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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM FAIRFIELD COUNTY
Court of Common Pleas

Carol A. Tolen, Special Referee

Op. No. 5784 (S.C. Ct. App. filed November 25, 2020)
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,.....Petitioner.

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RESTATED QUESTIONS PRESENTED

Respondent would re-state the questions presented as follows:

I. Did the court of appeals correctly affirm the denial to adopt the replacement mortgage doctrine where the lender was on constructive notice of the intervening lien and adoption of the proposed doctrine would disregard South Carolina's race-notice statute?

II. Even if the replacement mortgage doctrine is adopted, does the second mortgage's new terms which add principal to the loan, add a future advance clause, and included cash-out of equity by the borrower bar application as they prejudice the intervening lienholder?

INTRODUCTION and RESTATEMENT OF THE CASE

Borrowers refinanced their mortgage with Petitioner's predecessor, entering into a new loan and mortgage and satisfying the original mortgage. As a part of the new transaction, the principal amount of the loan increased, the new mortgage added a future advances clause, and the borrowers cashed out $26,235.11 in equity from the home. While Respondent's mortgage was clearly filed of record, Petitioner disavows actual knowledge of the mortgage which both the special referee and Court of Appeals concluded was in the position of lien priority. Petitioner asks this Court to wholly disregard South Carolina Code Annotated Section 30-7-10 and adopt a legal theory to place them in a position of lien priority despite Respondent's intervening mortgage. Petitioner's negligence in failing to recognize Respondent's properly filed mortgage should not give rise to a new equitable theory.

ARGUMENTS

I. SOUTH CAROLINA HAS NEVER RECOGNIZED REPLACEMENT MORTGAGE.

As noted above, the special referee and the Court of Appeals have rejected Petitioner's arguments, including the suggestion that South Carolina recognizes replacement mortgage. This Court should likewise reject their arguments for two main reasons.

First, adopting the replacement mortgage doctrine wholly disregards South Carolina's race-notice statute and eliminates the need for a title exam. There is no question that Respondent's mortgage was properly filed and should have been identified. Petitioner seeks to avoid the consequences of their failure to identify Respondent's mortgage by asking this Court to utilize a theory heretofore absent in our South Carolina jurisprudence.

Second, even if this theory were adopted, Petitioner's second mortgage is not identical to the first. It is significantly different in aspects that are materially adverse to Respondent. The second mortgage increases the amount of the obligation from $256,500 to $296,000 and adds a future advances clause which could increase the amount of the obligation secured by the mortgage by 150% to $444,000. (App. 182; 193). Additionally, the borrowers reduced the equity in the property through a cash out at closing. Despite this, Petitioner argues Respondent was not materially prejudiced and would not be harmed if Respondent's priority mortgage were "leapfrogged."

For the reasons set forth herein, this Court should deny the instant petition.

A. Petitioner's argument disregards South Carolina's "race-notice" statute and is not supported by the equitable subrogation doctrine.

The Court of Appeals correctly affirmed the special referee's determination that South Carolina has not recognized the replacement mortgage theory and that Respondent's mortgage is in priority position. South Carolina Code Annotated Section 30-7-10 clearly and unequivocally establishes that based upon the filing dates Respondent's mortgage has priority over Petitioner's second mortgage. There simply is no question as to the priority under this statute. Recognizing this problem Petitioner grasps at what they term as a "novel question of law left unresolved by *Matrix Fin. Services Corp. v. Frazer*, 394 S.C. 134, 138, 714 S.E.2d 532, 534 (2011)." *See* Petition for a Writ of Certiorari, p. 4. This "unresolved" question has never been answered in the affirmative in South Carolina, and the replacement mortgage theory is not a part of South Carolina's common law. Both the Court of Appeals and the special referee correctly found such.

