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S.C. SUPREME COURT

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

REPLY BRIEF OF APPELLANT

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ARGUMENTS

I. SOUTH CAROLINA’S COMMON LAW, EQUITY, AND SOUND PUBLIC POLICY EMBRACES THE REPLACEMENT MORTGAGE DOCTRINE.

First, Respondent argues that South Carolina’s race-notice statute forbids this Court from formally recognizing the Restatement (Third) of Property (Mortgages) § 7.3 (1997) (the “*Restatement*”). Respondent urges that public policy and equitable maxims also demand this result. However, Respondent’s entire argument applies equally to the doctrine of equitable subrogation, which Respondent concedes is well-established in our common law. The fundamental question Respondent fails to address is this – why would South Carolina deny a lender that refinances its own senior mortgage the same equitable relief from the race-notice statute that it provides a lender that refinances another’s senior mortgage? There is no reasoning, no public policy, that justifies such a distinction. This is a mortgage foreclosure action, which is an action in *equity*. “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, 680 (1937).

Respondent conjures a vision of South Carolina without title searches or cautious real estate transactions if this Court adopts the Replacement Mortgage Doctrine as set forth in the Restatement. However, there is simply no evidence in the record or other reason to believe this prognostication; the practice of searching title thrives in South Carolina despite our embrace of the doctrine of equitable subrogation. Likewise, the Restatement specifically contemplates that the latter mortgage would lose the priority of the former mortgage:

- (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). This Court can confidently conclude that lenders will remain incentivized to protect their interests by conducting title searches and entering real estate transactions with caution. However, sound public policy urges adoption of the Replacement Mortgage Doctrine; Respondent cannot contest that the Replacement Mortgage Doctrine (a) reduces foreclosures and facilitates refinancing, (b) reduces title insurances premiums, and (c) accomplishes the equitable maxim that no one should be enriched by another's loss. Matrix Financial Services Corp. v. Frazer, 394 S.C. 134, 142, 714 S.E.2d 532, 536 (2011) (J. Pleicones, J. dissenting) (citing Bank of America v. Prestance Corp., 160 P.3d 17 (Wash. 2007)); Sovereign Bank v. Gillis, 74 A.3d 1, 8 (N.J. Supr. Ct. App. Div. 2013).

Second, Respondent refuses to reconcile its contention that our common law does not support the Replacement Mortgage Doctrine with Dodge City of Spartanburg, Inc. v. Jones, 317 S.C. 491, 454 S.E.2d 918 (Ct.App.1995). In Dodge, the Court of Appeals held that Carolina First Bank enjoyed the priority held over an intervening lien when Carolina First Bank's refinance transaction *paid off and satisfied its own prior debt and mortgage*, as well as one held by First Federal. While the Court of Appeals spoke in terms of the doctrine of equitable subrogation, the substance of the relief is that afforded under Restatement's Replacement Mortgage Doctrine. It is substance, not semantics, that should guide this Court's understanding of our common law. The reasoning in our caselaw overwhelmingly supports the Replacement Mortgage Doctrine; for the sake of brevity, Appellant directs this Court to the South Carolina authorities previously cited, which demonstrate a robust body of common law in South Carolina supporting the Replacement Mortgage Doctrine and persuasive authorities from nineteen (19) other states. (Initial Brief, pp. 7 – 10.) In contrast, Respondent has failed to direct this Court to any decision that has considered and declined to adopt some form of the Replacement Mortgage Doctrine.

Third, Respondent contends it would not obtain an unequitable windfall if the judgment of the special referee is affirmed. This argument is incredible. Respondent admits it intended to possess a second position behind an adjustable-rate mortgage that secured a \$265,000 Note and “all renewals, extensions and modifications” of it. (App. 273.) Unless this Court reverses the special referee’s decision in this case, Respondent will have, by sheer inadvertence, overcome this impairment at Appellant’s expense and assume Appellant’s first position, which no one – not even the Respondent – intended Respondent to possess. One is hard-pressed to imagine a more obvious windfall, and equity abhors such forfeitures.

