RECEIVED

Feb 09 2022

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

Trial Court Case No. 2012-CP-20-00132

Appellate Case No. 2021 -- 000149

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

FINAL BRIEF OF RESPONDENT

Christy C. Jones
Sherpy & Jones, P.A.
3109 Devine St.
Columbia, SC 29205
(803) 356-3327, X102

Jonathan M. Milling
Milling Law Firm, LLC
2810 Devine St.
Columbia, SC 29205
(803) 451-7700

Attorneys for Respondent

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

QUESTIONS PRESENTED

1. Did both lower courts properly hold that the Replacement Mortgage theory is not the common law of the State of South Carolina, believing that all mortgage creditors should protect their own interests through the use of thorough and accurate searches of title?
2. Given that the Replacement Mortgage theory is not recognized in South Carolina, did the Court of Appeals accurately hold that it is unnecessary to examine whether an exception applies to the inapplicable theory?

STATEMENT OF THE CASE

This is a lien priority dispute between two mortgage creditors. The timeline is undisputed.

The Baileys gave Appellant a $265,000 mortgage, which was recorded October 20, 2009.

(R. p. 312). ("Appellant October Mortgage").

The Baileys gave Respondent a $99,000 mortgage, which was recorded November 4, 2009.

(R. p. 297, ¶ 12). ("Respondent November Mortgage").

The Baileys gave Appellant a $290,000 mortgage, which was recorded December 15, 2009.

(R. p. 299, ¶ 18) ("Appellant December Mortgage").

The proceeds of Appellant December Mortgage were used partially to satisfy Appellant October mortgage. The Baileys cashed out some equity and left this December closing with $26,235.11. (R. p. 399, line 1604). None of the proceeds of Appellant December Mortgage were used to pay down the Respondent November Mortgage. (R. p. 399).

The Baileys defaulted on the mortgage given to Respondent, filed Chapter 7 bankruptcy, and abandoned the property to creditors. (R. pp. 16-24). Respondent initiated foreclosure of its

mortgage loan, noting its November 4, 2009 mortgage is the first mortgage. (R. p. 22, ¶ 19.a.). Appellant answered, claiming its December 15, 2009 mortgage is the first mortgage. (R. pp. 25-36). During the litigation, Respondent paid real property taxes that came due in the amount of $37,706.63 on the property in question. (R. p. 3). The parties each filed a Motion for Summary Judgment. (R. pp. 171-175; 276-285). The Special Referee found that the mortgage filed in November, 2009 has priority over the mortgage filed in December, 2009 and granted Respondent's Motion for Summary Judgment. (R. pp. 1-11). The Court of Appeals unanimously agreed with the Special Referee's finding and reasoning. Op. No. 5784 (S.C. Ct. App. filed Nov. 25, 2020) (App. 1-10).

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 when the facts are undisputed, the Court is free to apply its own reasoning in applying the law to the undisputed facts. WDW Props. v. City of Sumter, 342 S.C. 6, 10, 535 S.E.2d 631, 632 (2000).

ARGUMENTS

I. BOTH LOWER COURTS PROPERLY HELD THAT THE REPLACEMENT MORTGAGE THEORY IS NOT THE COMMON LAW OF THE STATE OF SOUTH CAROLINA, BELIEVING THAT ALL MORTGAGE CREDITORS SHOULD PROTECT THEIR OWN INTERESTS THROUGH THE USE OF THOROUGH AND ACCURATE SEARCHES OF TITLE.

Appellant argues that the Court should fashion a new remedy, create an exception to statutory law, and disregard equitable maxims all in order to cure a problem that Appellant created through its own negligence, and a problem for which a separate remedy exits. The Respondent is the only party to the case that has not failed to do something that it ought to do. Statutory law, common

law, equitable maxims, and public policy all call for the Court to affirm the lower court's decision. The Special Referee and Court of Appeals correctly held that South Carolina common law does not support the theory of Replacement Mortgage to assist mortgage creditors who fail to thoroughly and accurately search title before refinancing an existing mortgage loan.

