THE STATE OF SOUTH CAROLINA
In The Supreme Court

Matrix Financial Services Corporation, Respondent,

v.

Louis M. Frazer, Linda S. Frazer, Matthew Kundinger, and Parks Grove Homeowners Association, Inc., Defendants,

of whom Matthew Kundinger is the Appellant.

Appeal from Greenville County
Charles B. Simmons, Jr., Circuit Court Judge

Opinion No. 26859
Heard April 21, 2009 – Filed August 16, 2010

REVERSED

David Alan Wilson, of Horton Drawdy Ward & Jenkins, PA, and Edward Scott Sanders, both of Greenville, for Appellant.

Earle G. Prevost, and Michael J. Giese, both of Leatherwood, Walker, Todd & Mann, of Greenville, for Respondent.

CHIEF JUSTICE TOAL: In this case, Matthew Kundinger (Appellant) enrolled a default judgment against Louis and Linda Frazer (the Frazers) before the Frazers closed a refinance mortgage with Matrix Financial Services Corporation (Matrix). In Matrix's foreclosure action, the master-in-equity granted Matrix equitable subrogation, giving the refinance mortgage priority over Appellant's judgment lien. We certified this case pursuant to Rule 204(b), SCACR. We reverse.

FACTS/PROCEDURAL BACKGROUND

In 1998, Appellant brought suit against the Frazers in California. In 2000, the Frazers moved to South Carolina, and defaulted in Appellant's California lawsuit.

In January 2001, the Frazers purchased a home in Greenville County. The original mortgage was assigned to Matrix in June 2001. In September 2001, Matrix and the Frazers entered into a loan commitment for a refinance mortgage. A title search was conducted on September 18, 2001. The refinance loan was closed on November 26, 2001, but was not recorded until April 3, 2002.

Meanwhile, on September 4, 2001, Appellant obtained a default judgment against the Frazers in California, and enrolled that judgment in Greenville County on October 31, 2001.

The Frazers filed bankruptcy, and Matrix sought to foreclose its November 2001 mortgage. Appellant counterclaimed, alleging his judgment had priority over Matrix's mortgage because it had been recorded first. Matrix then sought to be equitably subrogated over Appellant's judgment lien. The master-in-equity granted Matrix's request, and Appellant appeals that order.

ISSUES

I. Did the master-in-equity err in equitably subrogating Matrix's refinance mortgage to the primary priority position of the original mortgage over Appellant's judgment lien?

II. Does the doctrine of unclean hands prevent Matrix from receiving the remedy of equitable subrogation?

ANALYSIS

Equitable Subrogation

Appellant argues the master-in-equity erred in holding Matrix was entitled to equitable subrogation. We agree.

In *Dedes v. Strickland*, 307 S.C. 155, 158, 414 S.E.2d 134, 136 (1992), this Court listed the requirements a mortgagee must meet to qualify for equitable subrogation: (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 equitable subrogation; and (5) the party asserting the doctrine did not have actual notice of the prior mortgage.

In *Dedes*, a bank refinanced its initial mortgage and sought to be equitably subrogated over the rights of an intervening mortgagee. This Court held that the bank could not meet the elements of equitable subrogation merely by paying "itself [the] outstanding debt by refinancing the balance owed" because the bank had no "direct interest necessitating discharge of the debt . . . ." *Dedes*, 307 S.C. at 159, 414 S.E.2d at 136. To meet the criteria for equitable subrogation, a party must have liability for the debt other than a voluntary agreement to refinance its own earlier mortgage. Otherwise, a lender can simply refinance the debt at any time to prevail over an

intervening lien holder, rendering the requirement of secondary liability meaningless.

Here, we are faced with the same situation presented to the court in *Dedes*. Matrix seeks to be equitably subrogated over Appellant's judgment lien based solely on its voluntary refinancing of its own debt. Matrix had no liability for the original mortgage before it voluntarily refinanced the balance owed. Thus, Matrix had no obligation to pay off its existing mortgage. Matrix admits that it would not have obligated itself unless it could obtain a first lien, and that if it knew about Appellant's lien it would not have authorized disbursement. Because Matrix cannot prove that it was secondarily liable on the initial mortgage, Matrix was a mere volunteer when it disbursed the funds and is not entitled to equitable subrogation.

