IN THE

ARIZONA COURT OF APPEALS

DIVISION ONE

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

v.

COMMONWEALTH LAND TITLE INSURANCE COMPANY,
Defendant/Appellee/Appellant.

No. 1 CA-CV 21-0039
FILED 5-23-2023

Appeal from the Superior Court in Maricopa County
No. CV2011-008600
The Honorable Christopher Whitten, Judge

AFFIRMED IN PART; REVERSED IN PART AND REMANDED WITH INSTRUCTIONS

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OPINION

Judge Brian Y. Furuya delivered the opinion of the Court, in which Presiding Judge David D. Weinzweig and Judge Jennifer M. Perkins joined.

F U R U Y A, Judge:

¶1 Centerpoint Mechanic Lien Claims, LLC ("CMLC") appeals the grant of summary judgment on its insurance contract coverage claims in favor of Commonwealth Land Title Insurance Co. ("Commonwealth"). Because in so ruling, the superior court impermissibly applied contractual liability defenses to coverage questions, we hold that the court erred in granting summary judgment as to CMLC's contract claims. CMLC further appeals the court's denial of its motion in limine, arguing the court violated the collateral source rule. But the collateral source rule is inapplicable to this case. CMLC also challenges the court's refusal to give its requested jury instructions on punitive damages and tort damages. While we hold the court erred in declining to instruct the jury on punitive damages, we discern no error in the court's refusal to give a special instruction on tort damages.

¶2 In its cross-appeal, Commonwealth challenges the 2019 jury award for $5 million to CMLC on its remaining insurer bad faith claims, arguing that the jury's verdict is not supported by substantial evidence establishing damages. But because sufficient evidence supports this award, we conclude the award is not speculative and the court did not err by refusing to enter a directed verdict as Commonwealth requests.

¶3 Thus, we affirm the superior court in part, reverse in part, and remand with instructions, as further explained below.

FACTS AND PROCEDURAL HISTORY

¶4 The long and complicated history of this case spans more than a decade of litigation. We previously resolved certain preliminary issues but now confront the merits of the parties' claims and defenses. Thus, we set out the following comprehensive history to establish context for those claims and defenses.

I. Parties, Bankruptcy, and Fidelity Title Insurance Policy (2008 to Sept. 2009)

¶5 Between 2007 and 2008, Mortgages, Ltd. ("ML"), a private lender headquartered in Phoenix, agreed to loan a developer funds to construct the Centerpoint Towers (the "Centerpoint Property"), a high-rise residential condominium in Tempe. Development had begun in 2005. *See Fid. Nat'l Title Ins. Co. v. Centerpoint Mech. Lien Claims, LLC*, 238 Ariz. 135, 137 ¶ 3 (App. 2015) ("*Centerpoint I*"). ML secured the loan with a deed of trust on the Centerpoint Property. It also purchased a lender's title insurance policy (the "ML Policy") from Fidelity National Title Insurance Company ("Fidelity"), to insure the priority of ML's deed of trust.

¶6 During this timeframe, ML held approximately 50 outstanding loans representing hundreds of millions of dollars. ML's operations encountered financial difficulties, which ultimately resulted in an involuntary bankruptcy proceeding in June 2008. *Fid. Nat'l Title Ins. Co. v. Osborn III Partners LLC*, 250 Ariz. 615, 618 ¶ 4 (App. 2021), *vacated in part*, 254 Ariz. 440 (2023). With the project's primary lender in financial straits, funding became erratic and development on the Centerpoint Property stalled. *Centerpoint I*, 238 Ariz. at 138 ¶ 8.

¶7 Starting in April 2008, contractors, subcontractors, and suppliers began recording mechanics' liens and notices of lis pendens against the Centerpoint Property. Some of the mechanics' lien claimants first sued in superior court in October 2008. *See id.* Ultimately, this litigation would consolidate dozens of mechanics' lien claims, valued at approximately $38 million in combined liability (the "Lien Litigation"). This Lien Litigation sought (1) a determination that the mechanics' liens had priority over ML's security interest in the Centerpoint Property and (2) to foreclose on the Centerpoint Property. *See id.*; *see Gould Evans Assocs., LC et al. v. Tempe Land Co., LLC et al.*, Maricopa Cnty. Super. Ct. No. CV2008-024849.

¶8 Meanwhile, per its bankruptcy reorganization plan, separate limited liability companies were created to hold assets related to each of the 50 loans formerly owned by ML (collectively the "Loan LLCs"). As relevant here, ML's deed of trust interests in the Centerpoint Property were transferred to Centerpoint I Loan, LLC ("CP1") and Centerpoint II Loan, LLC ("CP2"), which were, in part, organized to receive the loans regarding the Centerpoint Property. A different company, ML Manager, LLC, was organized to act as manager of the various Loan LLCs, including CP1 and CP2. ML Manager, LLC was also appointed to act as agent and attorney-in-

fact for certain fractional interest holders, who also obtained an interest in the loans and security associated with the Centerpoint Property through the bankruptcy process. We refer to CP1, CP2, the fractional interest holders, and ML Manager, LLC collectively as "the ML Investors."

¶9 In June 2009, the ML Investors needed exit financing to pay expenses related to the bankruptcy. Another private lender, Universal SCP-1 LP ("Universal"), agreed to loan the ML Investors up to $20 million for this purpose. Universal structured the loan with promissory notes issued by each respective Loan LLC, including CP1 and CP2, and secured those notes against the various ML deeds of trust. Universal's loan was also cross-collateralized with a "bucket of security," comprised of interests in any real property to which the Loan LLCs then held title or in the future received title (for instance, through judicial or non-judicial foreclosure of a ML deed of trust).

¶10 As the successor to ML's interests, the ML Investors tendered defense of the mechanics' lien claims in the ongoing Lien Litigation to Fidelity, and in September 2009, Fidelity accepted the defense with a general reservation of rights. *Centerpoint I*, 238 Ariz. at 138 ¶ 9.

