IN THE SUPREME COURT

STATE OF ARIZONA

RICHARD GRAND and MARCIA GRAND, co-trustees of the R. M. Grand Revocable Living Trust, dated January 25, 1991, Plaintiffs-Respondents, v. JOSEPH P. NACCHIO, a New Jersey resident; JOHN A. McMASTER, a New Jersey resident; QWEST COMMUNICATIONS INTERNATIONAL INC., a Delaware corporation; and QWEST B.V., a foreign organization, Defendants-Petitioners.	No. CV-07-0041-PR Court of Appeals No. 2 CA-CV 2006-0033 Pima County Superior Court No. C20025348

AMICI CURIAE BRIEF OF CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND ARIZONA CHAMBER OF COMMERCE AND INDUSTRY IN SUPPORT OF PETITION FOR REVIEW

Thomas L. Hudson (014485)
Maureen Beyers (017134)
Sara S. Greene (022706)
Osborn Maledon PA (00196000)
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012-2794
(602) 640-9000
Attorneys for Chamber of Commerce of the United States of America and Arizona Chamber of Commerce and Industry

Robin S. Conrad (*Pro Hac Vice Pending*)
National Chamber Litigation Center, Inc.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337
Attorneys for Chamber of Commerce of the United States of America

IN THE SUPREME COURT

STATE OF ARIZONA

RICHARD GRAND and MARCIA GRAND, co-trustees of the R. M. Grand Revocable Living Trust, dated January 25, 1991,	)	No. CV-07-0041-PR
Plaintiffs-Respondents,	)	Court of Appeals No. 2 CA-CV 2006-0033
v.	)	
JOSEPH P. NACCHIO, a New Jersey resident; JOHN A. McMASTER, a New Jersey resident; QWEST COMMUNICATIONS INTERNATIONAL INC., a Delaware corporation; and QWEST B.V., a foreign organization,	)	Pima County Superior Court No. C20025348
Defendants-Petitioners.	)	

AMICI CURIAE BRIEF OF CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AND ARIZONA CHAMBER OF COMMERCE AND INDUSTRY IN SUPPORT OF PETITION FOR REVIEW

Thomas L. Hudson (014485)
Maureen Beyers (017134)
Sara S. Greene (022706)
Osborn Maledon PA (00196000)
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012-2794
(602) 640-9000
Attorneys for Chamber of Commerce of the United States of America and Arizona Chamber of Commerce and Industry

Robin S. Conrad (*Pro Hac Vice Pending*)
National Chamber Litigation Center, Inc.
1615 H Street, N.W.
Washington, D.C. 20062
(202) 463-5337
Attorneys for Chamber of Commerce of the United States of America

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

INTRODUCTION

This case raises whether a plaintiff may recover losses caused by a general market decline (rather than from any alleged fraud), *regardless* of whether the plaintiff actually purchased the stock from the defendant, *regardless* of whether the plaintiff still owns the stock, and *regardless* of whether the plaintiff actually suffered *any loss* due to the alleged fraud. To our knowledge, no court anywhere has previously interpreted any state or federal statute (or the common law) to permit such windfall recoveries – recoveries that may well come at the expense of those actually harmed by the alleged fraud. The Court of Appeals nevertheless held that a plaintiff may recover such losses, and in doing so has incorrectly decided important issues of law that will impact not just Arizona-based companies, but *every* company that does business in Arizona. Given Arizona's strong interest in developing a robust economy that treats both investors and businesses fairly – combined with the broader implications of the Court of Appeals Opinion (the "**Opinion**") – this case presents a paradigm example of the kind of case that warrants review. For these and other reasons, the Chamber of Commerce of the United States of America and the Arizona Chamber of Commerce and Industry urge the Court to grant the Petition for Review.

