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. (R. p. 6). The pertinent part of the Appellant Mortgage 1 states that it secures the instant Note and “any renewal, extension or modification.” (R. p. 314). 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 (R. p. 355) 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. (R. p. 399). 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. (R. p. 399). They are two separate and distinct obligations (R. p. 399, line 1501).

**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. (R. p. 313, ¶ E) (*contra* R. p. 355, ¶ 1). It merely mentions the amount already advanced at closing, which is consistent with a closed-end mortgage. *Id.* (R. p. 313, ¶ E). 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. (R. p. 313, ¶ E- p. 373, ¶ E). The Borrowers walked away from the transaction with \$26,235.11 in additional cash. Joint Stipulation, Exhibit P. (R. p. 399, line 1604). The Borrowers cashed out supposed equity, apparently using a loan-to-value ratio that did not include the balance of the Respondent Mortgage loan. (R. p. 399, line 1501). There were substantial closing costs in excess of \$12,000.00 associated with the Appellant Mortgage 2. Joint Stipulation, Exhibit P. (R. p. 399, line 1400).

Appellant Mortgage 2 also contains terms that are materially prejudicial to intervening lienholders. (R. p. 313, ¶ E- p. 373, ¶ E). Because Appellant advanced

significant additional money to the Borrowers in its mortgage for the Appellant Mortgage 2 (R. p. 399, line 1604), 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. (R. p. 133, lines 11-14). 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. (R. p. 355). 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. (R. p. 313, ¶ E- p. 373, ¶ E). 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. (R. 399, lines 1400, 1604).

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. (R. p. 355, ¶ 1).

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. (R. p. 211, lines 24-25, p. 212, lines 1-2). 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. (R. p. 3, ¶ 5.e.). 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. (R. pp. 405-406). 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. (R. pp. 388-397).

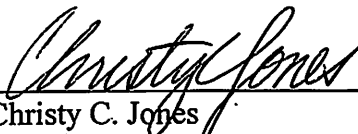
CONCLUSION

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 an 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

RECEIVED
JUL 18 2018
SC Court of Appeals

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.

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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”).

(Respondent’s 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. (Footnote 6, p. 24, Appellant’s 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 convoluted calculations.” (p. 23, Appellant’s 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”). (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. (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. (Joint Stipulation 16-17) (R. p. 167). 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. (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

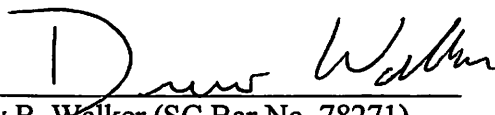
ArrowPointe and U.S. Bank based their lien priority arguments in the lower court solely on whether Replacement Mortgage applied in South Carolina courts. ArrowPointe raises S.C. Code Ann. § 29-3-40 concerning *ad valorem* taxes for the first time in its brief. (Respondent's Brief, p. 24). Because the 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) (R. p. 414). ArrowPointe has "Taxes, insurance, etc. not included above" in the amount of \$37,706.63. (R. 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 Brief of Appellant, 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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