IN THE SUPREME COURT
STATE OF ARIZONA

CENTERPOINT MECHANIC LIEN CLAIMS, LLC, Plaintiff/Appellant/Appellee, vs. 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

COMMONWEALTH LAND TITLE INSURANCE COMPANY'S RESPONSE TO CROSS-PETITION FOR REVIEW

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INTRODUCTION

CMLC's Cross-Petition for Review raises no viable issue of statewide concern regarding the collateral source rule. The court of appeals and the trial court both correctly found that the collateral source rule ("CSR") was inapplicable because the loan repayments came from the exact sources contemplated by the parties to the loan agreements and by the title insurance policies themselves (the proceeds from sale of the properties pledged to secure the loans). Therefore, the loan repayments were not "collateral" but were "an intrinsic and integral part of the same transaction underlying Commonwealth's policies." Slip op., ¶ 56. *See also* R. 676.[1]

Specifically, the VRCP loan was secured by the Centerpoint property, and VRCP's loan was repaid from the proceeds of the Centerpoint sale.

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[1] "…[T]here is no reason to purchase title insurance unless sale of the property is envisioned. The sale of the property is thus not collateral to the purchase of the policy. It is part of the bargain.

The collateral source rule is inapplicable when the source of other payment is part of the benefit bargained for by the parties. The original bargain in the present case included insurance on the priority of VRCP's loan, which was secured solely by a deed of trust on Centerpoint, and insurance on the priority of Universal's loan, which was secured by a 'bucket of security.' The existence of that collateral was part of the benefit bargained for by the parties." (emphasis added.)

Universal made a single loan with multiple borrowers (the ML Loan LLCs) that was secured by a "bucket of security"—the Centerpoint property and numerous other Mortgages Ltd. properties[2]—and the Universal loan was fully repaid, plus millions of dollars in profit (nearly $18 million), solely from the sale of those properties, exactly as contemplated by the loan agreement.

As a result, the "loan repayments were not the result of the intrusion of a stranger into Commonwealth's and CMLC's relationship. Rather, the payments in question were made by the ML Investors, which are not individuals 'wholly independent' from Commonwealth's relationship with CMLC's assignors—Universal and VRCP." Slip op., ¶ 56. Therefore, as the court of appeals held, "the payments in question were not collateral and the rule does not apply." *Id.*

Because tort liability exists only to the extent a plaintiff, like CMLC, can prove actual damages, the court of appeals' holding does not, as CMLC argues, allow for a reduction in tort liability. *Lewin v. Miller Wagner & Co., Ltd.*, 151 Ariz. 29, 34 (App. 1986) ("[p]roof of the fact of damages must be of

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[2] Slip op., ¶¶ 8-9.

a higher order than proof of the amount of damages") (citation omitted); *see also* Revised Arizona Jury Instructions ("RAJI") (Civil) 6th, Bad Faith 4 & 5 (plaintiff must prove existence and amount of damages); *Nunn v. Mid-Century Ins. Co.*, 215 P.3d 1196, 1199-1200 (Colo. App. 2008) ("***Actual damages are an essential element of a claim for bad faith*** breach of an insurance contract…" (emphasis added)), *rev'd on other grounds*, 244 P.3d 116 (Colo. 2010). Here, it is undisputed "Universal and VRCP received full repayment of their loans,"[3] and therefore did not sustain any damage, whether in tort or contract. Attempting to manufacture a theory of damages, CMLC relies on the CSR for the fallacy that the Universal and VRCP deeds of trust ("DOT") had "value" independent of the loans they secured, and that the value of those deeds of trust were somehow "impaired" by Commonwealth. A DOT, however, does not, by itself, have any intrinsic value, but is simply a mechanism to secure repayment of a loan. Where, as here, a loan secured by a DOT is fully repaid, the "value" of DOT cannot be impaired or damaged.[4] Indeed, the court of appeals described CMLC's

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[3] Slip op., ¶ 58.

[4] *See* Commonwealth's Petition for Review, filed August 7, 2023.

fiction of impaired value to the DOTs as an "inverted application" of the CSR,[5] which CMLC employs to get around the fact that Universal and VRCP were made whole by the very security contemplated in the loan agreements.