REASONS THE COURT SHOULD GRANT THE PETITION

I. The Court of Appeals Decision, Which Allows Plaintiffs to Recover Losses Not Proximately Caused by Defendants, Results in a Number of Inequities and Creates Bad Policy

As Arizona law now stands under the Court of Appeal's Opinion, a plaintiff who allegedly overpaid *any* amount for stock due to a defendant's alleged fraud but never suffered *any loss* proximately caused by the alleged fraud, may recover the full value of losses caused by *a general market decline*. For example, a plaintiff could pay $100/share for stock, and sell the stock for $50/share after a general market decline. If the company *subsequently* revises its financial statements and the stock declines to $49/share (and would have been worth only $99/share before the market decline in the absence of any fraud), the investor may, under the Opinion, recover a $50/share *market loss* brought about by nothing more than ordinary market risks.[1]

A rule that allows investors to recover such market losses will inevitably cause myriad perverse effects on capital markets and the larger economy, and potentially harm the very victims the securities laws intend to protect. Three of these perverse effects include the following. First, although investors ordinarily have strong incentives to assess whether the potential rewards genuinely justify the

[1] Although this example may seem extreme, such dramatic price swings are hardly far-fetched; this case, for example, arose out of the "dot-com" bust, which resulted in the NASDAQ declining 73% in just ten months.

potential risks, the Opinion skews the normal risk/reward dynamic by effectively providing insurance against the negative consequences of risky activity. *Cf. Dura Pharms. v. Broudo*, 544 U.S. 336, 345 (2005) (noting that federal securities statutes are not meant to "provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause"); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1447 (11th Cir. 1997) (same).

Encouraging risky investments by promulgating what amounts to court-dictated insurance for speculators will cause unwanted distortions to the market. *Cf. May Dep't Stores Co. v. Federal Ins. Co.*, 305 F.3d 597, 601 (7th Cir. 2002) (noting the general problem of "moral hazards" that results from "the incentive that insurance can give an insured to increase the risky behavior covered by the insurance"). One obvious distortion will occur when issuers, suddenly transformed into uncompensated insurers, respond to their losing side of the deal. Market participants like investment banks and others will have a new and strong disincentive to undertake or participate in securities transactions.

Second, permitting investors to recover market losses that are not proximately caused by any alleged fraud will exacerbate the already intense pressure on companies to settle groundless securities fraud actions. Securities fraud litigation has always presented "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739 (1975). The high-stakes nature of securities litigation thus often causes businesses to settle even meritless suits. *See Goldberger v. Integrated Res. Inc.*, 209 F.3d 43, 52 (2d Cir. 2000) (citing Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 578 (1991)).

No doubt investors who can prove fraud should be compensated for their losses proximately caused by the fraud. But rules that compel companies to settle meritless actions drain the economy, without compensating the true victims of securities fraud. Left intact, the Opinion will exacerbate this problem by (1) drastically upping the stakes after any market decline, and (2) eliminating any means for weeding out at the pleading stage suits where the alleged fraud or wrongdoing had no real-world effect on share price, and thus created no demonstrable harm to the plaintiffs. As it stands, if a stock's price declines, speculators can sue, and likely obtain a significant settlement, merely by alleging that the defendant made a "misleading" statement – and do so even if (1) they sold the stock before any corrective disclosure impacted the stock price, or (2) the corrective disclosure had no influence on the stock price.

Third, because the Opinion allows plaintiffs to recover (via substitute tender) market losses regardless of whether they still own the stock, regardless of the magnitude of the loss, and regardless of any connection between the loss and the nature or extent of the alleged fraud, the Opinion allows investors who suffered *no loss* proximately caused by the defendant's fraud to reap a windfall that may come at the expense of those who actually suffered losses due to the alleged fraud. Between the time of a securities offering and an issuer's corrective public disclosure, thousands of shareholders may have bought and sold the issuer's stock numerous times. A much smaller number of investors may own the stock at the time of the corrective disclosure, and only *they* will have suffered a loss due to the alleged misrepresentation. *See Dura Pharms.*, 544 U.S. at 342 ("as a matter of pure logic . . . [if a] purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss"). Yet *all other investors* who ever owned the stock may, by invoking the Opinion's substitute tender rule, assert a claim entitling the investors to recover their market losses.