II. Commonwealth Title Insurance Policies and Handling of Claims (Apr. 2010 to Feb. 2011)

A. Foreclosure of Centerpoint Property and Issuance of Commonwealth Title Policies

¶11 In April 2010, the ML Investors purchased the Centerpoint Property in foreclosure for a credit bid of $8 million. As required by its loan agreement, Universal then received a deed of trust against the Centerpoint Property, partially securing repayment of its loan to the ML Investors.

¶12 In July 2010, Commonwealth issued Universal a $5 million lender's title insurance policy (the "Universal Policy"), insuring priority of Universal's security interest in the Centerpoint Property—ahead of any mechanics' liens. Contemporaneously, VR CP Funding, LP ("VRCP") loaned an additional $5 million to CP1 and CP2 for the purchase of an additional parcel of property adjacent to the Centerpoint Property. VRCP also secured its loan with a deed of trust against the Centerpoint Property. Commonwealth issued VRCP a $5 million lender's title policy (the "VRCP Policy"), insuring priority of its security interest in the Centerpoint Property, subordinate only to Universal—but still ahead of any mechanics' liens.

B. Common Administration and Knowledge of Claims Between Fidelity and Commonwealth

¶13 Although not a party to this appeal, Fidelity shares a parent company—Fidelity National Title Group ("FNTG")—with Commonwealth, making both companies FNTG affiliates. FNTG performed substantial work for customers of both Commonwealth and Fidelity, underwriting all their policies and handling all their claims.

¶14 Regarding this case, the same FNTG personnel handled the underwriting and claims processing for the ML Policy issued by Fidelity, as well as the Universal Policy and VRCP Policy later issued by Commonwealth. This FNTG personnel had been involved with the Lien Litigation since September 2009, after the ML Investors' tender of their defense. Thus, Commonwealth's underwriter had knowledge of the multitude of mechanics' liens recorded against the Centerpoint Property prior to issuance of the Universal and VRCP Policies in July 2010.

C. The ML Investors' Default on Loans and First Failed Closing on Sale of Centerpoint Property

¶15 Universal and VRCP learned about the mechanics' liens between June 2010 and October 2010, and pressured the ML Investors to liquidate the Centerpoint Property to fund payments on their exit loan or risk substantial default penalties. The ML Investors asked Universal and VRCP for time to cure the default. The ML Investors' counsel, Keith Hendricks, told Universal and VRCP that the ML Investors intended to sell the Centerpoint Property and repay the loans. To that end, Fidelity initially provided the ML Investors with an informal title insurance commitment that was used in marketing materials for the Centerpoint Property, to ease concerns of potential buyers about the mechanics' liens.

¶16 In September 2010, the ML Investors found a buyer that agreed to purchase the Centerpoint Property for $30 million. From this sum, approximately $14.1 million would be paid to Universal and $5.4 million would be paid to VRCP. Closing was set for October 4, 2010, but the sale was contingent on delivery of "clean title," free of the $38 million in mechanics' lien claims at issue in the Lien Litigation.

¶17 Fidelity contemplated issuing a title insurance policy to this potential buyer that would insure priority over the mechanics' liens, but ultimately it declined to issue a final policy to the prospective buyer, and the sale failed to close as planned.

D. Initial Negotiations on Commonwealth Policies and Second Failed Closing on Sale of Centerpoint Property

¶18 Prior to the failed closing, Hendricks, under authority from Universal and VRCP, emailed FNTG on October 5, 2010. This email stated that the Lien Litigation posed an issue concerning the Universal and VRCP Policies. As requested by FNTG, Hendricks attached copies of both the Universal and VRCP policies issued by Commonwealth in the same email.

¶19 Although the sale failed to close on October 4, the buyer remained interested in purchasing the Centerpoint Property and the closing deadline was extended to early November 2010. In further emails sent to FNTG in October, Hendricks urged Fidelity to provide an insurance policy to the buyer as it had previously contemplated.

¶20 Hendricks also informed FNTG that the mechanics' lien claimants were willing to settle their claims for between $8 million and $11 million (which was "within the coverage amounts under the three policies"), though FNTG would need to recognize undisputed liability under the ML, Universal, and VRCP policies. But Fidelity decided against issuing an insurance policy to the buyer and sale of the Centerpoint Property again failed to close.

E. Tender of Defense to Commonwealth and Reservation of Rights; Requests for Information

¶21 Despite Hendricks' October communications with FNTG concerning the Universal Policy and VRCP Policy, FNTG told Hendricks that these policies were not at issue because no formal claims had been tendered to Commonwealth. In response, Hendricks advised Universal and VRCP to "make a formal claim and tender of the defense" to Commonwealth. Universal and VRCP did so on November 2.

¶22 About a week after Universal and VRCP tendered their defense, Commonwealth acknowledged receipt of the claims and requested certain categories of information from Universal and VRCP to determine if they were "proper claimant[s]" entitled to coverage.

¶23 On December 29, Commonwealth accepted the defense but did so under a general reservation of rights. It also broadened its unanswered request for information from Universal and VRCP.

F. Notice to Commonwealth of Intent to Settle with Mechanics' Lien Claimants

¶24 Because of the failed closing, the pending Lien Litigation, and Commonwealth's assertion of its reservation of rights, Universal and VRCP informed Commonwealth in a January 27, 2011 demand letter that they had "entered into negotiations with and intend[ed] to consummate agreements with the mechanic lien holders . . . on the Centerpoint condominium project and related parcels . . . ." This letter expressed Universal's and VRCP's settlement demands, but also stated they would not enter into any settlement if Commonwealth withdrew its reservation of rights.