Unclean Hands

Appellant also argues Matrix is not entitled to an equitable remedy because it closed the refinance loan unlawfully, and thus has unclean hands. We agree.

Real estate and mortgage loan closings, including refinance loans, must be supervised by an attorney. *See Doe v. McMaster*, 355 S.C. 306, 585 S.E.2d 773 (2003). Performing a title search, preparing title and loan documents, and closing a loan without the supervision of an attorney constitutes the unauthorized practice of law. *Id.* The court grants equity at its discretion and can refuse to provide a remedy when the party has failed to act equitably in the transaction at issue. *See Ingram v. Kasey's Assocs.,* 340 S.C. 98, 531 S.E.2d 287 (2000).

In *Wachovia Bank v. Coffey*, Op. No. 4685, 2010 WL 1904876 (S.C. Ct. App. May 6, 2010), Wachovia closed a home equity loan without the supervision of an attorney and later instituted foreclosure proceedings. The court of appeals held that Wachovia, having committed the unauthorized practice of law in closing the loan without attorney supervision, came to the

court with unclean hands and thus was barred from seeking equitable relief. In so holding, the court of appeals said:

> The unauthorized practice of law is inherently prejudicial to not only the parties involved in the instant transaction but also to the public at large for the reason so cogently stated in *Buyers*:
>
> > The reason preparation of instruments by lay persons must be held to constitute the unauthorized practice of law is not for the economic protection of the legal profession. Rather, it is for the protection of the public from the potentially severe economic and emotional consequences which may flow from erroneous advice given by persons untrained in the law.

Coffey, at * 3 (citing *State v. Buyers Serv. Co.*, 292 S.C. 426, 431, 357 S.E.2d 15, 18 (1987)).

Similarly, in this case Matrix comes to the court with unclean hands, and is thus barred from seeking equitable relief. Matrix hired LandAmerica OneStop to perform the title search, prepare the documents, and close the refinance loan–all admittedly without the supervision of a licensed attorney. Thus, Matrix has committed the unauthorized practice of law in closing the refinance mortgage, clearly violating South Carolina law. The dissent's protestations aside, a party cannot violate the law and expect not to bear the consequences of its actions. This Court will not grant a discretionary, equitable remedy to a party who refused to follow the laws of this state. Therefore, even if Matrix were able to satisfy the requirements for equitable subrogation, Matrix would not be entitled to that equitable remedy because it has unclean hands.

CONCLUSION

For the above reasons, we hold Matrix is not entitled to equitable subrogation, and also has unclean hands barring it from receiving an equitable remedy. The master-in-equity's order is reversed.

WALLER, and BEATTY, JJ., concur. KITTREDGE, J., concurring in a separate opinion. PLEICONES, J., dissenting in a separate opinion.

JUSTICE KITTREDGE: I concur in result. I would reverse on the issue of unclean hands and not reach the merits of the equitable subrogation issue. Concerning the matter of unclean hands, I would reverse the judgment of the trial court only because Matrix, as a result of its unlawful conduct, is not entitled to the benefit of having its lien equitably subrogated over Appellant's judgment lien. To resolve this appeal, I see no need to reach the broader question of the underlying efficacy of a real estate mortgage secured through the unauthorized practice of law and the general availability of foreclosure relief in such circumstances. I would go no further than to hold that the benefit of equitable subrogation is not available where, as here, the mortgage was secured through the unauthorized practice of law.

JUSTICE PLEICONES: I respectfully dissent. First, I believe the majority misapprehends the requirement in equitable subrogation that the party asserting the doctrine be "secondarily liable." Second, in dicta, the majority creates a new rule that equity will not aid a party that violated South Carolina law in closing a mortgage because that party has unclean hands, a rule I believe may have chaotic unintended consequences.

A. Equitable Subrogation

Equitable subrogation is a remedy favored by the courts, and it is to be liberally and expansively applied. So. Bank and Trust Co. v. Harrison Sales Co., Inc., 285 S.C. 50, 328 S.E.2d 60 (1985). The doctrine:

> is founded on the fictional premise that an obligation extinguished by a payment made by a third person is to be treated as still subsisting for the benefit of such third person, whereby he is substituted to the rights of the creditor when he has made such payment.
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> St. Paul – Mercury Indem. Co. v. Donaldson, 225 S.C. 476, 83 S.E.2d 159 (1954) citing Aetna Life Ins. Co. of Hartford v. Town of Middleport, 124 U.S. 534 (1888).