Given that the total number of shares owned by the various investors over time will necessarily exceed the total shares available at any given time (due to trading), identically situated former shareholders will be treated differently depending on who most quickly races to the courthouse and re-purchases substitute shares.[2] Even worse, a past shareholder who has suffered no harm or loss due to a defendant's conduct may recover significant monetary sums from the defendant (as in this case), meaning that those plaintiffs who actually suffered a loss proximately caused by a defendant's misrepresentations may, in the end, recover nothing; those recovering for general *market* declines may leave the defendant's pockets empty.

II. The Opinion Will Harm Arizona by Encouraging Investors Anywhere in the World to File Actions Here

The Opinion raises fundamental questions of fairness and equity. Different shareholders may receive compensation that bears no relationship to the losses they incurred. Similarly, the amounts defendants will be forced to pay will (1) have nothing to do with the amount (if any) of their unjust enrichment, (2) be wildly unpredictable, and (3) bear no relationship whatsoever to the harm caused by any wrongdoing.

But these inequities, which translate into potential windfalls for investors, will likely make Arizona the new favored forum for securities litigation. Individual investors living anywhere in the world can assert a claim against *any* company with the requisite minimal contacts necessary for personal jurisdiction – virtually any company doing business in Arizona. *See* A.R.S. § 44-2001(A)

---

[2] Although the Opinion's elimination of the tender requirement via equitable considerations may allow all former shareholders to pursue a claim (Op. ¶ 64), this exposes a defendant to limitless liability for losses not proximately caused by the alleged fraud.

(limiting parties only to a "court of competent jurisdiction"); *A. Uberti and C. v. Leonardo*, 181 Ariz. 565, 569, 892 P.2d 1354, 1358 (1995) (personal jurisdiction in Arizona permitted "to the maximum extent allowed by the federal constitution"); *see, e.g., Standard Chartered PLC v. Price Waterhouse,* 190 Ariz. 6, 12, 945 P.2d 317, 323 (App. 1997) (British banking corporation and its subsidiaries brought action under the Arizona securities laws against national accounting firm). Moreover, although the Securities Litigation Uniform Standards Act of 1998 ("**SLUSA**") eliminated most securities class action litigation in state courts, it reserved for state jurisdiction securities class actions against companies in the state where the company is incorporated. *See Malone v. Brincat*, 722 A.2d 5, 13 (Del. 1998) (SLUSA "preserves the availability of state court class actions, where state law already provides that corporate directors have fiduciary disclosure obligations to shareholders"). Accordingly, Arizona corporations now face a threat of state class action litigation different from companies incorporated elsewhere. New companies, of course, will recognize this potential competitive disadvantage, and have a strong incentive to incorporate elsewhere.

Given Arizona's economy and demographics, the Opinion creates an unnecessary economic stumbling block in Arizona's path to growth. Arizona is no longer an outpost with an economy driven by "the Five Cs" – cotton, copper, cattle, citrus and climate. *See* Arizona Dept. of Commerce, *Arizona's Economic*

Future, Aug. 2002, at 5-9. Arizona's new economy needs the "economic policies and programs" to attract and retain traded sector jobs, including the science, engineering and medical technology businesses. Greater Phoenix Leadership, *Making Arizona Competitive in Science, Engineering and Medical Research and Innovation: Understanding the Pathway to Success,* Nov. 2006, at 16.[3] The faultless liability crafted by the Opinion does just the opposite, and, as is explained below, goes well beyond anything ever intended by the Legislature or the common law.

III. The Opinion's Inequitable and Anomalous Results Are a Consequence of Disregarding Plain Statutory Language and Misapplying Common Law Principles

Much of the mischief caused by the Opinion results from its evisceration of the loss causation rule via rescission and substitute tender.[4] Neither A.R.S. § 44-2001 nor the common law, however, permits rescission, substitute tender, or "rescissory damages" under the circumstances of this case.

---

[3] Arizona has been trying to do this with other measures. *See, e.g.,* Angel Investor Tax Credit, A.R.S. § 41-1518 (aids early-staged companies in attracting capital investments).