A. South Carolina's race-notice statute controls.

The Appellant rushes into advocating for the Replacement Mortgage theory without so much as acknowledging the established rule that has long governed the methods of cautious real estate practitioners in South Carolina: the race-notice statute. S.C. Code Ann. § 30-7-10 (1976). The Restatement's view on the Replacement Mortgage theory cannot be discussed in a vacuum. The South Carolina Legislature weighed in first, weighed in heavily, and weighed in clearly.

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 (1976).

> "[A]ll mortgages . . . required by law to be recorded in the office of the register of deeds or clerk of court. . . are valid so as to affect the rights of subsequent creditors . . . only from the day and hour when they are recorded in the office of the register of deeds or clerk of court . . . 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 its mortgage on December 15, 2009. (R. p. 299, ¶ 18). The Respondent was first in line, and based upon South Carolina law, first in right. Respondent put the Appellant on notice of Respondent's mortgage when it recorded its mortgage, which was also before Appellant closed its mortgage. (R. 298, ¶ 17). See Leasing Enter. Inc. v. Livingston, 294 S.C. 204, 207, 363 S.E.2d 410, 412 (Ct. App. 1987). Recording alerts third parties to other parties' interest in the real property. Id. Adopting the theory of Replacement Mortgage as advanced would render the Respondent's act of recording Respondent November Mortgage meaningless. The Buyers Services lines of cases tells us that recording is crucial, not meaningless. State v. Buyers Serv. Co., 292 S.C. 426, 357 S.E.2d 15 (1987).

Appellant cites to two cases where this Court has used the Restatement to help resolve issues related to servitudes. (App. Brief, pp. 3-4). This is telling. In these cases, unlike here, there is no statutory law that squarely addresses the issues presented. One case uses the Restatement (Third) of Property to define "notorious" and "open" for purposes of a prescriptive easement, such terms not being defined in statute. Simmons v. Berkeley Elec. Coop., Inc., 419 S.C. 223, 233-234, 797 S.E.2d 387, 392 (2016). The other case Appellant uses to show the Court's prior deference to the Restatement is likewise devoid of statutory references to the issue then being addressed. Boyd v. Bellsouth Tel. Tel. Co., 369 S.C. 410, 633 S.E.2d 136 (2006).

Appellant states that while Appellant "was on record notice of the [Respondent's] Mortgage recorded earlier that month, U.S. Bank did not have actual knowledge of the [Respondent's] Mortgage when it refinanced the Bailey's note . . . ." (Appellant's Initial Brief,

pg. 6). Yet Appellant concedes that Respondent's November Mortgage is recorded. In order for Appellant to be unaware of a prior recorded mortgage, the title search must have been nonexistent, premature, or faulty. Appellant's insistence that a modification is equivalent to a refinance clarifies and informs its cavalier attitude when it comes to the failure to properly search title in order to close a refinance. The fact remains that had Appellant properly searched the title, Respondent's mortgage loan would have been made apparent to Appellant, and this entire dispute avoided. Appellant laments the Bailey's inaccurate affidavit that no prior liens exist; however, the standard for closing a refinance does not include a sworn promise from the borrowers regarding prior liens. It includes an accurate and thorough title search for prior liens. State v. Buyers Serv. Co., 292 S.C. 426, 357 S.E.2d 15 (1987).

Appellant emphasizes that Respondent believed it was in second position when Respondent gave the loan to the Baileys. While true, Respondent also believed that Appellant would not unilaterally increase the amount of its loan, all to the detriment of Respondent's equity position. Appellant's failure to adequately search title was a true surprise to Respondent.

For the lower courts to ignore this State's race-notice statute and fashion a new remedy out of the Restatement would have been an 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 or Court of Appeals to craft an equitable relief based on secondary sources.

B. The common law does not support the Replacement Mortgage theory

Appellant wrongly claims that the common law supports the theory of Replacement Mortgage. A reference to the theory is not support for the theory. A passing mention in dicta that an argument can be made using the theory is not a statement in the holding that the theory is approved. 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, (R. p. 298, ¶ 17) should not give rise to new legal theories in South Carolina that erode established and clear statutory authority.

