ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY

EQUITY INCOME PARTNERS, LP, et al. v.
CHICAGO TITLE INSURANCE COMPANY.
CV 16-0162-CQ

PARTIES:

Appellants/Plaintiffs:	Equity Income Partners, LP and Galileo Capital Partners Limited (collectively "Lenders")
Appellee/Defendant:	Chicago Title Insurance Company ("Insurer")

FACTS:

Factual Background: In May 2006, Lenders extended two $1.2 million loans, secured by deeds of trust, to two borrowers for the purchase of two adjacent parcels in Carefree, Arizona. Lenders obtained a title insurance policy for each parcel from Insurer's predecessor-in-interest, Ticor Title Insurance Company. Each policy provided $1.2 million in coverage.

In September 2006, the borrowers discovered that they did not have legal access to the parcels. After exhausting their legal remedies, the borrowers and their title insurer stopped paying on the loans. That led Lenders to foreclose and notice trustee sales for the parcels. In January 2011, Lenders purchased the parcels at two trustee sales through full-credit bids totaling over $2.6 million, reflecting the borrowers' unpaid indebtedness and other amounts allowed by statute. *See* A.R.S. §§ 33-801(5) (defining components of a "credit bid") & 33-810(A) (authorizing deed of trust beneficiary to make a "credit bid" in lieu of cash at a trustee's sale).

In October 2010, Lenders submitted a claim to Insurer for the full $1.2 million coverage amount of each policy. Unable to resolve the claim, Lenders filed suit against Insurer in superior court in July 2011, and Insurer removed the action to federal court for the District of Arizona. In January 2013, Insurer filed a motion for partial summary judgment arguing that Lenders' full-credit bids should be "treated as actual payments of the principal of the indebtedness," thus "reducing the amount of title insurance" to zero under Section 9(b) of the policy. Lenders responded by filing their own motion for partial summary judgment, contending that they were entitled to $1,003,000, reflecting a second appraisal of Lenders' loss calculated by Insurer ($1,346,000) minus what Insurer had already paid to Lenders based on a first appraisal ($343,000).

The Contractual Provisions at Issue. At issue is the meaning of four provisions of Insurer's standard form title insurance policy:

> **2. Continuation of Insurance.**
>
> **(a) After Acquisition of Title.** The coverage of this policy shall continue in force as of Date of Policy in favor of (i) an insured who acquires all or any part of the estate or interest in the land by foreclosure, trustee's sale, conveyance in lieu of foreclosure, or other legal manner which discharges the lien of the insured mortgage; [or] (ii) a transferee of the estate or interest so acquired from an insured corporation, provided the transferee is the parent or wholly-owned subsidiary of the

insured corporation, and their corporate successors by operation of law and not by purchase, subject to any rights or defenses the Company may have against any predecessor insureds....

* * *

(c) Amount of Insurance. The amount of insurance after the acquisition or after the conveyance shall in neither event exceed the least of: (i) the Amount of Insurance stated in Schedule A; [or] (ii) the amount of the principal of the indebtedness secured by the insured mortgage as of Date of Policy, interest thereon, expenses of foreclosure, amounts advanced pursuant to the insured mortgage to assure compliance with laws or to protect the lien of the insured mortgage prior to the time of acquisition of the estate or interest in the land and secured thereby and reasonable amounts expended to prevent deterioration of improvements, but reduced by the amount of all payments made . . . .

* * *

7. Determination and Extent of Liability

This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the insured claimant who has suffered loss or damage by reason of matters insured against by this policy and only to the extent herein described.

(a) The liability of the Company under this policy shall not exceed the least of:

(i) the Amount of Insurance stated in Schedule A, or, if applicable, the amount of insurance as defined in Section 2(c) of these Conditions and Stipulations;

(ii) the amount of the unpaid principal indebtedness secured by the insured mortgage as limited or provided under Section 8 of these Conditions and Stipulations or as reduced under Section 9 of these Conditions and Stipulations, at the time the loss or damage insured against by this policy occurs, together with interest thereon; or

(iii) the difference between the value of the insured estate or interest as insured and the value of the insured estate or interest subject to the defect, lien or encumbrance insured against by this policy.

(b) In the event the Insured has acquired the estate or interest in the manner described in Section 2(a) of these Conditions and Stipulations or has conveyed the title, then the liability of the Company shall continue as set forth in Section 7(a) of these Conditions and Stipulations.

* * *

9. Reduction of Insurance; Reduction or Termination of Liability

(a) All payments under this policy, except payments made for costs, attorneys' fees and expenses, shall reduce the amount of the insurance pro tanto. However, any payments made prior to the acquisition of title to the estate or interest as provided in Section 2(a) of these Conditions and Stipulations shall not reduce pro

tanto the amount of the insurance afforded under this policy except to the extent that the payments reduce the amount of the indebtedness secured by the insured mortgage.

(b) Payment in part by any person of the principal of the indebtedness, or any other obligation secured by the insured mortgage, or any voluntary partial satisfaction or release of the insured mortgage, to the extent of the payment, satisfaction or release, shall reduce the amount of insurance pro tanto. The amount of insurance may thereafter be increased by accruing interest and advances made to protect the lien of the insured mortgage and secured thereby, with interest thereon, provided in no event shall the amount of insurance be greater than the Amount of Insurance stated in Schedule A.

(c) Payment in full by any person or the voluntary satisfaction or release of the insured mortgage shall terminate all liability of the Company except as provided in Section 2(a) of these Conditions and Stipulations.

