

IN THE SUPREME COURT  
STATE OF ARIZONA

CENTERPOINT MECHANIC LIEN  
CLAIMS, LLC,

Plaintiff / Appellant / Appellee,

v.

COMMONWEALTH LAND TITLE  
INSURANCE COMPANY,

Defendant / Appellee / Appellant.

No. CV-23-0164-PR

Arizona Court of Appeals  
No. 1 CA-CV 21-0039

Maricopa County Superior Court  
No. CV2011-008600

**RESPONSE TO PETITION FOR REVIEW**

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10/6/2023

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## INTRODUCTION

Petitioner (“Commonwealth”) does not seek review of the jury’s finding that it acted in bad faith against its insureds (Universal and VRCP). Nor does it deny that it displayed the evil mind required for a punitive damages instruction. Instead, it raises arguments resting entirely on a factual premise—namely (at 3, 4), that the “undisputed” evidence shows that the insured lenders “suffered no loss because their loans were fully repaid.” But that factual premise is false. As the Court of Appeals explicitly recognized (§ 71): “trial evidence and the parties’ briefs make clear that there was genuine disagreement as to whether Universal’s and VRCP’s loans were repaid.” That factual dispute has no business in this Court.

While Commonwealth’s flawed factual premise alone warrants denial of its Petition, its legal arguments fare no better. First, Commonwealth contends that the Court of Appeals’ coverage ruling in favor of Centerpoint Mechanic Lien Claims, LLC (“CMLC”) somehow “muddled” an insurer’s right to contest coverage under *United Services Automobile Ass’n v. Morris*, 154 Ariz. 113 (1987) and its progeny. To the contrary, the Court of Appeals correctly recognized that Commonwealth did not raise any coverage defense in this case, but instead relied on two policy provisions limiting Commonwealth’s *liability* for claims that *are covered*. The court faithfully applied *Morris* in rejecting those arguments.

Commonwealth’s other coverage arguments—such as under Exclusion 3(c) of the title policies—were, in addition to being without merit, not raised in the trial court and are waived. And in any event, the Court of Appeals’ ruling that CMLC is entitled to summary judgment on coverage is also correct for several additional reasons discussed below. Thus, even if the court’s ruling based on *Morris* was open to debate, which it is not, its direction for entry of summary judgment in favor of CMLC on coverage is independently supported by the record.

As to its second argument, Commonwealth’s professed alarm that the Court of Appeals’ decision authorizes bad faith tort damages where the plaintiff suffers no loss is a *chimera*. The court did not find that either loan was repaid or that the insureds suffered no loss. Rather, as noted above, it explicitly found that there was conflicting evidence at trial regarding whether Universal and/or VRCP’s loans were repaid, and that in accordance with Arizona precedent it would therefore not disturb the jury’s verdict on tort damages.<sup>1</sup>

Commonwealth’s Petition should be denied.

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<sup>1</sup> Opinion of the Court, *Centerpoint Mechanic Lien Claims, LLC v. Commonwealth Land Title Insurance Co.*, No. 1 CA-CV 21-0039 (Ariz. App. May 23, 2023) (“Slip op.”) ¶¶ 71, 74, 75.

## BACKGROUND

Commonwealth insured Universal's deed of trust against Centerpoint as a first-priority lien, and VRCP's deed of trust as a second-priority lien.<sup>2</sup> Under the title policies, Commonwealth indemnified Universal and VRCP for loss or damage to the value of their deeds of trust resulting from defects including mechanic's liens.<sup>3</sup>

Before Commonwealth issued these title policies Centerpoint was under contract to be sold for \$30 million.<sup>4</sup> It is undisputed that, if Universal and VRCP's deeds of trust had been in first and second positions *as insured*, they would have received approximately \$19.5 million from that sale.<sup>5</sup> But their insured deeds of trust were subordinate to approximately \$38 million in mechanic's liens, which meant that they were worthless.<sup>6</sup>

After Universal and VRCP discovered the mechanic's liens, Commonwealth refused—"without a legitimate basis for doing so"—to acknowledge that the liens

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<sup>2</sup> *Id.* ¶ 12.

<sup>3</sup> Separate Appendix to CMLC's Opening Brief ("APP") at APP007. Commonwealth's Claims Handbook confirms that a lender's title policy "does not insure that the loan will be repaid," but instead "insures the validity and priority of the mortgage itself." Supplemental Appendix to CMLC's Reply Brief ("SS-APP") at 576.

<sup>4</sup> Slip Op. ¶ 16.