Commonwealth's title insurance policies insured the priority of Universal and VRCP's DOTs, and obligated Commonwealth to indemnify Universal and VRCP only if they sustained "actual monetary loss or damage" as a result of their loans not having priority over other, competing liens. [Trial Exs. 10, 22.] The case law uniformly holds that a loss under a lender's title insurance policy exists only if Universal and VRCP's loans were not repaid or if the other, unaffected properties serving as security proved to be of insufficient value, neither of which happened here. *See Green v. Evesham Corp.*, 430 A.2d 944, 946 (N.J. App. 1981) (In a situation involving multiple properties securing a loan, "To say that the loss here consisted of the diminution in the security misses the point that the diminished security is now supplied by the title policy, ***but only*** to the extent that there ***has been a debt loss*** which remained unsatisfied from the proceeds of the mortgaged

[5] Slip op., ¶ 57.

property. ***By requiring the insurer to pay now for the cost of removing the lien merely creates the conditions for a windfall should the debt be repaid or should the remaining lands provide sufficient security for payment***." (emphasis added)).[6]

Similarly, the recognized categories of recoverable damages for bad faith are (1) the unpaid benefits of the policy; (2) monetary loss or damage to credit reputation experienced and reasonably probable to be experienced in the future; and (3) emotional distress, humiliation, inconvenience, and

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[6] *See also Twin Cities Metro-Certified Dev. Co. v. Stewart Title Guar. Co.*, 868 N.W.2d 713, 718 (Minn. App. 2015) (rejecting argument that "devalued" security constituted "actual damage," and holding that diminished value of security of property caused by the presence of liens could constitute damage but "only to the extent to which the insured debt is not repaid") (internal quotation marks and citation omitted); *Cale v. Transamerica Title Ins.*, 225 Cal. App. 3d 422, 427 (1990) ("Title insurance indemnifies a lender only against loss with respect to the secured indebtedness, not a diminution of profits potentially obtainable from resale of the property." (emphasis added)); *Falmouth Nat'l. Bank v. Ticor Title Ins. Co.*, 920 F.2d 1058, 1062-63 (1st Cir. 1990) ("…The loss must be actual; the mere existence of a defect covered by the policy in and of itself is not sufficient to justify recovery…[A] mortgagee-insured's loss cannot be determined unless the note is not repaid and the security for the mortgage proves inadequate."); *Karl v. Commonwealth Land Title Ins. Co.*, 24 Cal.Rptr.2d 912, 917 (Cal. App. 1993) ("…a secured lender's interest in the security is limited to repayment of its loan; if the loan is fully satisfied a lender ordinarily suffers no damage.") (internal citations omitted).

anxiety experienced, and reasonably probable to be experienced in the future. *See* RAJI (Civil) 6th, Bad Faith 7 (citing *Rawlings v. Apodaca*, 151 Ariz. 149, 153 (1986), and *Farr v. Transamerica Occidental Life Ins. Co. of Cal.*, 145 Ariz. 1, 7 (App. 1984)).

Damages for "emotional distress" were unavailable to CMLC because business entities cannot suffer emotional distress, and damage to "credit reputation" was similarly unavailable because Universal and VRCP were both single-purpose entities created solely to make loans to the ML Parties. [R. 676.] CMLC's damage claim, therefore, was limited to monetary losses, if any, actually suffered by Universal and/or VRCP as a direct and proximate result of Commonwealth's alleged bad faith. [*Id.*]

Proof of such a "monetary loss" was, under the facts of this case, necessarily tied to Universal and VRCP's loans. CMLC asks the Court to "pretend" the loans were not repaid, but as the court of appeals recognized, the loans, and their repayment, were inextricably intertwined with CMLC's theory of "loss" and Commonwealth's obligations under the title insurance policies. Accordingly, "[n]one of the payors here can be said to be wholly independent from Commonwealth's relationship with Universal and

VRCP", and evidence of the loan repayments "was properly submitted for consideration by the jury…" Slip op., ¶ 58.

Just as the court of appeals did here, courts have consistently rejected the suggestion that loan repayments are "collateral sources." CMLC does not cite, and has never cited, any authority to the contrary, and provides no cogent reason for this Court to accept review and make Arizona an outlier of American jurisprudence.

FACTUAL BACKGROUND

A. Universal Exit Financing.

In June 2009, after the Bankruptcy Court approved Mortgages Ltd.'s ("ML") plan of reorganization, ML Manager obtained exit financing from Universal, a hard-money lender, of up to $20 million to implement the plan. The Universal loan was secured by multiple ML properties, including the Centerpoint project. Slip op., ¶¶ 8-9.

Dan Reeb, a principal of Universal, estimated the total, collective value of the properties securing the Universal loan to be approximately $100 million. [Trial Tr. Day 4, pp. 31-34.] From this collateral, Reeb estimated Universal would receive approximately $5 million from a sale of Centerpoint, and Universal therefore purchased a title policy from

Commonwealth, specifically covering the Centerpoint property, in the amount of $5 million. [R. 653, Ex. 1, pp. 99-100.] The policy was purchased in July 2010, and when the Centerpoint project was sold in February 2011, Universal received $4.2 million from the sale. [Trial Tr. Day 4, pp. 10-11; Trial Ex. 133, p. 2.][7]