Just as this Court should not rely on the Restatement (Third) of Property (Mortgages) § 7.3 to adopt Replacement Mortgage theory, the Matrix Court 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). 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. South Carolina courts hold that 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). However, in the instant case, Appellant advanced cash out to the Baileys in Appellant December Mortgage.

Appellant wrongly equates its refinance (Appellant December Mortgage) with a modification, and appropriates positive Reinstatement commentary regarding modifications for its own inadequate cause. When it comes to the issue of priority, there is a difference between a modification and 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. The repayment terms of the existing debt, such as interest rate, payment amount, due dates, maturity dates are simply modified. 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 replace and take the priority of an earlier, satisfied mortgage.

However, the Restatement supports replacement in conjunction with a modification, with important exceptions, discussed infra. South Carolina distinguishes a modification from a refinance and indicates that a refinance is not appropriate and eligible for being replaced under the Replacement Mortgage theory. See Matrix Financial Serv. Corp. v. Frazer, 394 S.C. 134, 714 S.E.2d 532 (2011).

C. Public policy and equitable maxims are upheld by not extending the common law to create an exception to the race-notice statute

Appellant repeatedly states that upholding the two lower courts' decisions giving Respondent priority would constitute an inequitable windfall for Respondent. This is not an accurate observation. Mortgage creditors consider loan to value ratios when underwriting loan applications. (R. p. 212, lines 11-14). The value, or equity, in the proposed collateral ideally supports the requested amount borrowed. Indeed, Respondent considered the value of the subject property and also considered the balance of the October Mortgage when deciding whether and how much to lend to the Baileys. (R. p. 28, line 16; p. 117, line 20). A windfall would occur if the November

Mortgage was given priority over the October Mortgage. This did not happen. The November Mortgage's priority was confirmed to be prior to the December Mortgage.

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). Appellant's title search was incomplete or inaccurate; therefore, Appellant did not protect itself. 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). The Buyers Services line of cases instructs real estate attorneys in the list of things that ought to be done in a closing. State v. Buyers Serv. Co., 292 S.C. 426, 357 S.E.2d 15 (1987). 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. Id.

If the advanced Replacement Mortgage theory is adopted as it relates to refinances, even with cash payouts, a title search becomes unnecessary. Lenders like Appellant would have no reason to conduct a title search when refinancing their own mortgage loans, despite the prejudicial terms of the refinance. We know that the closing of a refinance must be accompanied by the knowledgeable assistance of an attorney licensed to practice law in the State of South Carolina. 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). In addition, if Appellant's Replacement Mortgage theory is adopted, South Carolina Code Annotated Section 30-7-10 becomes meaningless. This cannot be the case.

II. GIVEN THAT THE REPLACEMENT MORTGAGE THEORY IS NOT RECOGNIZED IN SOUTH CAROLINA, THE COURT OF APPEALS ACCURATELY HELD THAT IT IS UNNECESSARY TO EXAMINE WHETHER AN EXCEPTION APPLIES TO THE INAPPLICABLE THEORY.

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

According to the secondary source that Appellant urges 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.

A. Change in Terms

In the instant case, the terms of the Appellant December Mortgage are different than the terms of Appellant October Mortgage. 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 December Mortgage. Joint Stipulation, Exhibit P. (R. p. 399, line 1400).

B. Material Prejudice

Appellant's December Mortgage also is prejudicial to the Respondent in a material way. (R. p. 313, ¶ E- p. 373, ¶ E). Because Appellant advanced significant additional money to the Borrowers in Appellant December Mortgage (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 (1997). 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 December Mortgage 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 wrongly argues that because Appellant's October Mortgage contained an adjustable-rate provision, intervening lienholders cannot be materially prejudiced by a subsequent mortgage such as Appellant's December Mortgage. This ignores the substantial increase in the principal balance of Appellant's December Mortgage loan. If this Court accepts Appellant's argument on this point, there will be no second mortgage market when the first mortgage has an adjustable rate. An adjustable rate changes the payment amount on a set principal balance. It does not increase the principal balance at all, unless it is also negatively amortizing. Appellant's

October Mortgage was not an adjustable balance mortgage; it was an adjustable-rate mortgage. Appellant's October Mortgage gave no notice to intervening creditors that the balance would adjust substantially upward at Appellant's whim.