"The purpose of subrogation is to prevent a junior lien holder from converting the mistake of the lender into a magical gift for himself." U.S. v. Baron, 996 F.2d. 25 (2nd Cir. 1993) (internal citation omitted). Thus, the proper focus is whether equity should elevate appellant's judgment lien over Matrix's mortgage, not whether Matrix should be punished for its participation in an unlawful closing.

A mortgagee seeking to be equitably subrogated to an earlier mortgage must establish:

1) that the mortgagee has paid the earlier debt;

2) that the mortgagee was not a volunteer but had a direct interest in the discharge of the earlier mortgage;

3) that the mortgagee was secondarily liable for the debt or for the discharge of the mortgage;

4) that no injustice will be done to another creditor if subrogation is permitted; and

5) the mortgagee asserting the doctrine did not have actual knowledge of the other lien.

Dedes v. Strickland, 307 S.C. 155, 414 S.E.2d 134 (1992).

The majority holds Matrix is not entitled to equitable subrogation because it cannot satisfy the second and third requirements in that it voluntarily paid off the original mortgage, upon which it was not secondarily liable. In making this argument the majority relies on Dedes, while the master and Matrix rely upon Dodge City of Spartanburg, Inc. v. Jones, 317 S.C. 491, 454 S.E.2d 918 (Ct. App. 1995) *cert. denied* Feb. 8, 1996. I believe that the majority misreads Dedes, but if they are correct, I would overrule that case to the extent it holds a lender refinancing its own mortgage can never invoke equitable subrogation.

In Dedes, as here, the mortgagee (Bank) of the original mortgage entered a new agreement with the debtors, who executed a new note and mortgage. When Dedes, an intervening mortgagee, sought to foreclose its mortgage, the Bank pled equitable subrogation seeking to have its new mortgage assume the priority its original mortgage held over Dedes' intervening mortgage. In upholding the master's order finding the Bank was not entitled to invoke the doctrine, this Court held:

> [Bank] paid itself [Debtor's] outstanding debt by refinancing the balance owed. **There is no showing of any direct interest necessitating discharge of the [first mortgage]. The record is silent as to what secondary liability [Bank] could have for [Debtor's] debt secured by its own first mortgage lien.**
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> Dedes, 307 S.C. at 159, 414 S.E.2d at 136 (emphasis supplied).

I read Dedes as a failure of proof case, not as the majority does, as a decision holding that one who satisfies a preexisting mortgage as a condition of giving a new mortgage is never entitled to equitable subrogation. In 1927, this Court held that a lender who pays the original mortgage itself, or furnishes money to the mortgager to pay off an existing mortgage, pursuant to an agreement by which the lender will give a new mortgage, has the equitable right to be subrogated to the paid-off mortgage. Enterprise Bank v. Fed. Land Bank, 139 S.C. 397, 138 S.E. 146 (1927). In this situation, the lender furnishing the money is not a volunteer, and becomes secondarily liable for the discharge of the first mortgage under the instruments creating the new mortgage which require the satisfaction of the first mortgage as a condition of the giving of the second. Id.; see also James v. Martin, 150 S.C. 75, 147 S.E. 752 (1929) (applying Enterprise Bank and quoting: "One satisfying a lien note at the request of the property owner, upon the understanding that he is to have new security upon the property released, acting in ignorance of a second mortgage lien upon the property, although it is on record, is entitled to subrogation to the rights of the first lien holder"). In Dedes, it appears the Bank failed to present evidence that its second loan was conditioned on the satisfaction of its first loan. I do not view Dedes as overruling Enterprise Bank or James.

Matrix was not a volunteer[1] but was directly interested in the discharge of the original mortgage, and was secondarily liable for its discharge by

[1] The majority holds that Matrix was a 'volunteer' for purposes of equitable subrogation because it voluntarily refinanced the original mortgage. A rule

virtue of its agreement to make a new loan to the Frazers conditioned on the payoff of the first mortgage. See Enterprise Bank, *supra*; James, *supra*; Dodge City, *supra*. Matrix has established its entitlement to equitable subrogation under existing South Carolina law. Moreover, as explained below, the majority's decision to deny a refinancer equitable subrogation does not comport with the current Restatement of Property.