G. FNTG's Internal Memo Acknowledging Lack of Coverage Defenses and Advising Against Settlement; Information Exchanged

¶25 On February 6, 2011, FNTG's claims handler and "Senior Major Claims Counsel" drafted an internal memo to his superiors evaluating the claims and settlement demands made by ML, Universal, and VRCP. This internal memo informed FNTG leadership that there were no known coverage defenses concerning the Universal and VRCP title insurance policies. But notwithstanding the lack of apparent coverage defenses, the memo further advised against settling because "continuing litigation on the validity and effect of [a] settlement should yield plenty of opportunities for the company to settle for less[.]"

¶26 Commonwealth sent letters on February 15, 2011, reminding Universal and VRCP of the information it sought in its November and December 2010 letters. A day later, Universal and VRCP provided the requested information to Commonwealth—two days before the sale of the Centerpoint Property and subsequent entrance of a settlement agreement. Despite having authority to arbitrate or invoke court assistance to obtain the information sought at earlier junctures, Commonwealth elected not to do so.

III. Sale of the Centerpoint Property; *Morris* Agreement; Assignment of Claims (Feb. 2011)

¶27 Facing the imminent prospect of losing the Centerpoint Property, the ML Investors, Universal, and VRCP (among others) negotiated a settlement with the Lien Litigation plaintiffs to facilitate sale of the Centerpoint Property. As part of these efforts, the ML Investors, Universal, and VRCP entered a *Morris* settlement agreement under *United Servs. Auto. Ass'n v. Morris*, 154 Ariz. 113 (1987). *Centerpoint I*, 238 Ariz. at 139 ¶¶ 14–17.

¶28 As part of the settlement, the ML Investors created CMLC—wholly owned and controlled by CP2—to acquire the mechanics' lien claims for $13.65 million. *See id.* CMLC purported to purchase the mechanics' liens to provide clear title to the buyer and further agreed to subordinate its interests in the Centerpoint Property to the buyer's fee interest. Universal and VRCP likewise agreed to subordinate their interests. As the purported successor to the mechanics' lien claims, CMLC agreed to refrain from executing on the Centerpoint Property. Universal and VRCP also waived their rights to demand payment of $5 million each from the sale proceeds and assigned their claims against Commonwealth to CMLC. Per the agreement, CMLC took assignment of these claims after the superior court entered judgment on the *Morris* agreement in June 2012 (the "*Morris* Judgment").

¶29 Commonwealth did not timely appeal the *Morris* Judgment. *Centerpoint I*, 238 Ariz. at 140 ¶ 19.

IV. Coverage and Bad Faith Litigation

A. Complaint and Counterclaims

¶30 Commonwealth pursued declaratory relief against CMLC, challenging its claimed interests in the Universal and VRCP title insurance policies. Commonwealth contended both Universal and VRCP had been "paid in full on all indebtedness" that had been secured by the interest insured under the Universal and VRCP policies; therefore, Universal and VRCP suffered no loss from which they could recover under those policies.

¶31 In turn, CMLC asserted counterclaims, arguing Commonwealth: (1) breached the contract terms of the Universal and VRCP policies by failing to indemnify them for losses arising from the mechanics liens, and (2) committed bad faith in handling the tendered claims. CMLC sought both compensatory and punitive damages.

B. Motions and Trial

1. Motions for Summary Judgment

¶32 Commonwealth moved for partial summary judgment on the issue of coverage (breach of contract) under the Universal and VRCP title insurance policies. In granting Commonwealth's partial summary judgment, the superior court agreed with Commonwealth that because Universal's and VRCP's loans had been paid, CMLC, as their assignee, could not establish a breach of contract.

¶33 After the court granted partial summary judgment on its contract coverage arguments, Commonwealth moved for summary judgment on CMLC's remaining bad faith claims for the same reasons—that under the policies, a bad faith claim could not be maintained without a showing of actual loss. The court denied this motion without addressing its merits. Thus, the case proceeded to trial on CMLC's bad faith claims only.

2. Cross-Motions in Limine

¶34 Before trial, CMLC moved to exclude evidence that showed Universal or VRCP received payments toward its loans from sources other than Commonwealth (i.e., from the proceeds of the sale of the Centerpoint Property, from proceeds of subsequent sales of other properties securing Universal's loan, or from payments received by the partners of VRCP for their ownership interests in VRCP). CMLC argued that Arizona's collateral source rule could not be used to offset its damages by applying these outside payments to reduce Commonwealth's liability. The court rejected CMLC's position and admitted the evidence, reasoning that the collateral source rule could be applied to reduce the amount of CMLC's claims.

3. Motions Made During Trial and After

¶35 Before the jury rendered its verdict, the court denied CMLC's motion for directed verdict on its request for a punitive damages jury instruction. The court also denied CMLC's request for a specialized instruction explaining the difference between tort damages versus contract damages.

¶36 In addition, the court denied Commonwealth's motion for directed verdict on the issue of bad faith. Commonwealth again argued the evidence showed neither Universal nor VRCP suffered a loss or actual damage to support the bad faith insurance claims because both Universal's and VRCP's loans were fully repaid. But the court found that notwithstanding its ruling in favor of Commonwealth on the coverage issue, evidence supported the claim that Commonwealth improperly handled Universal's and VRCP's tendered claims for purposes of bad faith damages. The jury ultimately awarded CMLC $5 million on its bad faith insurance claims in 2019.

¶37 Following trial, Commonwealth moved for renewed judgment as a matter of law under Arizona Rule of Civil Procedure 50(b). Commonwealth argued that because the evidence allegedly showed Universal and VRCP did not suffer any loss, the jury impermissibly

invented a damages amount based on speculation. CMLC also moved for a new trial. The court denied both motions.

C. Attorneys' Fees

¶38 After briefing by the parties, the court found CMLC to be the successful party for purposes of awarding attorneys' fees under Arizona Revised Statutes ("A.R.S.") § 12-341.01.