[4] Although the Response seems to suggest (at 5) that the Petition does not raise the issue of rescission or substitute tender, the Petition raises whether an investor may recover losses not caused by the alleged fraud, and the Opinion holds that such losses can be recovered through seeking rescission by making "substitute tender." The correctness of the Opinion's "substitute tender" holding is thus at the very center of the issue raised by the Petition, and both the Petition and Response have briefed the issue.

A. A.R.S. § 44-2001(A) Unambiguously Limited Plaintiffs to a Damages Claim

The sole cause of action for a purchaser who wishes to bring suit for a violation of A.R.S. § 44-1991 is set forth in A.R.S. § 44-2001(A). Section 44-2001(A) provides two mutually exclusive remedies that depend upon whether the purchaser still owns the securities:

> A sale or contract for sale of any securities to any purchase [in violation of securities law] is voidable at the election of the purchaser, and the purchaser may bring an action in a court of competent jurisdiction to recover the consideration paid for the securities . . . on tender of the securities purchased or the contract made *or for damages if the purchaser no longer owns the securities.*

A.R.S. § 44-2001(A) (emphasis added). Thus, under the statute's plain language, a purchaser who "no longer owns the securities" must pursue damages. Indeed, the Court of Appeals acknowledged in another part of the Opinion that "[u]nder § 44-2001(A), if a plaintiff 'no longer owns the securities,' his or her only recourse is to bring an action for damages." (*See* Op. ¶ 62.) The Opinion also correctly recognized that any action for "damages" is necessarily subject to the loss causation requirement enacted in the 1996 Arizona Private Securities Litigation Reform Act, found at A.R.S. § 44-2082(E). (Op. ¶ 60, 62.)

Despite the statute's clear requirement that plaintiffs "who no longer own the securities" must seek "damages," the Opinion concluded that under A.R.S. § 44-2001(A), a plaintiff may recover the consideration paid for shares purchased (and sold) long ago by tendering new "substitute" shares. (Op. ¶ 48.) But the statute limits a party seeking restitution to "the consideration *paid for the securities . . . on tender of the securities*." A.R.S. § 44-2001(A) (emphasis added). By specifically limiting the recovery to the consideration paid for the tendered securities, the statute precludes a party from tendering "the securities," and recovering consideration paid for *different* securities. The Opinion erroneously construed the identical term "the securities" to mean two entirely different things. *Cf. State v. Oehlerking*, 147 Ariz. 266, 268, 709 P.2d 900, 902 (App. 1985) ("Where the same words or phrases appear in the same statute, they should be given a consistent meaning unless there is a clearly expressed legislative intent to the contrary.").

The Court of Appeals deviated from the plain language on the basis of two pre-World War II cases from other states and *Baker v. Walston & Co.,* 7 Ariz. App. 590, 442 P.2d 148 (1968). (*See* Op. ¶¶ 39, 42.) The out-of-state cases did not purport to interpret A.R.S. § 44-2001 or any similar statute, and were decided in completely different contexts having nothing to do with loss causation. And, contrary to Plaintiffs' contention (Resp. at 9), *Baker* did *not* hold that a plaintiff seeking rescission under A.R.S. § 44-2001(A) may do so even where the plaintiff no longer owns shares, and thus cannot tender the shares; it said only in dicta in a footnote that a plaintiff must "elect" a remedy. 7 Ariz. App at 591 n.1, 442 P.2d at

149 n.1. Given this Court's repeated emphasis that a statute's clear and unequivocal language must control, the statute's clear language here should have ended the inquiry. *Cf. Deer Valley Unified Sch. Dist. No. 97 v. Houser*, 214 Ariz. 293 ¶ 8, 152 P.3d 490 (2007) (plain language controlled); *Parrot v. DaimlerChrysler Corp.*, 212 Ariz. 255, 257, 130 P.3d 530, 532 (2006) (same).