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 its true understanding and position.

Respondent makes mortgage loans and then services them, which motivates Respondent to completely and accurately 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).

Appellant argues that Respondent was on notice that the principal balance of the Appellant October Mortgage could increase, according to its terms. The lower courts did not agree with Appellant. The pertinent part of the Appellant October Mortgage states that it secures the instant Note and "any renewal, extension or modification." 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 and Home Equity Lines of Credit, not in the instant, closed-end Appellant October Mortgage mortgage. Appellant's argument is without merit.

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. Appellant December Mortgage was not a renewal.

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 December Mortgage is not an extension of Appellant October Mortgage. They are two separate and distinct obligations.

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) (emphasis added).

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 October Mortgage does not contain a reference to the maximum amount that can be advanced. Joint Stipulation Exhibit A, Page 2. It merely mentions the amount already advanced at closing, which is consistent with a closed-end mortgage. Id. The language upon which Appellant relies does not establish a future advance clause or open-end mortgage.

Appellant argues that not only should the Court extend the law to include Replacement Mortgage theory, and that the theory should apply to cash-out refinances, but that the so-called replacement mortgage in question was not materially prejudicial to the Respondent, despite advancing significant funds. 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.

Even if the Replacement Mortgage theory is adopted, it should be prospective only in application. This will give lenders an opportunity to make intelligent decisions on loan applications. Matrix Financial Serv. Corp. v. Frazer, 394 S.C. 134, 140, 714 S.E.2d 532, 535 (2011).

C. Public policy

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

(1997). However, in this case, Appellant December Mortgage did not result in more favorable terms to the Baileys. On the contrary, the Baileys 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 expecting to maintain priority will 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 by Appellant does not advance public policy in South Carolina.

Appellant contends in its first argument that giving Respondent's November Mortgage priority over Appellant's December Mortgage would result in an unearned windfall and a magical gift. (App. Brief, p. 12). However, in its second argument, Appellant declares the prejudice done to Respondent is "not so substantial." (App. Brief, p. 17). The harm to Respondent is as substantial as any supposed windfall to Respondent; the only difference is that the Appellant unilaterally decided to increase the amount due, while Respondent met all of its legal obligations. Appellant's December Mortgage created a substantial disadvantage to Respondent's interests and left Respondent in a far worse position, due to the additional funds advanced to the Baileys. This additional amount advanced after the Respondent's mortgage closed is almost 40% of Respondent's total original loan

amount. (R. p. 355, ¶ 1). This is material prejudice.

The manner in which Appellant closed the Appellant December Mortgage denied Respondent the opportunity to properly evaluate the Baileys' request to Respondent for a mortgage loan at all. (R. p. 211, lines 24-25, p. 212, lines 1-2). If Appellant October Mortgage was in the amount of $290,000 then Respondent may have denied the Baileys' application for a $99,000 mortgage loan. Id. The parties cannot argue this in hindsight with credibility. At a minimum, Appellant's contention confirms the material prejudice suffered by Respondent.

CONCLUSION

The Court should uphold the Court of Appeals' finding that Respondent's November Mortgage is entitled to priority over Appellant's December Mortgage, as set forth in South Carolina statute and case law.

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 its 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 and accurate 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 and not refinances. 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 the theory. This theory should not be applied when the new mortgage's terms materially

prejudice the rights of innocent intervening mortgage lien creditors. If this Court decides to adopt Replacement Mortgage theory as it applies to refinanced mortgage loans that substantially prejudice intervening lienholders, it should apply this novel outcome prospectively. 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 Court of Appeal's Order granting Respondent priority.

Respectfully submitted,

s/Christy C. Jones

Christy C. Jones
Sherpy & Jones, P.A.
3109 Devine St.
Columbia, SC 29205
(803) 356-3327, X102

Jonathan M. Milling
Milling Law Firm, LLC
2810 Devine St.
Columbia, SC 29205
(803) 451-7700

Attorneys for Respondent