¶39 Both parties timely appealed, and we have jurisdiction pursuant to A.R.S. §§ 12-120.21(A)(1), -2101(A)(4)–(5)(a), and -2102(A).

DISCUSSION

I. Summary Judgment—Coverage Claim (Breach of Contract)

¶40 CMLC argues the superior court erred in granting partial summary judgment in favor of Commonwealth on the coverage claims. We review the court's grant of summary judgment, which was based on its interpretation of Universal's and VRCP's insurance policies, de novo. *See Fid. Nat'l Title Ins. Co. v. Osborn III Partners LLC*, 254 Ariz. 440 ¶ 14 (2023) ("[W]e review de novo the meaning of insurance policies," citing *Teufel v. Am. Fam. Mut. Ins. Co.*, 244 Ariz. 383, 385 ¶ 10 (2018)); *Tritschler v. Allstate Ins. Co.*, 213 Ariz. 505, 509–510 ¶ 8 (App. 2006). As such, we are not bound by the court's interpretation of the insurance contracts. *See Ariz. Biltmore Ests. Ass'n v. Tezak*, 177 Ariz. 447, 448 (App. 1993). Entry of summary judgment is only appropriate when "there is no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law." Ariz. R. Civ. P. 56(a); *City of Tempe v. State*, 237 Ariz. 360, 363 ¶ 8 (App. 2015). We view the evidence and all reasonable inferences drawn from it in the light most favorable to the non-moving party. *Sanders v. Alger*, 242 Ariz. 246, 248 ¶ 2 (2017).

¶41 In its motion for summary judgment, Commonwealth argued conditions (8)(a)(ii) and 10(b) of the policies operated to preclude coverage because CMLC could not prove contractual damages. Commonwealth reasoned that Universal's and VRCP's loans had been fully repaid as of 2011 and both lenders had subordinated. As a result, Universal and VRCP released their interests in the Centerpoint Property as part of the *Morris* settlement. Therefore, under these conditions, Universal and VRCP could not demonstrate they had suffered loss or retained any interest in the Centerpoint Property.

¶42 Condition 8(a)(ii) is located within the document section titled "Determination and Extent of *Liability*" (emphasis added) and states:

> 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. . . . The extent of *liability* of the Company for loss or damage under this policy shall not exceed the least of (i) the Amount of Insurance, (ii) the Indebtedness, (iii) the difference between the Title as insured and the value of the Title subject to the risk of insured against by this policy. . . .

(emphasis added).

¶43 Condition 10 is titled "Reduction of Insurance; Reduction or Termination of *Liability*" (emphasis added). Condition 10(b) states that "[t]he voluntary satisfaction or release of the Insured Mortgage shall terminate all *liability* of the Company except as provide[d] in Section 2 of these Conditions" (emphasis added).

¶44 The court erroneously adopted Commonwealth's characterization of conditions 8(a)(ii) and 10(b) of the insurance contracts as defenses to coverage. In so doing, it conflated two distinct concepts applicable to the insurance contracts—coverage and liability.

¶45 "We accord words used in insurance policies their plain and ordinary meaning, examining the policy from the viewpoint of an individual untrained in law or business." *Osborn III Partners LLC*, 254 Ariz. at ¶ 14 (cleaned up); *Aztar Corp. v. U.S. Fire Ins. Co.*, 223 Ariz. 463, 469 ¶ 17 (App. 2010) ("In construing a contract, we 'give words their ordinary, common sense meaning.'" quoting *A Tumbling–T Ranches v. Flood Control Dist. of Maricopa Cnty.*, 220 Ariz. 202, 209 ¶ 23 (App. 2008)). Further, insurers bear the burden of establishing the applicability of any policy exclusions. *Osborn III Partners LLC*, 254 Ariz. at ¶ 14. As when construing statutes, in the absence of express definitions within a contract, we may consider dictionary definitions to assist in determining the ordinary meaning of words. *See DBT Yuma, L.L.C. v. Yuma Cnty. Airport Auth.*, 238 Ariz. 394, 396 ¶ 9 (2015).

¶46 In the context of insurance, "coverage" may be understood as "inclusion within the scope of an insurance policy or protective plan." *Coverage*, Merriam-Webster Dictionary, May 10, 2023, https://www.merriam-webster.com/dictionary/coverage. *See also Coverage*,

Black's Law Dictionary (11th ed. 2019) ("the inclusion of a risk under an insurance policy," or "the risks within the scope of an insurance policy"). Whereas "liability" is defined as the "the quality or state of being liable" or "something for which one is liable." Merriam-Webster Dictionary, May 10, 2023, https://www.merriam-webster.com/dictionary/liability. *See also Liability*, Black's Law Dictionary (11th ed. 2019) ("the quality, state, or condition of being legally obligated or accountable," the "legal responsibility to another . . ., enforceable by civil remedy," or "financial or pecuniary obligation in a specified amount").

¶47 Thus, broadly speaking, "coverage" relates to whether an insurance contract will apply to indemnify an insured, while "liability" relates to the amount to which an insurer will indemnify, assuming coverage has been established. To be sure, there is great interconnection between the two concepts, since if there is no coverage, there will also be no liability on the part of the insurer. *See Morris*, 154 Ariz. at 121 (treating coverage and liability in the insurance context as discreet issues and observing that "[i]f the insurer wins on the coverage issue, it is not liable for any part of the settlement[,] [but] [i]f it loses, it may or may not be bound by the amount of the judgment" dependent upon whether such judgment is shown to be fair and reasonable and not fraudulent or collusive). Similarly, if no liability is discernable or possible, as a practical matter, there will be no need to evaluate coverage, making the coverage question irrelevant. But the legal distinction between the two concepts is particularly important where—as here—*Morris* agreements are concerned, because "[i]n the *Morris* context, liability-related issues are not pertinent to coverage." *Associated Aviation Underwriters v. Wood*, 209 Ariz. 137, 143 ¶ 3 (App. 2004). This separation is what preserves coverage defenses, even in the face of a *Morris*-style settlement agreement that resolves all questions related to liability. *See Quihuis v. State Farm Mut. Auto. Ins. Co.*, 235 Ariz. 536, 547 ¶ 38 (2014) (observing that *Morris* judgments "will not preclude the insurer from litigating its identified basis for contesting coverage, irrespective of any fault or damages assessed against the insured").