B. The Court of Appeals Erred by Applying a Restitution Analysis Although There Was No Underlying Transaction Between the Parties

In addition to erroneously holding that the Plaintiffs could seek rescission via substitute tender under Arizona's security statutes, the Court of Appeals held that the Plaintiffs could seek rescission (using substitute tender or elimination of the tender requirement) pursuant to the tort claims alleged (breach of fiduciary duty and fraudulent concealment), and Arizona's Consumer Fraud Act. (Op. ¶ 6.) Although Plaintiffs argue that the Opinion merely "followed and applied" settled precedent to reach these holdings (Resp. at 5), there is no authority anywhere – let alone any Arizona authority – that has ever allowed an investor to avoid the loss causation rule via the mechanism of rescission and substitute tender in a case like this.

1) The Opinion Improperly Applies Contract Principles to the Tort Claims

The Opinion explains that rescission is available "as a remedy" for fraudulent concealment and that "damages are not [an] element of [a] rescission claim based on misrepresentation." (Op. ¶ 27 & n.5.) However, by holding that a party need not prove damages (or the amount of damages) in connection with pursuing rescission on the basis of the tort claims alleged here, the Opinion confuses tort and contract principles. For example, the Opinion cites *Lehnhardt v. City of Phoenix,* 105 Ariz. 142, 144, 460 P.2d 637, 639 (1969), for its conclusion that "proof of proximate cause is not required for traditional rescission relief." (Op. ¶¶ 51, 65.) But *Lehnhardt* involved the application of *contract principles* (specifically the Restatement of Contracts § 476 (1932)) to rescind a quitclaim deed transaction. *Id.*[5]

As the authorities the Court of Appeals relied upon show, although a party may generally rescind a *contract transaction* without proving proximate cause and damages, that contract principle has no application to the tort and consumer fraud claims alleged here as they do not arise out of an underlying transaction between the parties.[6] Indeed, a rescission is, by definition, "an avoidance of *a*

---

[5] Section 476 of the Restatement of Contracts reads in pertinent part: "(1) Where a party is induced to enter into a transaction with another party that he was under no duty to enter into by means of the latter's fraud or material misrepresentation, the transaction is voidable as against the latter, and all who stand in no better position."

[6] The other authorities cited by *Lehnhardt* likewise concern this unrelated contract principle and fraud in connection with an underlying contract *between the parties. See Prudential Ins. Co. of Am. v. Anaya*, 428 P.2d 640, 643 (N.M. 1967) (if a misrepresentation is "material to the contract, then it makes no difference whether the party acted fraudulently, negligently, or innocently"); *Lanners v.*

transaction."[7] The Court of Appeals even acknowledged that rescission "contemplates the 'undoing of the transaction,' whereby each party gives back to the other what it parted with in the original transaction." (Op. ¶ 27 (citation omitted).) Yet, it applied rescission and substitute tender in this case notwithstanding that the *Defendants never engaged in a transaction with the Plaintiffs*.

This lack of transaction between the parties likewise renders the Court of Appeals' application of "substitute tender" on the basis of the Restatement of Restitution inappropriate. The Defendants, never having engaged in any transaction with Plaintiffs, had no gains to give up in "restitution." Indeed, although rescission may, in certain limited circumstances, be available as an *alternative remedy* in connection with certain tort claims, the availability of that remedy presupposes the existence of a transaction involving some gain to the

---

Whitney, 428 P.2d 398, 402 (Or. 1967) (noting the innocent representation rule applicable to "the rescission of a contract"); *see also Berry v. Robotka*, 9 Ariz. App. 461, 453 P.2d 972 (1969); *Horne v. Timbanard*, 6 Ariz. App. 518, 520, 434 P.2d 520, 522 (1967); *Miller v. Boeger*, 1 Ariz. App. 554, 558, 405 P.2d 573, 577 (1965); *Watkins v. Grady County Soil & Water Conservation Dist.*, 438 P.2d 491, 495 (Okla. 1968).