<sup>5</sup> *Id.*

<sup>6</sup> Commonwealth knew about the mechanic's liens before issuing the title policies and knowingly insured over them. *Id.* ¶¶ 12-14, 16, 63.

were covered.<sup>7</sup> It refused in bad faith to settle the mechanic's liens and forced the insureds to settle on their own. Under their settlements, Universal sold its claims against Commonwealth to CMLC, and VRCP's partners sold their partnership interests in VRCP as a means of transferring VRCP's claims against Commonwealth to CMLC.<sup>8</sup> Commonwealth did all of that "in order to manufacture defenses . . . and/or a more favorable settlement position."<sup>9</sup>

Commonwealth intervened in the pending mechanic's lien lawsuit (the "Reasonableness Action") and objected to approval of these settlements. Commonwealth argued that the insureds breached their duty to cooperate under the title policies by settling because *Morris* purportedly did not apply to title insurance.<sup>10</sup> Alternatively, Commonwealth argued that: (1) Universal and VRCP had not suffered any loss because their loans were purportedly repaid, including by the settlement payments discussed in the preceding paragraph; and/or (2) Commonwealth's liability was purportedly excused because Centerpoint was sold in connection with the settlements.<sup>11</sup>

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<sup>7</sup> *Id.* ¶ 63.

<sup>8</sup> *Id.* ¶¶ 73, 74.

<sup>9</sup> *Id.*

<sup>10</sup> Am. Electronic Index of Record ("IR") 296, Ex. 1 at 11.

<sup>11</sup> IR 288 at 9:20-10:2; IR 289, Ex. 1; IR 293 n.4; IR 294 ¶ 1.

Following trial, the court in the Reasonableness Action held that *Morris* applies to title insurance.<sup>12</sup> That court also rejected Commonwealth’s remaining arguments, including that the subject payments to VRCP’s partners were disguised loan repayments, and expressly found to the contrary that a condition of the settlements was that Universal and VRCP’s loans would not be repaid from the sale proceeds.<sup>13</sup>

The court in the Reasonableness Action then entered a final judgment (“*Morris* Judgment”) holding that Commonwealth “***is bound by both the fact and the amount of the Settlement, in the following amounts . . . : (b). On . . . (Universal ‘Exit Lender Policy’, Hearing Exhibit 33): \$5,000,000.00[;] (c). On . . . (‘VRCP Policy’, Hearing Exhibit 32): \$5,000,000.00.***”<sup>14</sup> These damage awards were not based on stipulated facts as Commonwealth insinuates (at 3, 12). Instead, as found in the court’s seventeen-page ruling minute entry they were “reasonable, prudent, and fully supported by the evidence produced at the hearing.”<sup>15</sup> Commonwealth did not appeal from—and is now bound by—the *Morris* Judgment.

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<sup>12</sup> IR 760, Ex. F at 12-13.

<sup>13</sup> *Id.*, Ex. F ¶ 41. Despite that finding, the trial court in this case and the Court of Appeals allowed Commonwealth’s argument that the settlement payments to Universal and VRCP’s partners were payments on their loans.

<sup>14</sup> IR 289, Ex. 2 ¶ 5 (emphasis added).

<sup>15</sup> IR 760, Ex. F at 17.

Commonwealth commenced this case with a complaint seeking a declaration that the insureds' claims arising from the mechanic's liens are not covered under the title policies, and CMLC counterclaimed on the issues of coverage and bad faith.<sup>16</sup> The Court of Appeals' opinion (¶¶ 30-37) describes the post-complaint procedural history, including the parties' various cross-motions.

Most relevant here, the trial court granted Commonwealth's motions for summary judgment on the issue of coverage, even though Commonwealth did not contend that the insureds' claims were excluded under any policy exclusion(s).<sup>17</sup> Instead, its motions were based on the same arguments relating to Commonwealth's *liability* for covered claims under Conditions 8(a) and/or 10(b) of the policies that were raised and rejected in the Reasonableness Action.<sup>18</sup>

The trial court, however, denied Commonwealth's motion for summary judgment on CMLC's bad faith claims.<sup>19</sup> The jury found that Commonwealth acted in bad faith and awarded CMLC \$5 million in tort damages.<sup>20</sup>

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<sup>16</sup> IR 1, IR 95.

<sup>17</sup> IR 377.

<sup>18</sup> IR 255, IR 277. Relevant provisions of Conditions 8(a) and 10(b) appear in the Court of Appeals' decision. Slip op. ¶¶ 42, 43.

<sup>19</sup> IR 542.

<sup>20</sup> Slip op. ¶ 36.