¶48 Here, per their express terms, conditions 8(a)(ii) and 10(b) do not provide or define coverage defenses, but instead operate as defenses to payment liability. However, for purposes of this case, the fact and amount of Commonwealth's liability are resolved and may not be relitigated, since it is bound by the *Morris* Judgment. *Wood*, 209 Ariz. at 150 ¶ 37 ("*Morris* does not authorize, but rather essentially prohibits, an insurer's attempt . . . to litigate tort liability and damage issues in the guise of a coverage defense."). Thus, entry of judgment in Commonwealth's favor based upon application of contractual *liability* defenses was improper.

¶49 We resolve the question of coverage by applying the definition of coverage provided by the policy documents. Commonwealth issued policies to both Universal and VRCP that include language expressly defining coverage and limiting coverage through "exclusions from coverage" and "exceptions from coverage contained in Schedule B." *See Centennial Dev. Grp., LLC v. Lawyer's Title Ins. Corp.*, 233 Ariz. 147, 149 ¶ 6 (App. 2013) ("Before a title insurer issues a policy, it reviews public records for defects, then issues a title commitment that lists exceptions to coverage.") (citing *First Am. Title Ins. Co. v. Action Acquisitions, LLC*, 218 Ariz. 394, 398 ¶ 11 (2008)). The exclusions and exceptions to coverage in Universal's and VRCP's policies contain no term that excludes coverage in the event known mechanics' liens affect Universal's and VRCP's priority in the Centerpoint Property. To the contrary, both policies expressly insure the priority of Universal's and VRCP's deeds of trust against the Centerpoint Property ahead of any encumbrances, including mechanics' liens. At the time Commonwealth issued the policies to Universal and VRCP, its claims personnel knew the Centerpoint Property was subject to mechanics' lien claims dating back to 2008. Yet, Commonwealth did not exclude these liens from coverage when issuing the policies for Universal's and VRCP's 2010 deeds of trust. Moreover, Commonwealth's claims handler acknowledged to FNTG leadership that he could not identify any coverage defenses based on the policies themselves. Because both policies expressly define lack of priority of a deed of trust as a covered circumstance, and because Commonwealth did not otherwise exclude or exempt from coverage the mechanics' lien claims at issue in the Lien Litigation, the policies' terms provide coverage as to those lien claims. Our coverage inquiry ends here.

¶50 As noted, conditions 8(a)(ii) and 10(b) relate only to Commonwealth's ultimate liability for payment of covered occurrences under the policies. Both conditions by their terms and placement are unrelated to the question of what constitutes a covered event under the policies. The conditions make Commonwealth's *liability* to tender payment for covered occurrences contingent upon enumerated circumstances. But Commonwealth cannot avail itself of these contractual limitations because it failed to timely appeal from the *Morris* Judgment, which decided all questions of liability in CMLC's favor. *Centerpoint I*, 238 Ariz. at 140 ¶ 19.

¶51 Because the *Morris* Judgment is final and binding against Commonwealth as to both the fact and amount of damages, our inquiry is limited to the question of coverage. *See Quihuis*, 235 Ariz. at 541 ¶ 13 (citing *Wood*, 209 Ariz. at 150 ¶ 37). In other words, the *Morris* Judgment renders conditions 8(a)(ii) and 10(b) inapplicable because they constitute defenses

to liability and not to coverage. Commonwealth may not relitigate the existence and extent of its payment *liability* for any covered occurrence "in the guise of a coverage defense." *Id.*

¶52 Thus, the superior court's interpretation of the policies impermissibly revived Commonwealth's extinguished liability defenses "in the guise of a coverage defense." *Id.* Accordingly, we vacate the court's grant of partial summary judgment in favor of Commonwealth on the breach of contract claims and remand to the court with instructions to enter summary judgment in favor of CMLC. On remand, we direct the court to award contract damages to CMLC in the amount of $10 million, pursuant to the limits of the combined Universal and VRCP policies. Given this resolution of the coverage (breach of contract) claim, we need not address CMLC's other arguments pertaining to this issue.

II. Motion in Limine – Collateral Source Rule

¶53 Generally, we review a court's admission of evidence for an abuse of discretion. *See Warner v. Sw. Desert Images, LLC*, 218 Ariz. 121, 133 ¶ 33 (App. 2008) (citing *Lewis v. N.J. Riebe Enters., Inc.*, 170 Ariz. 384, 396 (1992)). "If an evidentiary ruling is predicated on a question of law, however, we review that ruling *de novo*." *In re Conservatorship for Hardt*, 242 Ariz. 449, 452 ¶ 9 (App. 2017) (citation omitted).

¶54 CMLC argues that, in violation of Arizona's collateral source rule, the court erred in admitting evidence of loan repayments made to Universal and VRCP by their borrowers. In denying CMLC's motion in limine to preclude evidence of these loan repayments, the court determined that the payments were primary to the insurance relationship between Universal, VRCP, and Commonwealth, and therefore the collateral source rule was inapplicable to them. On appeal, as in its motion, CMLC contends evidence of payment from sources other than Commonwealth could not be introduced to "offset" Commonwealth's tort liability regarding the bad faith claims asserted against it.