[7] 1 Dan B. Dobbs, *The Law of Remedies* § 4.3(b) at 614 (2d ed. 1993) (emphasis added); *see also Reed v. McLaws*, 56 Ariz. 556, 562-63, 110 P.2d 222, 225 (1941) ("To rescind a contract is . . . to abrogate and undo it from the beginning; that is . . . [to] restore the parties to the relative positions which they would have occupied if no such contract had ever been made."). As Professor Dobbs notes, rescission is the undoing of the transaction, which often leads to "restitution" – taking away the defendant's gains.

defendant that came at the plaintiff's expense. *See* Restatement (Second) of Torts § 549 cmt. e (1977).

Moreover, in the context of the torts alleged here, the availability of the alternative remedy requires establishing the requisite tort *liability*, which requires proof of harm proximately *caused* by the alleged tort. *See* Restatement (Second) of Torts § 548A (setting forth legal causation requirement for fraudulent misrepresentation); *AMERCO v. Shoen,* 184 Ariz. 150, 156, 907 P.2d 536, 542 (App. 1995) (action for breach of fiduciary duty requires showing causation and damages); *Fromkin*, 196 Ariz. at 228 ¶ 19, 994 P.2d at 1043 ("damage is an element of the cause of action for consumer fraud when suit is brought by a private party") (citing cases). As another Restatement comment clarifies, there is "no liability" when the value of stock declines, not as a result of a defendant's misrepresentation, but rather as a result of other market factors unrelated to the fraudulent misrepresentations. Restatement (Second) of Torts § 548A cmt. b (1977).[8]

---

[8] The Court of Appeals also noted *Fromkin's* observation that "damage is not an element of securities fraud." (Op. ¶ 27.) But *Fromkin* made clear that this exception applies only to "statutory securities fraud," not common law fraud claims. *Aaron v. Fromkin*, 196 Ariz. 224, 227 ¶ 13, 994 P.2d 1039, 1042 (App. 2000).

2) The Court Improperly Suggested Rescission and Substitute Tender Would Be Appropriate Notwithstanding the Severe Market Decline Caused by Neutral Forces

The Court of Appeals further erred (and exacerbated the problems identified in Section I) by allowing rescission and substitute tender without proof of loss causation because the property subject to tender had already dramatically declined in value for reasons unrelated to the alleged fraud. As Professor Dobbs has explained, rescission should not be available, absent proximate cause, where the tendered property has depreciated through no fault of the defendant but rather through "neutral forces, extraneous to the defendant's misrepresentation." 2 Dan B. Dobbs, *The Law of Remedies* § 9.3(3) at 588-89 (2d ed. 1993) (attached hereto). Although Professor Dobbs acknowledges that not all authorities have adopted this view, it is the better reasoned view – particularly in the context of publicly traded securities where the only issues are *economic* ones. As this case illustrates, rescission in the securities context is merely a vehicle to recoup market losses, and thus the very reasons that counsel in favor of requiring proximate cause to recover damages weigh in favor of requiring proximate cause to recoup market losses under the guise of "rescission."

Both the Court of Appeals and Plaintiffs nevertheless suggest that a qualification Professor Dobbs acknowledges renders the general rule inapplicable in this case – that returning depreciated property for "restoration" may be appropriate where the fraud was such that "plaintiff would not have entered [into the transaction] at any price if he had known the truth." *Id.* But that *narrow* exception covers only those transactions that would not have occurred "at any price" absent the alleged fraud. As Professor Dobbs explains, "[w]hen the fraud seems more likely to have affected only the price a buyer would pay," as in this case, "the 'proximate cause' limitation seems sound, and with it the requirement of full-value restoration." *Id.* at 589.

CONCLUSION

The Opinion incorrectly decided significant issues of statewide importance. The Court should therefore grant the Petition.

RESPECTFULLY SUBMITTED this 19th day of April, 2007.

OSBORN MALEDON, P.A.

By ______________________

Thomas L. Hudson
Maureen Beyers
Sara S. Greene
2929 North Central Avenue, Suite 2100
Phoenix, Arizona 85012-2794
Attorneys for Chamber of Commerce of the United States of America and Arizona Chamber of Commerce and Industry

Robin S. Conrad (*Pro Hac Vice Pending*)
National Chamber Litigation Center, Inc.
1615 H Street, N.W.
Washington, D.C. 20062
Attorneys for Chamber of Commerce of the United States of America

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 14 of the Arizona Rules of Civil Appellate Procedure, I certify that the attached brief uses proportionally spaced typeface of 14 points or more, is double spaced using a Times New Roman font and contains 3,766 words.