## ARGUMENT

### I. CMLC IS ENTITLED TO JUDGMENT ON COVERAGE.

Commonwealth's argument (at 9) that the Court of Appeals supposedly contravened its right to contest coverage because the insureds' loans "were fully repaid" fails because that was a disputed issue of fact. Beyond that, Commonwealth's argument is foreclosed by *Morris* and the additional reasons set out below.

#### A. The *Morris* Ruling is Correct.

Nothing about the Court of Appeals' analysis of coverage issues was "muddled" as Commonwealth contends (at 1); it was instead faithful to *Morris* and its progeny. *Morris* itself held that "the indemnitor [Commonwealth] may contest *its liability*" during the hearing on reasonableness of a settlement and that "[f]ailing in that, the indemnitor *will be liable* to the indemnitee to the extent that the indemnitee establishes that the settlement was reasonable and prudent . . ." *Morris*, 154 Ariz. at 120 (emphasis added). The only exception to that outcome permitted under *Morris* was if the insurer could show that coverage was excluded under a specific policy *exclusion*. See *Associated Aviation Underwriters v. Wood*, 209 Ariz. 137, 149 ¶ 34 (App. 2004).

Mechanic’s liens are included here among the title defects covered under the title policies’ insuring clauses,<sup>21</sup> so Commonwealth was limited under *Morris* in this case to litigating whether any specific policy *exclusion* applied, which it did not do. Other precedent reaffirms the point. *See, e.g., Quihuis v. State Farm Mut. Auto. Ins. Co.*, 235 Ariz. 536, 541 ¶ 14 (2014) (only permissible coverage issue was applicability of a policy exclusion); *Ariz. Prop. & Cas. Ins. Guar. Fund v. Martin*, 210 Ariz. 478, 481 ¶ 15 (App. 2005) (coverage issues limited to those “based on specific policy exclusions”); *Wood*, 209 Ariz. at 150 ¶ 37 (*Morris* prohibits insurers from litigating “damage issues in the guise of a coverage defense”).

Lacking any contrary authority, Commonwealth attempts to manufacture defenses with arguments that were not made before, and which as discussed below are unavailing in any event.

**B. Commonwealth’s New Arguments.**

**1. Exclusion 3(c).**

Commonwealth relies here on Exclusion 3(c), which excludes coverage when a mechanic’s lien or other insured title defect causes “no loss or damage.”<sup>22</sup> But Commonwealth did not raise Exclusion 3(c) as a purported defense in the trial court,

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<sup>21</sup> *Id.* ¶ 49.

<sup>22</sup> APP010.

and so it has waived the argument here. *See, e.g., State ex rel. Brnovich v. Miller*, 245 Ariz. 323, 324 ¶ 5 (App. 2018).<sup>23</sup>

In any event, Exclusion 3(c) does not apply here. First, Commonwealth ignores the meaning of the term “loss” under its title policies. As the Court of Appeals has explained, “loss” is ambiguous because it is not defined in the title policies, and so it is construed against the insurer. *Swanson v. Safeco Title Ins. Co.*, 186 Ariz. 637, 640-41 (App. 1995). *Swanson* also establishes that: “The measure of an insured’s loss due to a title encumbrance” in Arizona “is the difference between the fair market value of the property if no impairment existed and the fair market value of the property with the impairment.” *Id.* at 641. Commonwealth concurs in its Claims Handbook that a “loss” occurs under the lender’s title policies here when, as the result of an insured title defect such as a mechanic’s lien, “there is insufficient value in the insured land to support the mortgage.”<sup>24</sup>

This same diminution-in-value measure of loss under lender’s title policies is recognized throughout the country. Indeed, one of the authorities cited by Commonwealth on appeal surveyed such cases and found:

[M]ost of the cases in which the question has arisen have deemed a mortgagee’s loss [under a lender’s title policy]

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<sup>23</sup> Commonwealth mentioned Exclusion 3(c) in its Answering Brief on appeal (at 12 n.11) merely as “[s]ee also,” but never argued how it applied or could apply in this case. Regardless, it was already waived at that point.

<sup>24</sup> SS-APP578.

to be the difference between the value of the mortgage subject to the defect and what its value would have been had the defect not existed, in other words, *the extent to which his security has been impaired*.