¶55 The collateral source rule is usually applied in personal injury cases. *See Michael v. Cole*, 122 Ariz. 450, 452 (1979) (citing *Hall v. Olague*, 119 Ariz. 73 (App. 1978)). However, it has found application in some contract cases on a case-by-case basis. *John Munic Enters., Inc. v. Laos*, 235 Ariz. 12, 19 ¶ 23 (App. 2014). The rule is derived from the common law and has been defined in Arizona via the Restatement (Second) of Torts § 920A, which states that payments made by a tortfeasor (or by a person acting for him) to a person whom he has injured reduces the tortfeasor's liability. *See John*

Munic Enters., Inc., 235 Ariz. at 17 ¶ 14. But, payments made to the injured person from other sources—i.e., collateral sources—do not reduce the tortfeasor's liability. *Id.* This is true even though payments from collateral sources may cover all or part of the harm for which the tortfeasor is liable. *Id.* In other words, the "total or partial compensation for an injury which the injured party receives from a collateral source *wholly independent* of the wrongdoer does not operate to reduce the damages recoverable from the wrongdoer." *Hall*, 119 Ariz. at 73 (emphasis added). The justification for the rule is that the injured party should be made whole by the wrongdoer himself—who should not reap the benefit from expenditures made by the injured party or take advantage of contracts or other relations that may exist between the injured party and third persons. *Lopez v. Safeway Stores, Inc.*, 212 Ariz. 198, 206–07 ¶ 25 (App. 2006) (citation omitted).

¶56 We agree with the court's reasoning that the collateral source rule is inapplicable here. 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. *Hall*, 119 Ariz. at 73. As such, they were not independent, but an intrinsic and integral part of the same transaction underlying Commonwealth's policies. Therefore, the payments in question were not collateral and the rule does not apply.

¶57 CMLC seeks an inverted application of the rule, arguing that payments by the ML Investors—the borrowers on Universal's and VRCP's loans—should not reduce Commonwealth's liability for its bad faith refusal to pay claims under the policies. CMLC cites no Arizona authorities recognizing this application of the rule, nor has our search revealed any. To the contrary, neighboring jurisdictions appear to eschew such use of the rule. *See, e.g.*, *FDIC v. United Pac. Ins. Co.*, 20 F.3d 1070, 1083 (10th Cir. 1994) (applying Utah law in holding that even when an insurer has disputed its liability and refused payment of a claim, the collateral source rule should not be applied to prevent the insurer from receiving credit for a settlement with a separate party, provided both the settlement and the judgment represent common damages); *Leprino Foods Co. v. Factory Mut. Ins. Co.*, 653 F.3d 1121, 1135–36 (10th Cir. 2011) (applying Colorado law similarly). As the 10th Circuit Court of Appeals observes, secondary sources further bolster this position. *Leprino Foods Co.*, 653 F.3d at 1136 ("The collateral-source rule does not apply to exclude evidence of a settlement with a separate party relating to a loss on the same transaction, as the collateral-source rule does not prevent an insurer from receiving credit for settlement with a third party.") (quoting 22 Am. Jur. 2d *Damages* section 779).

¶58 We are persuaded that these authorities correctly express the law applicable here. Universal and VRCP received full repayment of their loans, including through the eventual sale of the Centerpoint Property made possible by settlement with the buyer and mechanics' lien claimants. None of the payors here can be said to be wholly independent from Commonwealth's relationship with Universal and VRCP. And with Commonwealth's liability for its bad faith remaining an outstanding question, evidence of the settlement was properly submitted for consideration by the jury, so that it could properly inform itself when weighing damages.

III. Jury Instructions

A. Punitive Damages

¶59 CMLC argues the court erred by denying its motion for directed verdict concerning a punitive damages award jury instruction, when the evidence showed Commonwealth acted with an "evil mind." That is, Commonwealth acted to serve its own financial interests, having reason to know—and consciously disregarding a substantial risk—that its conduct might significantly injure the rights of Universal and VRCP. We review de novo a court's ruling on a motion for directed verdict. *Dawson v. Withycombe*, 216 Ariz. 84, 95 ¶ 25 (App. 2007).

¶60 Insurance bad faith arises out of the insurer's duty of good faith and fair dealing. *Cavallo v. Phx. Health Plans, Inc.*, 250 Ariz. 525, 530–31 ¶ 15 (App. 2021), *vacated in part on other grounds*, 254 Ariz. 99 (2022). In every insurance contract, there is an implied legal duty obligating the insurer to act in good faith, which requires the "insurer treat its insured fairly in evaluating claims." *Id.* (citing *Deese v. State Farm Mut. Auto. Ins. Co.*, 172 Ariz. 504, 507 (1992)). The insurer owes the insured fiduciary-like duties, including "equal consideration, fairness[,] and honesty." *Lennar Corp. v. Transamerica Ins. Co.*, 227 Ariz. 238, 242 ¶ 8 (App. 2011) (citing *Zilisch v. State Farm Mut. Auto Ins. Co.*, 196 Ariz. 234, 237 ¶ 20 (2000)). Bad faith occurs when an insurance company intentionally, without a reasonable basis for doing so, delays or fails to pay a claim. *See Tritschler*, 213 Ariz. at 516 ¶ 32 (citing *Noble v. Nat'l Am. Life Ins. Co.*, 128 Ariz. 188, 190 (1981)); *see also Zilisch*, 196 Ariz. at 237 ¶ 20. Further, an insurer has an obligation to "immediately conduct an adequate investigation, act reasonably in evaluating the claim, and act promptly in paying a legitimate claim." *Lennar Corp.*, 227 Ariz. at 242 ¶ 9 (quoting *Zilisch*, 196 Ariz. at 238 ¶ 21). The insurer should not jeopardize the insured's security under the policy, force an insured to go through needless adversarial hoops to vindicate its rights

under the policy, or lowball or delay claims hoping that the insured will settle for less. *Id.* "Equal consideration of the insured requires more than that." *Id.*