Under the Restatement (Third) of Property § 7.3 (1996), a refinanced mortgage retains the same priority as the mortgage it replaces, except to the extent this priority would materially prejudice a junior lienholder. Material prejudice may exist where the principal amount is increased, or where the intervening lien is acquired after the release of record of the first mortgage and before the recordation of the replacement mortgage. In general, under the Restatement (Third), whether the refinancer is the original mortgagee or not, and regardless whether the refinancer has actual or constructive knowledge of any junior lienholder, it is entitled to be equitably subrogated to the first mortgage. As the Washington Supreme Court explained, the theory underlying the doctrine and the following policy considerations support a rule that, absent material prejudice to a junior lienholder, equitable subrogation should be automatically available to a mortgage refinancer who can show it expected to have first priority:

1) Equitable subrogation preserves priorities by keeping mortgages and other liens in their proper recordation order;

2) Equitable subrogation accomplishes substantial justice and rests on the maxim that no one (here, the junior lienholder) should be enriched by another's loss;

3) Facilitating refinancing helps prevent foreclosures; and

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that only lenders forced to refinance an existing mortgage are not volunteers would effectively eliminate the availability of the equitable subrogation remedy.

4) A liberal equitable subrogation policy reduces title insurance premiums.[2]

Bank of America v. Prestance Corp., 160 Wash.2d 560, 160 P.3d 17 (2007).

Of course, we need not adopt the Restatement (Third) in order to affirm the master's ruling that Matrix is entitled to equitable subrogation here. Enterprise Bank, *supra*; James, *supra*; Dodge City, *supra*.

B. Unclean Hands

The majority also holds that appellant may assert that Matrix has "unclean hands" because it "unlawfully" closed the refinancing mortgage, and thereby defeat Matrix's right to equitable subrogation. It is unclear to me how appellant, a stranger to the mortgage transaction, is in a position to assert "unclean hands" with respect to the closing. See Arnold v. City of Spartanburg, 201 S.C. 523, 532, 23 S.E.2d 735, 738 (1943) ("'clean hands' means a clean record with respect to the transaction with the defendants themselves and not with respect to others"). The majority does not explain why appellant may assert "unclean hands" with respect to the mortgage between Matrix and the Frazers, leaving the reader to assume the Court is altering the requirement that only a party to the transaction may assert the bar. I am not comfortable altering the principles of equity in the absence of a persuasive policy reason.

Perhaps more disturbingly, the impact of a decision holding that equity will not aid a mortgagee when the closing was unlawful will be devastating, undermining lender confidence in an already unstable market, and making title insurance virtually unavailable in South Carolina.[3] Even if we were to

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[2] Citing Nelson & Whitman, *Adopting Restatement Mortgage Subrogation Principles: Saving Billions of Dollars for Refinancing Homeowners*, 2006 BYU L.Rev. 305.

[3] One need only review this Court's attorney disciplinary cases to see that many closings are conducted unlawfully, often without the knowledge of the

adopt such a harsh rule, the Court should acknowledge in fairness and equity, that the law has been evolving in the area of residential real estate closings, and thus many mortgagees may hold mortgages that were closed "unlawfully." See State v. Buyers Serv. Co., Inc., 292 S.C. 426, 357 S.E.2d 15 (1987); Doe v. McMaster, 355 S.C. 306, 585 S.E.2d 773 (2003); Doe Law Firm v. Richardson, 371 S.C. 14, 636 S.E.2d 866 (2006). In fact, it was not until McMaster, decided twenty-one months after the Matrix loan was closed, that we rejected the contention that refinance closings were subject to a different set of rules than original loans. To suggest that a mortgage given in an unlawful closing will not be protected in equity leads to uncertainty and increased costs.[4]

While I strongly disapprove of Matrix's failure to abide by South Carolina law in the processing of this mortgage, appellant's "unclean hands" claim is insufficient to defeat Matrix's entitlement to equitable subrogation of its November 2001 mortgage.

CONCLUSION

I would affirm the master's order.

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lender. To hold that equity will not aid the lender in such a situation, will deny it the right to foreclosure. See Wachovia Bank, N.A. v. Coffrey, 2010 WL 19048786 (S.C.Ct. App. May 6, 2010).

[4] For example, will a financial institution be willing to purchase a mortgage without ensuring that the loan was closed lawfully?