*Blackhawk Prod. Credit Ass'n v. Chi. Title Ins. Co.*, 423 N.W.2d 521, 525 (Wis. 1988) (emphasis added) (citation omitted).<sup>25</sup>

Second, Commonwealth tries to hide from the correct date for calculating an insured's diminution-in-value losses under its title policies. As previously held by this Court, lender's title policies are ambiguous because they do not specify any date for calculating such losses, and so are construed against the insurer on that point. *First Am. Title Ins. Co. v. Johnson Bank*, 239 Ariz. 348, 353 (2016). So construed, this Court held "the lender's diminution-in-value loss should be calculated as of the date the title policy was issued rather than as of the date of foreclosure." *Id.* at 349 ¶ 1.<sup>26</sup>

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<sup>25</sup> *Blackhawk* further held that a title insurer's liability for such loss is *not* reduced by loan repayments from liens on properties *not insured* under the title policy, as Universal had here. 423 N.W.2d at 526.

<sup>26</sup> See also *Equity Income Partners, LP v. Chi. Title Ins. Co.*, 241 Ariz. 334, 336 ¶ 8 (2017) (loss calculated as of the date the lender's title policy was issued). Contrary to its current position, Commonwealth's Claims Handbook instructs that the amount of its insured's diminution-in-value loss under a lender's title policy should be determined as of the date the defect is discovered. SS-APP576-577.

Exclusion 3(c) only applies in situations where an insured title defect does not cause any diminution-in-value of the insured deed of trust, and Commonwealth knows that too. As explained in its Claims Handbook:

There may be no actual loss or damage under a loan policy (even if a prior lien exists), because there may be enough value in the land so that both the prior lien and the insured mortgage can be satisfied from the sale thereof. . . .

So if the insured lender holds a \$75,000 mortgage on land having a value of \$100,000, and a prior lien in the amount of \$10,000 is discovered, the lender has not suffered a loss.<sup>27</sup>

But here, the value of Centerpoint (\$30 million) was insufficient to satisfy just the senior mechanic's liens (\$38 million) and so was insufficient to satisfy *any* of the insured deeds of trust (\$19.5 million). Universal and VRCP thus suffered actual diminution-in-value losses of \$19.5 million. This is true whether such losses are calculated on the date the title policies were issued, the date the mechanic's liens were discovered, or the date Centerpoint was sold. Exclusion 3(c) thus could not provide a coverage defense even if it was not already waived.<sup>28</sup>

**2. Commonwealth Was Not Precluded from Litigating any Coverage Defense.**

Commonwealth seemingly argues (at 2-4) that it should have only been precluded in this case from attempting to challenge facts that were stipulated to in

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<sup>27</sup> SS-APP578.

<sup>28</sup> The cases cited by Commonwealth (at 14-15) are not to the contrary.

the Reasonableness Action. Commonwealth did not raise this argument before, and so has waived it now. In any event, the argument fails under *Morris*. As explained above, under *Morris* the effect of a final judgment approving the reasonableness of an insured's settlement is to limit subsequent coverage litigation to whether the insured's claim is of a type that is **covered** under the policy, i.e., whether a specific policy exclusion applies, thereby prohibiting the insurer from litigating liability or damage issues as Commonwealth attempted to do here.

Beyond that, Commonwealth ignores that the *Morris* Judgment was not based on stipulated facts. To the contrary, it embodied the trial court's detailed findings of fact based on evidence introduced at trial, and related legal conclusions.<sup>29</sup> Commonwealth was never precluded from litigating any legitimate coverage defense in this case; it just had no such coverage defense to litigate.

### **3. *Morris* Applies to Title Insurance.**

Commonwealth argues (at 1-2) that *Morris* and its progeny don't apply or apply differently to first-party title insurance as opposed to third-party insurance. That argument too was not raised before in this case and so is waived. But again, the argument is wrong on the merits. First, the insurance policy in *Morris* was itself "first-party" insurance because it was a homeowner's policy. *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 164 Ariz. 256, 258 (1990).

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<sup>29</sup> IR 760, Ex. F.

Moreover, other Arizona precedent specifically holds that *Morris* applies to title insurance and rejects Commonwealth's purported distinctions between first-party and third-party insurance policies in this context. *See, e.g., Fid. Nat'l Title Ins. Co. v. Osborn III Partners LLC*, 250 Ariz. 615, 621-22 ¶¶ 24-26, 30 (App. 2021), *vacated in part* 254 Ariz. 440 (2023). Beyond that, Commonwealth is also bound by the final ruling in the Reasonableness Action rejecting such purported distinctions and holding that *Morris* applies to title insurance.<sup>30</sup>

Commonwealth is also wrong when it claims (at 4, 5) that the Court of Appeals' decision creates future confusion for title insurers. The decision *eliminates* potential confusion by reaffirming that once a court has approved of the reasonableness of an insured's settlement under *Morris*, title insurers (like all other insurers) may thereafter only litigate legitimate defenses to *coverage* and are prohibited from attempting to re-litigate liability issues "in the guise of a coverage defense." *Wood*, 209 Ariz. at 150 ¶ 37. That is exactly what Commonwealth is trying to do here.