II. THE REPLACEMENT MORTGAGE DOCTRINE PROVIDES THE MEANS TO ADDRESS THE PREJUDICE, IF ANY, EXPERIENCED BY RESPONDENT, AND RETROACTIVE APPLICATION OF THE DOCTRINE IS WARRANTED.

First, Respondent contends that this Court must find that Respondent was materially prejudiced because the Refi Mortgage did not include a maximum amount for future advances. Yet, “prejudice is determined by evaluating the risk undertaken by the intervening lienholder at the time it made the loan.” Markham Contracting Co. v. Fed. Deposit Ins. 379 P.3d 257, 262 (Ari. Ct. App. 2016). Respondent concedes it chose for its LOC Mortgage to be junior behind an adjustable-rate mortgage and subject to any renewal, extension and modification of that debt. Increases in interest rates can increase the debt ultimately secured by the First Mortgage and impair Respondent’s position just as easily as increases in principal; and like a refinance, extensions and modifications of the First Mortgage can increase or decrease the risk of loss junior creditors suffer in an eventual default. Respondent cannot credibly contend that it did not risk its secured position being eroded or impaired by alterations to the terms of the First Mortgage made between Appellant and the Baileys. Likewise, Respondent undertook the risks posed by the doctrine of equitable subordination, and that another lender would refinance Appellant’s note and First Mortgage.

However, if the Court disagrees and finds material prejudice to the Respondent in this case, Respondent fails to rebut that both the Restatement and our common law provide that the Refi Mortgage retains its first position except to the extent of material impairment – which Respondent states, under oath, is \$38,540.96. (App. 367, ¶ 20); *See* Restatement (Third) of Property (Mortgages) § 7.3, cmt. B and illus. 2; Meaders Bros. v. Skelton, 234 S.C. 134, 137, 107 S.E.2d 1, 2-3 (1959).

Second, Respondent offers much analysis on the mortgage market, forecasting collapses in the home equity line of credit market if this Court joins every other jurisdiction that has considered some form of the Replacement Mortgage Doctrine. The record lacks any expert testimony or basis for these forecasts, and Respondent cite to no decisions in other jurisdictions finding validity to its concerns. If Respondent’s forecasts were true, it begs the question: why has the doctrine of equitable subrogation has not collapsed the market for home equity lines of credit? Respondent does not dispute that the doctrine of equitable subrogation would have permitted another lender to refinance Appellant’s First Mortgage, leaving Respondent in the same position as if this Court formally recognizes the Restatement’s Doctrine of Replacement Mortgage. For Respondent’s argument to have merit, the impossible must be true; a home equity line lender would have to possess prescient knowledge of which lender will conduct a future refinance transaction at the time of underwriting a line of credit.

Third, Respondent argues that this court should only adopt the Replacement Mortgage Doctrine prospectively to “give lenders an opportunity to make intelligent decisions on loan applications.” This non sequitur is based on the same flawed logic underlying Respondent’s forecast of the collapse of the home equity line of credit market. Junior creditors currently make loan decisions with full knowledge of South Carolina’s embrace of the doctrine of equitable

subrogation. Plainly articulating that a lender that refinances its own first mortgage enjoys the same equitable protections South Carolina affords other refinancing lenders changes nothing for underwriters in the home equity line of credit market. Since the recognition of the Replacement Mortgage Doctrine is not “a break from precedent” - particularly considering decisions like Dodge, *supra* - this Court’s decision to adopt the Replacement Mortgage Doctrine should be given retroactive application. Miranda C. v. Nissan Motor Co., 402 S.C. 577, 588, 741 S.E.2d 34, 40 (Ct. App. 2013).

CONCLUSION

Respectfully, Respondent renews its request for relief stated in the conclusion of its Initial Brief.

Respectfully submitted,

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