* * *

10. Liability Noncumulative

If the insured acquires title to the estate or interest in satisfaction of the indebtedness secured by the insured mortgage, or any part thereof, it is expressly understood that the amount of insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B [listing 2006 tax liens, water rights, items on a boundary survey, etc.] or to which the Insured has agreed, assumed, or taken subject, or which is hereafter executed by an insured and which is a charge or lien on the estate or interest described or referred to in Schedule A [listing Borrower's mortgage], and the amount so paid shall be deemed a payment under this policy.

The District Court Decision. In December 2013, the district court granted Insurer's motion and denied Lenders' motion. *Equity Income Partners, LP v. Chicago Title Ins. Co.*, No. CV-11-1614-PHX-SMM, 2013 WL 6498144, at *11 (D. Ariz. Dec. 11, 2013).

The court started by explaining the nature of a "credit bid," which A.R.S. § 33-801(5) defines as "a bid made by the [deed of trust] beneficiary in full or partial satisfaction of the contract or contracts which are secured by the trust deed." *Id*. at *3 (quoting statute). A "full-credit bid," it further explained, "occurs when the lender bids 'the entire amount of unpaid principal, interest, and trustee's sale expenses.'" *Id*. (citation omitted). It noted that such a bid triggers an important consequence—the underlying secured obligation is deemed to have been fully satisfied. *Id*. at *4. "By way of analogy, if a full-credit bid results in the acquisition of the property, then the lender effectively pays to itself the outstanding balance of the debt, as well as interest and the costs of foreclosure, in exchange for title to the property." *Id*. (citation omitted).

It then noted that "[p]aragraph nine of the Policies makes it clear that the amount of insurance is reduced by any satisfaction—in whole or in part—of the insured mortgage." *Id*. at *6. The issue, the court explained, was "whether [Lenders'] credit bids constituted payment on the 'principal of the indebtedness,' thereby 'reducing the amount of insurance pro tanto.'" *Id*. at *7 (quoting Policy Section 9(b)). It noted that Insurer argued that Lenders' full-credit bids at the

trustee's sales constitute "actual payments" against the principal of the underlying debt. *Id*. In contrast, it continued, Lenders contended that credit bids are not "payments" because a lender's losses are not recouped as the bids return no "actual money" to the lender's pocket. *Id*.

It noted that in support of its position, Insurer cited two Arizona district court decisions. *Id*. In the first, the court ruled that under Arizona's anti-deficiency statute, a full-credit bid fully satisfies the underlying debt obligation, and thereby precludes a lender from recovering for an alleged deficiency against a third-party or from asserting damages based on the value of the property. *Id*. (citing *ING Bank, FSB v. Mata*, No. CV-09-748-PHX-GMS, 2009 WL 4672797, at *5 (D. Ariz. Dec. 3, 2009)). In the second, the court explained that a lender could avoid the broad repercussions of a full-credit bid by not bidding the full amount owed and instead bidding what the lender believes the property is worth. *Id*. at *8 (citing *M & I Bank, FSB v. Coughlin*, 805 F. Supp. 2d 858, 866 (D. Ariz. 2011)). The decision also concluded that the Arizona Supreme Court's decision in *Nussbaumer v. Super. Ct.*, 107 Ariz. 504, 489 P.2d 843 (1971), necessarily assumes that full-credit bids extinguish a debtor's obligation to the lender. *Id*. (citing *Coughlin*, 805 F. Supp. 2d at 867-68).

The court then ruled that Lenders' "full-credit bids constitute payment[s] under Paragraph nine of the Policies." *Id*. It contended that "Arizona statutes and precedent leave no doubt that when a lender acquires property pursuant to their full-credit bid, they are paying to themselves the entire amount of unpaid principal, interest, and associated fees—as a result, both the security interest and borrower's debt are extinguished." *Id*. (citing, among others, *Couglin*, *Mata*, and *Nussbaumer*). It also ruled that the policies were "unambiguous in limiting the amount of insurance directly to the satisfaction of the underlying mortgage" and that it was "uncontroverted that [Lenders] are 'any person' [under Paragraph nine] and that they could pay to themselves all or part of the insured obligation." *Id*.

From those premises, the court concluded that, "as a matter of law, [Lenders'] full-credit bids constituted payments against the principal of indebtedness" under Paragraph 9, that "the amount of insurance was thereby reduced to zero." *Id*. at *9. As a consequence, the court held that summary judgment was warranted in Insurer's favor because Lenders "cannot now assert any damages based on the value of the property, unless their overbids were fraudulently induced." *Id*.

Lenders then appealed to the Ninth Circuit.

ISSUES:

The Ninth Circuit has certified three questions to the Arizona Supreme Court:

(1) "When a lender purchases property by full-credit bid at a trustee's sale, does Section 9 apply, or does Section 2 apply?"

(2) "Is a full-credit bid at a trustee's sale a "payment" or "payment[ ] made" under [S]ections 2 or 9 of the policies?"

(3) "To what extent does a full-credit bid at a trustee's sale either (a) terminate coverage under [S]ection 2(a)(i) of the policies, or (b) reduce coverage under [S]ection 2 and any possible liability under Section 7?

This Summary was prepared by the Arizona Supreme Court Staff Attorneys' Office solely for educational purposes. It should not be considered official commentary by the Court or any member thereof or part of any brief, memorandum, or other pleading filed in this case.