## **II. CMLC IS ENTITLED TO SUMMARY JUDGMENT ON COVERAGE FOR OTHER REASONS.**

Even if *Morris* and its progeny did not exist, the trial court erred by granting summary judgment on coverage to Commonwealth rather than CMLC for several

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<sup>30</sup> *Id.* at 12-13.

reasons raised but not decided on appeal. Under Arizona Rule of Civil Appellate Procedure 23(f)(2), this Court may need to address these issues if it grants review.

**A. The Trial Court Used the Wrong Measure and Timing for Calculating Losses.**

Universal and VRCP suffered covered losses of \$19.5 million under the title policies because that was the amount of the diminution-in-value of their insured deeds of trust resulting from the mechanic's liens as of the date the title policies were issued. The trial court erred by refusing to follow controlling Arizona precedent on that issue.<sup>31</sup>

**B. The Trial Court Disregarded Other Terms of the Title Policies.**

The trial court erred by disregarding that Condition 8(b)(ii) of the title policies grants these insureds the right to have their diminution-in-value losses calculated as of the date they made claims under the policy.<sup>32</sup> Such losses were \$19.5 million at that point.<sup>33</sup>

**C. The Trial Court Disregarded Precedent on Condition 10(b).**

The trial court erred by finding that the sale of Centerpoint excused Commonwealth's liability under Condition 10(b), because according to Arizona

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<sup>31</sup> See § I(B)(1), *supra*. Commonwealth's liability for coverage (but not bad faith) is capped at \$5 million under Condition 8(a) of each policy, which also served to limit damages under the *Morris* Judgment to that amount.

<sup>32</sup> APP011.

<sup>33</sup> See § I(B)(1), *supra*.

precedent the insureds' diminution-in-value losses resulting from the mechanic's liens arose *before* Centerpoint was sold. *Osborn III*, 250 Ariz. at 624 ¶ 40.

**D. Payments for the Purchase of Claims Against an Insurer do not Reduce the Insurer's Liability.**

The trial court erred by disregarding Arizona precedent holding that payments for an insured's claims against an insurer do not reduce the insurer's liability. *See Aetna Cas. & Sur. Co. v. Valley Nat'l Bank of Ariz.*, 15 Ariz. App. 13, 16 (1971).

**E. The Collateral Source Rule Applies to CMLC's Coverage Claims.**

The trial court erred by not applying the collateral source rule in connection with CMLC's coverage claims. *See John Munic Enters., Inc. v. Laos*, 235 Ariz. 12 (App. 2014). We address this issue further in our Cross-Petition for Review regarding CMLC's tort claims.

**F. Commonwealth Was Collaterally Estopped.**

Commonwealth's arguments that its liability was excused by payments to Universal and VRCP's partners, and/or the sale of Centerpoint were raised by and decided adversely to Commonwealth in the Reasonableness Action.<sup>34</sup> The trial court erred by disregarding the preclusive effect of the *Morris* Judgment.

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<sup>34</sup> *See supra* notes 13-15 and accompanying text.

### **III. ON THE BAD FAITH CLAIM, THE COURT OF APPEALS DID NOT FIND THAT THERE WAS NO LOSS.**

Commonwealth's contention that the Court of Appeals' decision authorizes bad faith damages where the plaintiff suffers no loss is premised entirely on the erroneous assertion (at 3 n.1) that the court (§ 58) found VRCP's loan was "fully repaid." But paragraph 58 strictly concerns whether the collateral source rule barred evidence of certain payments and such arguments by Commonwealth at trial.

One thing is certain, however: the Court of Appeals did not decide that any payments to Universal and VRCP's partners in connection with their settlements were loan payments, or that the insureds suffered no loss. To the contrary, in paragraph 75, the court held that it was for the jury to decide what those payments were for. In all events, as the court explained (§ 71), "trial evidence and the parties' briefs make clear that there was genuine disagreement as to whether Universal's and VRCP's loans were repaid." How this question should be resolved, said the court (§ 75), "presented a conflicting issue that the fact finder was required to resolve."

#### **ATTORNEYS' FEE NOTICE**

This is an action arising out of contract, and so CMLC requests an award of attorneys' fees pursuant to A.R.S. § 12-341.01(A).

#### **CONCLUSION**

Commonwealth's Petition should be denied.

10/6/2023

Respectfully submitted,

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