¶61 Here, the jury found Commonwealth's conduct regarding Universal's and VRCP's claims constituted bad faith. But punitive damages may not be awarded "unless the evidence reflects 'something more' than the conduct necessary to establish the tort" of bad faith. *Rawlings v. Apodaca*, 151 Ariz. 149, 161 (1986). The standard is high. "We begin with the premise that punitive damages serve two functions: punishment and deterrence." *Swift Transp. Co. of Arizona L.L.C. v. Carman in & for Cnty. of Yavapai*, 253 Ariz. 499 ¶ 20 (2022). Punitive damages may be awarded only when a plaintiff can prove that the "defendant's evil hand was guided by an evil mind." *Rawlings*, 151 Ariz. at 162. Our supreme court has recently clarified that an "evil hand" is established by proving "that the defendant engaged in tortious conduct of any kind, intentional or negligent . . . ." *Swift Transp. Co.*, 253 Ariz. at ¶ 22. Establishing an "evil mind," however, requires a plaintiff to show by "clear and convincing evidence that the defendant's actions either (1) intended to cause harm, (2) were motivated by spite, or (3) were outrageous, creating a 'substantial risk of tremendous harm to others.'" *Id.* (quoting *Volz v. Coleman Co., Inc.*, 155 Ariz. 567, 570–71 (1987)). An evil mind can be inferred if the conduct is sufficiently "oppressive, outrageous or intolerable." *Rawlings*, 151 Ariz. at 162–63.

¶62 A directed verdict denying punitive damages is appropriate only "if no reasonable jury could find the requisite evil mind by clear and convincing evidence." *Thompson v. Better-Bilt Aluminum Prods. Co.*, 171 Ariz. 550, 558 (1992). In ruling, the non-movant's evidence is to be believed and all justifiable inferences drawn in his favor. *Id.* Even though single pieces of evidence taken alone might not satisfy this burden, several pieces taken together may be enough to survive a directed verdict. *Id.*

¶63 Here, evidence established that Commonwealth knew about the mechanics' liens recorded against the Centerpoint Property at the time it issued policies to Universal and VRCP in 2010. Despite this knowledge, Commonwealth refused to settle with Universal and VRCP when they submitted claims based on the impairment of the priority of their deeds of trust in the Centerpoint Property caused by these mechanics' liens. Instead, Commonwealth refused to withdraw its reservation of rights, without a legitimate basis for doing so. Indeed, the February 2011 memo indicates Commonwealth failed to negotiate a settlement in good faith in order to manufacture defenses against Universal and VRCP and/or a more favorable settlement position. Thus, Commonwealth failed to provide the

very protection it contracted for under its policies to exalt its own financial interests.

¶64 We cannot say as a matter of law that a reasonable jury could not find by clear and convincing evidence that Commonwealth exhibited the requisite evil mind, given these facts. As such, the court's refusal to instruct the jury on punitive damages in this case was error and we reverse the denial of CMLC's motion for directed verdict regarding a punitive damage's instruction. We remand and direct the court to hold a limited trial concerning Commonwealth's liability for punitive damages.

B. Contract vs. Tort Damages Instruction

¶65 CMLC argues the court erred by denying CMLC's request for a supplemental instruction explaining the difference between tort damages and contract damages. Specifically, the requested instruction stated that the jury could award CMLC damages arising from the diminution in value of the deeds of trusts held by Universal and VRCP as security for its loans, which was caused by the mechanics' liens.

¶66 We review the court's refusal to give a requested jury instruction for an abuse of discretion and will not reverse if the requesting party fails to show resulting prejudice. *Dupray v. JAI Dining Servs. (Phx.), Inc.*, 245 Ariz. 578, 585 ¶ 22 (App. 2018). We review jury instructions as a whole, viewing the evidence in the light most favorable to the requesting party. *Id.* The court must give a requested jury instruction if "(1) the evidence supports the instruction, (2) the instruction is proper under the law, and (3) the instruction pertains to an important issue, and the gist of the instruction is not given in any other instructions." *Id.* (citing *Brethauer v. Gen. Motors Corp.*, 221 Ariz. 192, 198 ¶ 24 (App. 2009).

¶67 The final jury instruction on damages read, in relevant part:

> If you find that Commonwealth is liable to CMLC on the bad faith claim, you must then decide the full amount of money that will reasonably and fairly compensate CMLC for any monetary damage or loss experienced resulting from Commonwealth's breach of the duty of good faith and fair dealing.

¶68 The court's instruction, based upon the standard Revised Arizona Jury Instructions (Civil) 6th, Bad Faith 7 (First-Party) Instructions, permitted the jury to award CMLC "for any monetary damage or loss" it experienced because of Commonwealth's bad faith. Despite the broad

instruction, CMLC requested a supplemental jury instruction of its own creation.

¶69 Our review of CMLC's requested instruction shows the court's damages instruction already captured the substance requested. And in any event, the court's rejection of its requested instruction did not prevent CMLC from arguing, at length, in its closing that Universal and VRCP purportedly suffered damages of $19.5 million due to Commonwealth's bad faith. Thus, CMLC was permitted to explain the nature and source of its damages, the jury received an adequate instruction, and the court did not abuse its discretion by refusing to include the supplemental jury instruction.

IV. Renewed Motion for Judgment as a Matter of Law

¶70 We review de novo the court's denial of a motion for judgment as a matter of law made pursuant to Rule 50. *Nardelli v. Metro. Grp. Prop. & Cas. Ins. Co.*, 230 Ariz. 592, 597 ¶¶ 17–18 (App. 2012). We will uphold the ruling unless "the facts produced in support of the claim or defense have so little probative value, given the quantum of evidence required, that reasonable people could not agree with the conclusion advanced by the proponent of the claim or defense." *A Tumbling-T Ranches*, 222 Ariz. at 524 ¶ 14 (citing *Orme Sch. v. Reeves*, 166 Ariz. 301, 309 (1990)). In making this determination, "we view the evidence in a light most favorable to upholding the jury verdict and will affirm if any substantial evidence exists permitting reasonable persons to reach such a result." *Id.* (internal quotation marks omitted).