South Carolina has clearly and consistently recognized equitable subrogation, but just as consistently determined that such relief does not apply where a lender refinances its own loan.[1] In *Dedes v. Strickland*, 307 S.C. 155, 414 S.E.2d 134 (1992), this Court plainly refused to apply this protection to a lender who, like Petitioner, refinanced the original loan, satisfied the mortgage, and thereafter recorded a new mortgage subsequent to an intervening lienholder. Of note, in *Dedes*, the new loan was for a *lower* amount, not a

[1] The rationale behind equitable subrogation is the new lender, having paid off the original debt, should "stand in the shoes" of the original lender and enjoy the protections of the original mortgage. In the instant situation, Petitioner threw out the old pair of shows and after putting on a new pair seeks to gain priority. This has never been supported by the laws of this state, equitable or otherwise.

higher amount like the instant situation.

Relying upon *Dedes*, this Court in *Matrix Fin. Services Corp. v. Frazer*, 394 S.C. 134, 714 S.E.2d 532 (2011), reaffirmed this position, noting that "equitable subrogation is simply not a remedy available to a lender that refinances the original debt owed to it." *Matrix*, 394 S.C. at 138, 714 S.E.2d at 534. Neither *Dedes*, nor *Matrix*, rely upon the Restatement as the basis for the doctrine of equitable subrogation, but rather South Carolina common law, and merely utilize the Restatement as collateral support.

While the majority in *Matrix*, and the dissent of Justice Pleicones, indicate that no position is taken "under the theory of replacement and modification," nothing in our South Carolina jurisprudence has established "replacement mortgage" as a viable theory. No statute or case law recognizes that a lender can refinance its own loan and have priority restored. Quite to the contrary, *Dedes* and *Matrix* say exactly the opposite. While *Matrix* provides no analysis as to what "replacement and modification" might mean, it is important to note the collective use of the terms, each of which have special meaning in South Carolina.

Between the majority opinion and the dissent, the phrase "replacement and modification" is repeated five separate times. In fact, the term "replacement" is not used anywhere in the case without "and modification" being used right after. Using these terms collectively demonstrates the importance of the terms, especially when used in conjunction with one another. 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).

A modification is commonly a result of foreclosure intervention; a new loan is not closed nor the existing debt extinguished. *See id*. Furthermore, different from a refinance, an attorney is not required to be present at the "closing" of a modification. *See Doe v. McMaster*, 355 S.C. 306, 585 S.E.2d 773 (2003). The prior loan is not satisfied with a modification and it retains its original priority. Because there is no change in terms, intervening lenders are not materially prejudiced. Nothing in *Dedes*, *Matrix*, *Crawford*, or any other South Carolina case supports the position we have here where a lender creates a new loan for a greater amount, a new future advances clause, and a cash-out payment from the equity in the home should assume the priority of their earlier, satisfied mortgage.

Beyond the foregoing, established equitable maxims run counter to the position espoused by Petitioner. 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, Petitioner failed to conduct a thorough, accurate title examination and act accordingly to protect its interests. Furthermore, "[i]t 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 (2011)(citations omitted). "When providing an equitable remedy, the court may not ignore statutes, rules, and other precedent." *Id*., 394 S.C. at 254, 715 S.E.2d at 355. With this in mind, South Carolina Code Annotated Section 30-7-10 would be rendered obsolete if our race-notice statute had no meaning.

Furthermore, if the advanced replacement mortgage theory is adopted as it relates to refinances with new principal amounts, new future advances clauses and cash payouts,

a title search becomes unnecessary and superfluous. The original mortgage would provide absolutely no notice to the public as the terms would always be subject to change. The requirement that an attorney supervise the closing and review the title becomes obsolete, contrary to this Court's specific instructions in *Buyers Services*, and reiterated time and again in other cases. *State v. Buyers Serv. Co.*, 292 S.C. 426, 429, 357 S.E.2d 15, 17 (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). Additionally, attorneys would be unable to provide any real guidance as to the terms of the original mortgage as they could always change and thereby leave subsequent lenders unprotected despite the filing of their mortgage. Petitioner, by asking that this Court adopt the replacement mortgage theory, is essentially asking this Court to overrule precedent which requires attorney involvement in the loan closing.

Contrary to Petitioner's position, replacement mortgage is not, nor has it ever been the common law of South Carolina. Argument that other States have adopted this theory carries no weight in South Carolina considering the foregoing existing law in our state. Adoption of this theory is contrary to established South Carolina statutory law on lien priority, and case law from this Court establishing the requirements of a loan closing. It is additionally in conflict with established equitable maxims in South Carolina. As such, this Court should deny the petition for certiorari.

