



**ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY**



**CENTERPOINT MECHANIC LIEN CLAIMS, LLC v.
COMMONWEALTH LAND TITLE INSURANCE COMPANY
CV-23-0164-PR**

PARTIES:

Petitioner/Cross-Respondent: Commonwealth Land Title Insurance Co. (“Commonwealth”)

Respondent/Cross-Petitioner: Centerpoint Mechanic Lien Claims, LLC (“CMLC”)

FACTS:

Background

In 2007 and 2008, Mortgages Ltd. (“ML”) agreed to loan a developer funds for the construction of the Centerpoint Towers (the “Project” or “Centerpoint”). The loan was secured by a deed of trust. In connection with the deed of trust, ML bought a lender’s title insurance policy (the “ML Policy”) from the predecessor to Fidelity National Insurance Company (“Fidelity”). Among other things, the ML Policy insured ML’s lien priority over later-recorded mechanics’ liens for the face amount of \$165,200,000.

In 2008, ML encountered financial difficulties. Funding on the Centerpoint loan became erratic, and construction eventually stalled. Starting in April 2008, subcontractors and suppliers began recording mechanic’s liens against Centerpoint. In October 2008, the first of what would become dozens of mechanic’s lien foreclosure claims were filed and asserted that the mechanic’s liens had priority over ML’s security interest in Centerpoint. Ultimately, this litigation would consolidate dozens of mechanic’s lien claims, valued at approximately \$38 million in combined liability (the “Lien Litigation”).

ML entered involuntary bankruptcy in June 2008. Under ML’s bankruptcy reorganization plan, ML’s deed of trust interest in Centerpoint was transferred to limited liability companies, Centerpoint I Loan, LLC (“CPI”) and Centerpoint II Loan, LLC (“CPII”), which were created to hold assets related to the Centerpoint loan. A different company, ML Manager, LLC (“ML Manager”), was organized to act as the manager of CPI and CPII, as well as other loan LLCs related to ML’s loans. ML Manager was also appointed to act as agent for certain fractional interest holders who obtained an interest in the loans and security associated with Centerpoint through the bankruptcy process. (CPI, CPII, and the fractional interest holders are collectively referred to as “the ML Investors”).

In 2009, the ML Investors needed additional financing. Another lender, Universal SCP-1 LP (“Universal”), agreed to loan ML Investors \$20 million. This loan was secured in part by the ML Investors’ Centerpoint interests, in addition to their interests in other ML projects.

In April 2010, the ML Investors purchased Centerpoint in foreclosure at a trustee's sale for a credit bid of \$8 million. Pursuant to the loan agreement with Universal, Universal then received a deed of trust against Centerpoint as partial security for repayment of the \$20 million loan. In July 2010, petitioner/cross-petitioner Commonwealth issued Universal a \$5 million lender's title insurance policy (the "Universal Policy") that, among other things, insured the priority of Universal's security interest in Centerpoint.

Around this same time, VR CP Funding, LP ("VRCP") loaned \$5 million to CPI and CPII to purchase property adjacent to Centerpoint. Commonwealth also issued VRCP a \$5 million lender's title insurance policy (the "VRCP Policy") that, among other things, insured the priority of VRCP's security interest in Centerpoint, subordinate only to Universal's interest in Centerpoint.

The Lien Litigation

In the meantime, the Lien Litigation continued to progress. The ML Investors, as successor to ML's interests, tendered defense of the mechanic's lien claims to Fidelity. In September 2009, Fidelity accepted the defense with a general reservation of rights. On November 2, 2010, Universal and VRCP made claims under their Commonwealth policies and tendered to Commonwealth defense of their priority against the mechanic's lien claimants; Commonwealth accepted the defense under a reservation of rights on December 29, 2010.