CMLC argues the value of the Centerpoint DOT was impaired before the Universal loan was repaid, but CMLC omits critical undisputed facts. In particular, Universal's assignment of its policy rights to CMLC did not become effective until June 2012. [R. 338-41, Ex. 7 ("…the Parties hereby agree and acknowledge that the 'Effective Date' as defined in paragraph B of the Settlement Agreement is hereby deemed for all purposes thereunder to have occurred as of June 20, 2012.").] Universal's loan, however, had been fully repaid by the end of 2011, some six (6) months earlier. [Trial Tr. Day 4, pp. 9-13, 19-20.] Indeed, the trial evidence showed that not only was the loan

[7] CMLC argues this $4.2 million was not a loan payment, but was a "purchase" of Universal's claims against Commonwealth. Universal's own records, however, show that the payment was treated as a loan payment and reduced the amount owing on the loan. [Trial Tr. Day 4, pp. 10-11.]

principal ($16.65 million) fully repaid, but Universal made an extraordinary profit of $17.9 million in less than three (3) years.[8]

B. VRCP Loan.

In June 2010, VRCP, another entity owned and/or controlled by Dan Reeb, separately loaned $5 million to CPI and CPII (the bankruptcy successors to ML's interest in the Centerpoint project). The VRCP loan was secured only by the Centerpoint project, and VRCP purchased a $5 million title insurance policy from Commonwealth. Slip op., ¶ 12.

When the Centerpoint property sold, VRCP received $5.9 million from the sale, which fully satisfied the amount due under the VRCP loan. [Trial Tr. Day 4, pp. 11-13; R. 377, pp. 5-6.] CMLC attempts to characterize this payment not as a loan repayment, but as a "purchase" of the VRCP partnership, but given that the "purchase price" matched, to the penny, the amount of principal and interest owed on the loan, the trial court properly eschewed this subterfuge: "Allowing a lender to manipulate and extend

[8] $6.7 million in interest, $3.7 million in origination and repayment incentive fees, and $7.5 million in a "loan disposition fee." [Trial Tr. Day 4, pp. 20-31; Trial Ex. 130.]

mortgage insurance coverage by agreeing to term the repayment of its loan in the manner described above would have dangerous and far reaching consequences," including "allow[ing] coverage to be controlled by the artful pretense of insureds in situations where none was anticipated by either party." [*Id*.]

Ultimately, as the court of appeals noted, "Universal and VRCP received full repayment of their loans, including through the eventual sale of the Centerpoint Property…" Slip op., ¶ 58 (emphasis added).

ISSUE PRESENTED FOR REVIEW

No one disputes that Universal and VRCP's loans were fully repaid, and that both lenders made millions of dollars of profit, from the sale of properties specifically pledged as security for the loans. Because the loan repayments were "an intrinsic and integral part of the same transaction underlying Commonwealth's policies" and were not wholly independent from Commonwealth's relationship with Universal and VRCP, Slip op., ¶ 56, the court of appeals correctly held that (i) the collateral source rule was inapplicable to the repayment of the loans, and (ii) the trial court properly admitted evidence of the repayments on the issue of CMLC's alleged damages.

REASONS REVIEW SHOULD BE DENIED

1. What CMLC characterizes as "indefensible" is, in reality, simply the court of appeals' application of existing Arizona law. Specifically, quoting from *Hall v. Olague*, 119 Ariz. 73 (App. 1978), the court of appeals noted that the CSR only applies to "total or partial compensation for an injury which the injured party receives from a collateral source *wholly independent* of the wrongdoer…" Slip op., ¶ 55 (emphasis supplied by court of appeals). Here, the court concluded that the borrowers (*i.e.*, the ML entities holding the properties securing the loan) were not "wholly independent", but instead were "an intrinsic and integral part of the same transaction underlying Commonwealth's policies." *Id.* at ¶ 56. In other words, the "sources of repayment" were in no sense "collateral".

2. The court of appeals decision aligns Arizona with other courts holding that repayment of loans does not constitute a "collateral source" with respect to calculation of damages for claims arising from those loans. "Absent some element of compensation to the injured party, the contracts here are no different than bank loans which must be repaid – and which can hardly be considered collateral sources." *Hutchins v. Michael Young Colo. Mustang Specialists, Inc.*, No. 2018 CV 30022, 2018 Colo. Dist. LEXIS 3723, at

*11 (Colo. Dist. Ct. Nov. 7, 2018); *see also Crowley v. Tr. Co. Bank, N.A.*, 466 S.E.2d 24, 26 (Ga. App. 1995) ("I agree that the collateral source rule does not apply to payments received by a creditor from a party who was contractually answerable to it in the same transaction which is the claimed basis for the creditor's damages.") (Blackburn, J., concurring).[9] It is therefore not surprising that CMLC does not cite a single decision applying the collateral source rule to a claim under a lender's policy of title insurance.