II. Even if replacement mortgage is ultimately adopted by this Court, it does not apply to the instant matter.

In their petition, curiously, the second Question Presented, asks this Court to make a factual determination that Respondent suffered no "material prejudice." Such a factual

question is not properly presented to this Court in a petition for certiorari. Including this question, however, and an evaluation of the differences between the terms of the original and second note and mortgage reveal the impropriety of certiorari in this matter.

As addressed in the previous section, South Carolina has never adopted replacement mortgage as a doctrine. As such, Petitioner, replying entirely upon the Restatement, urges this Court to overlook Petitioner's own negligence in missing Respondent's properly filed mortgage, and conclude that Respondent was not "materially prejudiced." This is despite material changes being made to the terms of the original note and mortgage. In so doing, Petitioner begs the Court to adopt a new legal theory which would place them in priority position over a lienholder who has done everything properly. The Court of Appeals concluded that, because replacement mortgage is not the law in South Carolina that the issue of prejudice need not be addressed. The special referee likewise concluded that replacement mortgage is not recognized in South Carolina, and that even if it were, "[b]ecause [Petitioner] advanced significant, additional money to the borrowers in its Second Note secured by the Second Mortgage in excess of the debt secured by the First Mortgage, [Respondent] was substantially and materially prejudiced." (R. pp. 000006-007). Because of these facts, this case would be a poor vehicle to review replacement mortgage in South Carolina.

While the Restatement talks in terms of "material prejudice," South Carolina's recognition of equitable subrogation, upon which Petitioner rests much of its argument, sets as an element that the intervening lienholder would suffer "no injustice." *See Dedes*, 307 S.C. at 158, 414 S.E.2d at 136; *Matrix*, 394 S.C. at 137, 714 S.E.2d at 533. Thus,

even if this Court were to ultimately adopt replacement mortgage as a theory, based upon the elements of equitable subrogation, "no prejudice" rather than "substantial prejudice" would be more appropriate and consistent with South Carolina precedent. That this point has to be raised reveals not only that replacement mortgage is not the law of South Carolina, but also that certiorari should be denied in this instance. The facts of this case simply do not lend themselves to this Court's review.

A. Petitioner's second loan was a different loan that worked to the disadvantage of Respondent.

As has been previously addressed, the loan which Petitioner seeks to "leapfrog" Respondent was not the same as the original loan. It was for a higher face amount. It was closed with borrowers "cashing out" significant equity in the home. It included, for the first time, a future advances clause. Petitioner attempts to bridge these differences by arguing that Respondent should have been on notice of the potential for Respondent "to increase the amount secured by its current or future loan." *See* Petition for a Writ of Certiorari, at 11. Unfortunately for Respondent, what they argue is a "future advances" clause was invalid under South Carolina law. *See* S.C. Code Ann. 29-3-50(A). There simply is no merit to the argument that the original mortgage secured "future advances." Contrast that with the "future advances" clause in Petitioner's second mortgage which they hope to gain priority which specifically secures up to 150% of the face value of the mortgage. This face value was already higher than the original mortgage but now can secure up to $444,000 and Petitioner argues Respondent is not prejudiced?

The lending industry is justified in relying upon those matters on record. The

original mortgage which was satisfied was for a lower amount, thereby allowing Respondent to evaluate the equity in the home in making lending decisions. There was nothing in the satisfied mortgage which allowed for the amount of indebtedness to increase. There was nothing in the satisfied mortgage which allowed for the cashing out of equity. Respondent, and others in the lending industry, had a right to rely upon this. Beyond this, the increased face value corresponds to a higher payment amount which increases the chances of a default. Allowing lenders to "leapfrog" other creditors by entering into new mortgages with different terms would stifle this industry and prevent South Carolinians from the benefits associated therewith. The uncertainty which would be created would eliminate second mortgages as an option. Certiorari is not proper in this case.

CONCLUSION

For the foregoing reasons this Court should deny the petition.

Respectfully submitted,

March 15, 2021

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