The ML Investors sought to sell Centerpoint but had trouble doing so without first settling the lien claims so that the buyer could receive clear title to Centerpoint. In February 2011, the ML Investors, Universal, VRCP, and the mechanic's lien claimants entered into a settlement agreement that they described as a "*Morris* agreement" based on *United Services Automobile Association v. Morris*, 154 Ariz. 113 (1987). Under the agreement, the ML Investors created a new entity, respondent/cross-petitioner Centerpoint Mechanic Lien Claims, LLC ("CMLC"), which was wholly owned and controlled by CPII. Among other terms, the agreement provided that: (1) CMLC would acquire the mechanic's lien claims for \$13.65 million in cash; (2) the buyer would purchase Centerpoint for \$30 million; (3) after CMLC was substituted for the lien claimants in the Lien Litigation, CMLC and the ML Investors would enter into a stipulated judgment for \$38 million in favor of CMLC and a declaration that the mechanic's liens had priority over the interests of the ML Investors, Universal, and VRCP; (4) the assignment of claims to CMLC would become effective when the superior court in the Lien Litigation approved and entered judgment on the *Morris* agreement; (5) CMLC would not execute the \$38 million stipulated judgment against the ML Investors, Universal, or VRCP and would instead pursue title insurance claims directly against Fidelity and Commonwealth; and (6) any money recovered from Fidelity and Commonwealth would be distributed to the ML Investors.

Upon executing the agreement, the ML Investors sold Centerpoint for \$30 million. The ML Investors waived \$13.5 million of the sale proceeds for CMLC to use in the mechanic's lien purchase and also set aside \$3 million for CMLC to use as a litigation fund for pursuing the title insurance claims against Fidelity and Commonwealth. In addition, according to the February 24, 2011 closing statement, \$4.1 million from the sale proceeds was paid directly to Universal and \$5.8 million was paid to the partners of VRCP for their "interests" in VRCP. Although the \$4.1 million paid to Universal from the sale proceeds was less than the \$5 million secured by Universal's interest in Centerpoint, the full \$20 million Universal loan, in addition to interest and fees, was soon fully repaid from a combination of the Centerpoint proceeds and other proceeds.

CMLC substituted itself for the mechanic's lien claimants in the Lien Litigation, and Fidelity and Commonwealth intervened in the Lien Litigation to challenge the purported *Morris* agreement's validity. After a hearing, the trial court approved the agreement, finding that it was a valid *Morris* agreement. Fidelity appealed the trial court decision on the *Morris* agreement's validity. Although Commonwealth seemingly also intended to appeal, it failed to successfully file its notice of appeal, and the court of appeals dismissed it from the appeal. In connection with Fidelity's appeal, the court of appeals reversed the trial court decision and held that the agreement was not a valid *Morris* agreement. *Fid. Nat'l Title Ins. Co. v. Centerpoint Mech. Lien Claims, LLC*, 238 Ariz. 135 (App. 2015), as amended (Dec. 30, 2016).

The Present Action

In addition to intervening in the Lien Litigation, Fidelity and Commonwealth initiated the present action, in which they alleged that the insureds breached their title insurance policies and in which they sought a declaration of no coverage under the title insurance policies. CMLC counterclaimed for breach of the title insurance policies and bad faith. After the court of appeals invalidated the *Morris* agreement, the trial court held that CMLC forfeited its claims against Fidelity by entering into an unenforceable *Morris* agreement; the court of appeals affirmed this decision. *Centerpoint Mech. Lien Claims LLC v. Fid. Nat'l Title Ins. Co.*, No. 1 CA-CV 21-0127, 2022 WL 289183 (Ariz. App. Feb. 1, 2022), review denied (Feb. 28, 2023). Following this decision, CMLC could no longer pursue its claims against Fidelity. CMLC, however, continued to litigate the present case against Commonwealth on the two \$5 million lender's title insurance policies issued to Universal and VRCP.

Commonwealth moved for summary judgment on the breach of contract claim, and the trial court granted the motion. The court relied on two policy provisions: Condition 8(a)(ii), which provides that Commonwealth's "extent of liability . . . for loss or damage under this policy shall not exceed the least of . . . the Indebtedness," and Condition 10(b), which provides that the "voluntary satisfaction or release of the Insured Mortgage shall terminate all liability" of Commonwealth except as otherwise provided. The superior court recognized that testimony and evidence from the Lien Litigation established that Universal had been fully repaid for its \$20 million loan and that CMLC also paid VRCP's owners \$5.8 million, which was the amount due on the VRCP loan, including principal and interest. These amounts were all paid before the assignment of rights to CMLC became effective. Based on these facts, the court reasoned that, at the time of the assignment of rights to CMLC, there was no debt left to pay on the Universal and VRCP loans and that the policy conditions therefore precluded coverage.