Indeed, the U.S. District Court for the District of South Carolina squarely held that the collateral source rule could not be invoked in the context of a lenders' policy of title insurance for the precise reason that the insurance is not independent from the underlying transaction. *See Flagstar*

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[9] "[T]he circumstances in the cases sub judice reveal that Steve Luce's guaranty is not such an outside collateral source, i.e., it is not wholly independent of the loan transaction which forms the basis of the bank's damage claim against Crowley." *Crowley*, 466 S.E.2d at 26; "[T]he issue is whether the assumption of a portion of the farmer-debtor's loan is the type of payment or benefit that is envisioned under the collateral source rule. We conclude that it is not." *Farmers State Bank v. United Cent. Bank*, 463 N.W.2d 69, 71-72 (Iowa 1990); "We again hold that loan participations are not analogous to insurance or other loss shifting agreements which fall within the Colorado collateral source rule." *FDIC v. Clark*, 768 F.Supp. 1402, 1413 (D. Colo. 1989), *aff'd* 978 F.2d 1541, 1553 (10th Cir. 1992).

Bank v. First Citizens Bank & Trust Co., No. 3:09-876-CMC, 2010 U.S. Dist. LEXIS 72935, at *6-7 (D.S.C. July 20, 2010). The *Flagstar* court agreed that the collateral source rule could not be applied because "the title insurance was purchased as part of the mortgage loan transaction at issue," (*id.* at *6) and stated as follows:

> The court agrees that the collateral source rule is inapplicable under the facts of this case because the title insurance was purchased by the borrower as part of the loan transaction. **Under these circumstances, the title insurance is simply not a collateral source**: it is part of the benefit bargained for by the originating financial institution (one of the Defendants) and passed on to Plaintiff with the sale of the loan. Indeed, had the originating financial institution not sold the loan to Plaintiff, that entity would have received the benefit of the same insurance policy.

Id. at *6-7 (granting summary judgment) (emphasis added). Moreover, the *Flagstar Bank* court specifically noted that the distinction between the collateral source rule's application to tort claims versus contract claims had

no bearing on its decision because *both* types of claims were before the court.[10]

Given that title insurance is an integral component of a loan transaction, the reciprocal proposition must also be true--*i.e.*, that payments on a loan are not a collateral source to the title insurance.

3. CMLC argues, in effect, that its own loan repayment obligations constitute a collateral source. Specifically, CMLC was formed by CPI and CPII, and is wholly owned and controlled by CPII. Slip op., ¶ 28; *Fidelity Nat'l Title Ins. Co. v. Centerpoint Mechanic Lien Claims, LLC*, 238 Ariz. 135, 139, ¶ 14 (App. 2015) ("*Centerpoint I*"). CPI and CPII were also the sole borrowers for the VRCP loan and were named borrowers for the Universal loan, Slip op., ¶¶ 9, 12, and used the proceeds from the sale of Centerpoint to satisfy their loan obligations to VRCP and Universal, just as the loan agreements contemplated.

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[10] "Given the conclusion that the title insurance policy is not a collateral source under the facts of this case, the court need not decide whether and to what extent the collateral source rule applies to contract claims. . . . In any event, Plaintiff asserts both tort and contract claims in this action." *Id.* at *7, n. 3.

Here, however, through CMLC as their proxy,[11] CPI and CPII argue that their loan repayments constitute a "collateral source" such that they should, in essence, be allowed to obtain a refund of their loan payments from Commonwealth. The court of appeals correctly refused CMLC's argument, and its decision marks the second time the court has rejected CMLC's attempts to artificially create damages that do not exist. *See Centerpoint I*, 238 Ariz. at 142, ¶ 35 ("The insureds may not, by using CMLC as a proxy, artificially inflate Fidelity's indemnity obligation…"). Review is not warranted here.

4. CMLC misstates Commonwealth's argument in the Reasonableness Action. The only issue in dispute in the Reasonableness Action was whether the stipulated judgment amount ($38 million) was unreasonable. Commonwealth argued the stipulated judgment amount was unreasonable because, as CMLC admitted, the loans were fully repaid. The trial court disagreed and ruled the settlement amount was reasonable, and the court of

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[11] *Centerpoint I*, 238 Ariz. at 142, ¶ 35 (referring to CMLC as CPI and CPII's "proxy").

appeals later reversed. *Centerpoint I*, 238 Ariz. at 135. The issue of the collateral source rule was never raised, argued or adjudicated.

The mere fact that the trial court, in a separate action, disagreed with Commonwealth's argument on the issue of "reasonableness" hardly equates, as CMLC suggests, to a determination, as a binding matter of law, that evidence of loan repayments is inadmissible under the collateral source rule.

CONCLUSION

For the foregoing reasons, Commonwealth Land Title Insurance Company respectfully requests the Court deny review of CMLC's cross-petition for review.

RESPECTFULLY SUBMITTED this 21st day of November, 2023.

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