



**ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY**



**FIDELITY NATIONAL TITLE INSURANCE COMPANY v.
OSBORN III PARTNERS LLC
CV-21-0086-PR**

PARTIES:

Petitioners: Osborn III Partners LLC

Respondent: Fidelity National Title Insurance Co.

FACTS:

In 2006, Mortgages Ltd. loaned Osborn III Partners (“Developer”) \$41.4 million, secured by a deed of trust, to fund construction of a Scottsdale condominium complex (the “Project”). In connection with the deed of trust, Mortgages Ltd. bought a title insurance policy (the “Policy”) from the predecessor to Fidelity National Insurance Company (“Fidelity”). The policy insures, among other things, Mortgages Ltd.’s lien priority over later-recorded mechanics’ liens, subject to the Policy’s exclusions and conditions. Exclusion 3(a) excludes from coverage any “[d]efaults, liens, encumbrances, adverse claims or other matters . . . created, suffered, assumed or agreed to by the insured claimant.”

The Developer hired Summit Builders (“Summit”) as the Project’s general contractor. Problems arose, including delays and the Developer’s inability to make interest payments. In March 2008, Mortgages Ltd. allowed the Developer to temporarily divert \$414,000 from the construction impound account to make its monthly interest payment. Mortgages Ltd. and the Developer agreed that the Developer would reimburse the construction impound account for these funds.

On April 23, 2008, Mortgages Ltd. withheld disbursement of the final \$1.1 million of its loan commitment. On April 24, 2008, Mortgages Ltd. wrote the Developer that the construction budget was under shortfall until reimbursement of the \$414,000. On June 24, 2008, Mortgages Ltd. sent the Developer notice that it had not received the June 17, 2008, loan payment, which was a default under the loan agreement.

Around the time that Mortgages Ltd. withheld the final \$1.1 million, the Developer stopped paying Summit. Summit and its subcontractors recorded mechanics’ liens against the condominium property, seeking payment for completed but unpaid work; these liens totaled approximately \$3 million.

Also during 2008, Mortgages Ltd. was placed in an involuntary bankruptcy proceeding. As part of the reorganization, the bankruptcy court transferred Mortgages Ltd.’s interest in the Project to a newly created company, Osborn III Loan LLC, and several individual fractional interest holders (collectively, the “Successors”). The bankruptcy court also created ML Manager to

manage this and other elements of the overall restructuring of Mortgages Ltd.

In December 2008, Summit and several subcontractors filed a lien foreclosure action in state superior court, asserting that their mechanics' liens had priority over the deed of trust recorded by Mortgages Ltd. and now held by the Successors. ML Manager and Summit settled the lien priority litigation. Under the settlement, Summit would receive \$1.75 million of escrowed sale proceeds, assign all of its mechanics' lien claims to ML Manager, and indemnify ML Manager against any other lien claims.

Fidelity intervened in the lien priority state court litigation. Among other claims, Fidelity contested coverage under the title insurance policy based on Exclusion 3(a). On cross-motions for summary judgment, the Successors argued that they were entitled to payment under the policy because the mechanics' liens took priority over the deed of trust, while Fidelity argued that the Successors were not entitled to payment based on Exclusion 3(a).

The superior court held the Exclusion did not apply. It reasoned that Mortgages Ltd. did not "create" the lien by failing to fully fund the loan because Mortgages Ltd. had the right under the loan agreement, based on the Developer's actions, to stop funding when it did. The superior court entered judgment in favor of the Successors for \$1,750,000 (the amount ML Manager paid to settle the lien claims with Summit), plus attorney's fees and costs.

The court of appeals reversed the trial court decision regarding Exclusion 3(a). It held that, as a matter of law, Mortgages Ltd. created or "suffered" the mechanics' lien by allowing funds to be diverted from the construction impound account for the interest payment and by cutting off funding entirely, even though the loan agreement allows it to do so. The court reasoned that Exclusion 3(a) applies whenever the insured intended the act causing the defect, regardless of whether the insured intended the defect.

ISSUE: Exclusion 3(a) of the standard title insurance policy excludes coverage for mechanics' liens "created" or "suffered" by the insured. Does an insured construction lender "create[]" or "suffer[]" a lien under that exclusion whenever it exercises its right under its loan agreement to stop paying any part of its loan to a defaulting borrower (the project developer), and at some point the borrower/developer also breaches its obligation to pay for work performed under its separate agreement with its contractor?

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