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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM FAIRFIELD COUNTY
Court of Common Pleas

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.

REPLY TO RETURN TO PETITION FOR WRIT OF CERTIORARI

Shaun C. Blake, Esq.
Andrew B. Walker, Esq.
Rogers Lewis Jackson Mann & Quinn, LLC
PO Box 11803
Columbia, SC 29211
(803) 256-1268

Sean Foerster, Esq.
Rogers Townsend & Thomas, PC
PO Box 100200
Columbia, SC 29202
(803) 744-1855
Attorneys for Petitioner

Other Counsel of Record:
Christy C. Jones, Esq.
Sherpy & Jones, P.A.
P.O. Box 5977
Columbia, SC 29205 (29250)
(803) 356-3326, X102

Jonathan M. Milling, Esq.
Milling Law Firm, LLC
2810 Devine Street
Columbia, SC 29205
(803) 451-7700
Attorneys for Respondent

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ARGUMENT

I. THE RETURN ONLY ILLUSTRATES THE NEED FOR THIS COURT TO DEFINITIVELY STATE SOUTH CAROLINA'S POSITION ON THE DOCTRINE OF REPLACEMENT MORTGAGE AND TO CLARIFY THE EXENT EQUITY MAY PROTECT REFINANCERS FROM ACCIDENTAL LOSS OF PRIORITY.

Respondent argues that the replacement mortgage doctrine is inconsistent with South Carolina law; yet, in Matrix, Justice Pleicones disagreed. Matrix Fin. Services Corp. v. Frazer, 394 S.C. 134, 141, 714 S.E.2d 532, 535–36 (2011) ("Heretofore, South Carolina has used the doctrine of equitable subrogation to restore a refinancer's lien to priority, and I would not reverse this order because it used this theory rather than the newly announced 'replacement and modification' rule.") As noted in the Petition, trial courts have followed suit. Now, Respondent characterizes any recognition of the replacement mortgage doctrine as the end of both the race-notice statute and the practice of title searches in South Carolina; yet Respondent fails to note that both have developed and persisted despite this court's longstanding embrace of the doctrine of equitable subrogation. Courts, practitioners, lenders, insurance underwriters, and other lending market participants would benefit from clear guidance on the role of equitable doctrines when accidents occur in refinance and whether South Carolina is to be the first state that has considered the replacement mortgage doctrine and rejected it.

Petitioner does not ask this court to recognize a new doctrine that renders S.C. Code Ann. § 30-7-10 (the "race-notice statute") meaningless. Like the doctrine of equitable subrogation, the replacement mortgage doctrine, typified in section 7.3 of the Restatement (Third) of Property (Mortgages), merely reflects our court's equitable power to ameliorate unjust results under the race-notice statute. The replacement mortgage doctrine allows a court sitting in equity to avoid accidental windfalls in favor a junior lienholder, and in particular one who knowingly bargained for that position and intended to be subordinate to the lienholder seeking to preserve its priority.

"The purpose of the recording statute is to protect a subsequent buyer without notice." Regions Bank v. Wingard Properties, Inc., 394 S.C. 241, 255, 715 S.E.2d 348, 355 (Ct. App. 2011). No objective of the recording statute is furthered when it creates an accidental windfall favoring a junior lienholder with notice; inherent in the court's equitable power is the ability to ameliorate mistake and grant a subsequent creditor the rights and priority of a prior creditor notwithstanding the recording statute. *See* Dodge City of Spartanburg, Inc. v. Jones, 317 S.C. 491, 454 S.E.2d 918 (Ct.App.1995); United Carolina Bank v. Caroprop, Ltd., 316 S.C. 1, 446 S.E.2d 415 (1994); Meaders Bros. v. Skelton, 234 S.C. 134, 107 S.E.2d 1 (1959); James v. Martin, 150 S.C. 75, 147 S.E. 752 (1929); Enter. Bank v. Fed. Land Bank, 139 S.C. 397, 138 S.E. 146 (1927). Tellingly, Respondent failed to mention or address any of these authorities in its return to the Petition.

Likewise, the recognition of the replacement mortgage doctrine would do no harm to State v. Buyers Serv. Co., 292 S.C. 426, 429, 357 S.E.2d 15, 17 (1987) or its progeny. The replacement mortgage doctrine does not completely remove a closing attorneys' obligation to search title – title searches are necessary for many reasons other than locating an intervening lien prior to a refinance transaction. Rather, the doctrine of replacement mortgage merely allows a court to ameliorate the accidental harm suffered by an innocent refinancer at the hands of an attorney's mistake and prevent an unjust windfall to a junior lienholder. One is hard pressed to imagine the public policy furthered by rejecting an equitable doctrine and, instead, favoring: (1) accidental loss of security for primary lenders; (2) financial windfalls not bargained for by junior creditors; (3) further malpractice claims and lawsuits against closing attorneys; and (4) increased insurance claims and associated increases in premiums associated with professional malpractice, errors and omissions policies, and title insurance.

Notably, the public policy distinction that Respondent attempts to create between a "modification" and a "refinance" simply does not exist. Both the Restatement, and the courts considering it, recognize that replacement mortgage doctrine "helps stem the threat of

foreclosure." Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 28 (Wash. 2007) (internal quotations omitted). The replacement mortgage doctrine 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. at 27. Courts adopting the replacement mortgage doctrine recognize that it benefits "everyone" – including junior creditors, as these otherwise have no promise of any payment in foreclosure. Id. at FN 18.

Finally, this court has repeatedly recognized that, "when the legal rights of the parties have been changed by mistake, equity restores them to their former condition, when it can be done without interfering with any new rights acquired on the faith and strength of the altered condition of the legal rights and without doing injustice to other parties." Young v. Pitts, 155 S.C. 414, 152 S.E. 640, 642 (1930) (internal quotations omitted). In this instance, the replacement mortgage does not materially prejudice Respondent, who took a junior lien with full knowledge that it was junior to an adjustable-rate mortgage which specifically secured all loan extensions and modifications. However, if there is any perceived prejudice in this instance, that is insufficient to defeat equity; the court can simply apply the doctrine of the replacement mortgage to restore these lenders' former conditions by providing that Petitioner retains its first position except *to the extent* of the impairment, which the parties stipulated to in the lower court proceeding. *See* Restatement (Third) of Property (Mortgages) § 7.3, cmt. B and illus. 2; Meaders Bros., 234 S.C. 134, 137, 107 S.E.2d 1, 2–3 (1959). Respondent's argument ignores the inherent flexibility of equity, and in particular the replacement mortgage doctrine, to avoid both windfall and prejudice to the junior lienholder.

CONCLUSION

For the foregoing reasons, the Return fails to persuade, and the Petition should be granted so that this Court might answer the question left open in its decision in Matrix ten years ago.

Respectfully submitted,

March 25, 2021

s/ Shaun C. Blake
Shaun C. Blake, Esq.
Andrew Bryant Walker, Esq.
Rogers Lewis Jackson Mann & Quinn, LLC
PO Box 11803
Columbia, SC 29211
(803) 256-1268
sblake@rogerslewis.com
dwalker@rogerslewis.com

&

Sean Matthew Foerster, Esq.
Rogers Townsend & Thomas, PC
PO Box 100200
Columbia, SC 29202
(803) 744-1855
Attorneys for Petitioner