¶71 As noted above, Commonwealth filed a motion for judgment as a matter of law after trial. It argued in this motion that the jury's award of damages on CMLC's bad faith claim was error because Universal's and VRCP's loans had been repaid. Commonwealth argues on appeal, as it did in its motion, the evidence unequivocally establishes this repayment, and therefore, as a matter of law, the failure to prove any harm means Commonwealth cannot be liable for any damages because of its bad faith. However, trial evidence and the parties' briefs make clear that there was genuine disagreement as to whether Universal's and VRCP's loans were repaid.

¶72 For example, at trial, CMLC argued Universal and VRCP suffered $19.5 million in damages because of Commonwealth's bad faith. CMLC argued the value in Universal's and VRCP's deeds of trust against the Centerpoint Property diminished to zero because of the mechanics'

liens. CMLC further argued that because Commonwealth refused to indemnify, Universal and VRCP were compelled to accept more risky and less favorable terms when the October 2010 sale of the Centerpoint Property failed due to the impairment of title from the mechanics' liens. Among other things, Universal and VRCP were required to subordinate their deeds of trust and waive portions of their claims to induce the buyers to complete their purchase of the Centerpoint Property. Thus, CMLC argued it was entitled to $19.5 million in damages, comprising CMLC's lost recovery from the failed October 2010 sale of the Centerpoint Property.

¶73 In response, Commonwealth pointed to a final revised closing statement for the sale of the Centerpoint Property, dated February 24, 2011, that indicated $4,167,996.38 from the sale proceeds of the Centerpoint Property would be paid to Universal and $5,883,799.78 would be paid to the *partners* of VRCP for their partnership interests in VRCP. Commonwealth also highlighted an earlier draft closing statement identifying the $5,883,799.78 figure to VRCP as a "payoff" and, according to witness testimony, this figure closely matched the full amount owed under the VRCP loan as of February 2011. And undisputed testimony established that by the end of 2011, the Universal loan was fully repaid from other security.

¶74 CMLC responded that the money it received was more properly characterized as payment for the acquisition of Universal's and VRCP's claims—not as repayment of their loans. CMLC points to witness testimony showing that sale proceeds from the Centerpoint Property were merely utilized by CP2 to acquire Universal's and VRCP's insurance claims against Commonwealth, as well as to purchase partnership interests in VRCP. The signed agreement for the sale and purchase of partnership interests in VRCP between CP2 and VRCP (among others), which documented this contention, was admitted at trial. And at oral argument before this court, CMLC's counsel highlighted that the reason the characterization of the payment to VRCP as a "payoff" in the draft closing statement was removed from the final version was because VRCP objected to it as an incorrect characterization of the payment.

¶75 In the end, the two parties' arguments demonstrate that both characterizations of the trial evidence were supported by reasonable evidence, and they presented a conflicting issue that the fact finder was required to resolve. The jury ultimately resolved the conflicting evidence by awarding $5 million in damages to CMLC for Commonwealth's bad faith. This award was within the range of damages presented by the parties' evidence. Given the legitimate dispute as to the facts, the jury was well

within its authority to resolve the conflict by making this award, and we will not reweigh the evidence to contradict the jury's findings. *A Tumbling-T Ranches*, 222 Ariz. at 524 ¶ 14. The court did not err in denying Commonwealth's renewed motion for judgment as a matter of law. And Commonwealth's further contention that trial evidence did not demonstrate its bad faith—and thus the court should have granted its renewed motion—is conclusory and without merit.

V. Attorneys' Fees

A. In the Superior Court

¶76 "'[A]n award of attorneys' fees is left to the sound discretion of the trial court and we will not overturn such an award unless the trial court abused its discretion.'" *Tucson Ests. Prop. Owners Ass'n v. Jenkins*, 247 Ariz. 475, 478 ¶ 8 (App. 2019) (quoting *A. Miner Contracting, Inc. v. Toho-Tolani Cnty. Improvement Dist.*, 233 Ariz. 249, 261 ¶ 40 (App. 2013)). "To find an abuse of discretion, there must either be no evidence to support the superior court's conclusion or the reasons given by the court must be 'clearly untenable, legally incorrect, or amount to a denial of justice.'" *Id.* (quoting *Charles I. Friedman, P.C. v. Microsoft Corp.*, 213 Ariz. 344, 350 ¶ 17 (App. 2006)).

¶77 The superior court awarded reduced attorneys' fees, concluding CMLC was unsuccessful on its breach of contract claims. CMLC requests that we direct the court to award additional fees for the contract claims. Inasmuch as the superior court denied fees based solely upon CMLC's failure to prevail on its breach of contract claims, this was error. However, although we resolve the breach of contract claims in favor of CMLC, the award of fees pursuant to A.R.S. § 12-341.01(A) is discretionary. In our discretion, we vacate the court's award of fees to CMLC and direct the superior court to reconsider the issue of attorneys' fees on remand consistent with this opinion.

B. On Appeal

¶78 Both parties have requested an award of their attorneys' fees on appeal pursuant to A.R.S. § 12-341.01(A) and Arizona Rule of Civil Appellate Procedure 21. Our opinion here will require significant additional proceedings before the superior court. Therefore, in our discretion, we decline to award attorneys' fees at this stage, but the superior court may reconsider any requests for fees on remand, including fees incurred in this appeal, pending the outcome of this litigation. *See Eans-*

Snoderly v. Snoderly, 249 Ariz. 552, 559 ¶ 27 (App. 2020). But, we award CMLC its costs on appeal upon its compliance with ARCAP 21.

CONCLUSION

¶79 We affirm in part and reverse and remand in part as explained.

AMY M. WOOD • Clerk of the Court
FILED: AA