Commonwealth also argued that it was entitled to judgment as a matter of law on CMLC's bad faith claim because neither Universal nor VRCP lost any money on the Centerpoint loans. CMLC countered that, if there had been no mechanic's liens against Centerpoint, the value of Universal and VRCP's interests would have been at least \$20 million, whereas the value of their interests in Centerpoint with the mechanic's liens was zero. The trial court held that, although CMLC could not recover bad faith damages based on unpaid policy benefits or emotional distress and humiliation, CMLC's claimed damages could constitute recoverable pecuniary losses if proven to have resulted from Commonwealth's bad faith.

CMLC moved to exclude evidence related to the payments that Universal and VRCP received

following the Centerpoint sale, contending that the collateral source rule applied and that those amounts could not be used to offset Commonwealth's liability. The trial court denied this motion, reasoning that the collateral source rule did not apply because the source of the payment was part of the benefit for which the parties to the loans bargained. The trial court also denied CMLC's request that the jury be instructed regarding punitive damages because Commonwealth's actions, even if sufficient to establish bad faith, did not demonstrate the evil mind required for punitive damages.

At the trial's conclusion, the jury determined that Commonwealth acted in bad faith and awarded CMLC \$5 million in damages. Commonwealth renewed its motion for judgment as a matter of law on bad faith, and CMLC moved for a new trial on the issue of damages. The trial court denied both motions. Both parties appealed to the court of appeals.

On CMLC's breach of contract claim, the court of appeals reversed the trial court decision granting Commonwealth summary judgment. It directed the trial court to instead enter summary judgment in CMLC's favor for breach of contract on both policies in the amount of \$5 million per policy. The court reasoned that Conditions 8(a)(ii) and 10(b) were not available defenses to Commonwealth because both conditions concerned Commonwealth's "liability" under the policies. The court stated that, under *Morris*, an insurer may contest coverage but may not dispute liability. Based on the *Morris* agreement, "the fact and amount of Commonwealth's liability are resolved and may not be relitigated, since it is bound by the *Morris* Judgment." Therefore, because the conditions, by their terms, operated as defenses to payment liability and not as coverage defenses, the *Morris* judgment made the conditions inapplicable to this case.

On the bad faith claim, the court of appeals affirmed the trial court decision. The court recognized that the parties presented contrasting characterizations of the facts: Centerpoint contended that Universal and VRCP suffered no losses because their loans were fully repaid, and CMLC contended that Universal and VRCP suffered almost \$20 million in damages because the mechanic's liens diminished the value of their deeds of trust. CMLC also contended that the payment to VRCP's owners was not to repay the VRCP loan but was instead to acquire both a partnership interest in VRCP and VRCP's insurance claims against Commonwealth. The court of appeals held that these conflicting characterizations presented a factual dispute that the jury was required to resolve and that the jury acted within its authority when it awarded CMLC \$5 million based on bad faith.

The court of appeals also affirmed the trial court decision admitting evidence of the loan repayments to Universal and VRCP. The court reasoned that the collateral source rule did not apply because the repayments were an integral part of the same transactions underlying the policies.

The court of appeals remanded the case for a new trial on the issue of punitive damages, concluding that a reasonable jury could find that Commonwealth acted with an evil mind.

ISSUES:

Commonwealth's Petition for Review

In this first-party title insurance case, the insured lenders stipulated in a *Morris* agreement that their deeds of trust on the property were inferior to competing mechanic's liens, and to the amount the lien claimants would receive from the sale of the property to satisfy their liens. The insurer does not challenge these stipulations but contends there is no coverage because the insureds were fully repaid.

Can the insurer contest coverage for the insured lenders' title insurance claims based on policy provisions stating that the insurer's liability for loss or damage shall not exceed the indebtedness owed to the insured and stating that there is no coverage for title defects or liens resulting in no loss to the insured?"

Where the loans secured by a deed of trust are fully repaid, can the purported "diminution in value" of the insured deed of trust constitute actual pecuniary damage to the insured lender so as to support a bad faith claim?

CMLC's Cross-Petition for Review

In an action against a title insurer for bad faith under a lender's title insurance policy that insures a single deed of trust, does the collateral source rule bar evidence of, and arguments that the title insurer's resulting tort liability is reduced by, subsequent payments to the insured under: (1) separate deeds of trust that were not insured under the title policy; and/or (2) the insured's settlement with parties to whom the insured assigned its bad faith claims?

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