Dated this 19th day of April, 2007.

Thomas L. Hudson

CERTIFICATE OF SERVICE

The undersigned has filed and served this Amici Curiae Brief this 19th day of April, 2007, as follows:

Original and seven (7) copies filed:

Clerk
Arizona Supreme Court
1501 West Washington
Phoenix, Arizona 85007-3329

Two (2) copies mailed and served by U. S. Mail to each of the following:

Tom Galbraith
Meyer, Hendricks & Bivens, P.A.
3003 North Central Avenue, Suite 1200
Phoenix, Arizona 85012-2915
Attorneys for Plaintiffs-Respondents

Michael J. Meehan
Munger Chadwick
33 North Wilmot, Suite 300
Tucson, Arizona 85711
Attorneys for Plaintiffs-Respondents

Timothy Berg
A. Bates Butler, III
James D. Burgess
One South Church Avenue, Suite 1000
Tucson, Arizona 85701-1627
Attorneys for Defendant-Petitioner Qwest
Communications International Inc.

James P. Denvir
Jonathan Sherman
5301 Wisconsin Avenue, N.W., Suite 800
Washington, DC 20015
Attorneys for Defendant-Petitioner Qwest
Communications International Inc.

John N. Iurino
Lewis and Roca LLP
One South Church Avenue, Suite 700
Tucson, Arizona 857010-1611
Attorney for Defendant-Petitioner John A. McMaster

Joseph E. Mais
Brian C. Lake
Perkins Coie Brown & Bain P.A.
2901 North Central Avenue
P. O. Box 400
Phoenix, Arizona 85001-0400
Attorneys for Defendant-Petitioner Joseph P. Nacchio

Thomas L. Hudson

DOBBS
LAW OF REMEDIES

DAMAGES–EQUITY–RESTITUTION

Second Edition

By

Dan B. Dobbs

Professor of Law
University of Arizona

Volume 2

Chapters 6–11

PRACTITIONER TREATISE SERIES®

WEST PUBLISHING CO.
ST. PAUL, MINN., 1993

before he had knowledge of the fraud.[20]

In addition, a general catch-all principle is sometimes stated to the effect that restoration is not required if the defendant's fraud made that restoration impossible.[21]

Restoration of Damaged or Depreciated Property

When the plaintiff seeks rescission, he may still possess the property he received in the transaction, but it may be altered, damaged or depreciated in value. Does return of such property count as restoration, or if not is the plaintiff to be excused from making specie restoration?

Property devalued because of plaintiff's fault. In two situations good solutions are relatively easy. Where the property received by the plaintiff as a result of fraud becomes less valuable because of the plaintiff's own fault or mismanagement, restoration of the damaged or depreciated property does not seem sufficient. In such cases restitution should be denied.[22]

Property devalued by forces fraudulently misrepresented by defendant. In the converse situation, where the property received by the plaintiff is damaged, destroyed or depreciated by forces or conditions as to which the defendant made a fraudulent representation, restoration of the property in its devalued condition should satisfy the plaintiff's obligation.[23] On the same idea, the plaintiff who is unable to restore the property because a mortgagor has foreclosed may have rescission without making restoration if the property's loss is seen to be a result of the defendant's own faulty misrepresentation.[24]

Property devalued by neutral forces, extraneous to the defendant's misrepresentation. Where the property depreciates due to factors not associated with the defendant's representations, the analysis must be more complex. For example, the seller of a house might fraudulently assure the buyer that there are no termites and that the roof is new.

20. Bellefeuille v. Medeiros, 335 Mass. 262, 139 N.E.2d 413 (1957) (some property damaged by flood and sold for that reason, semble, the fraud was discovered later); Robison v. Katz, 94 N.M. 314, 610 P.2d 201 (App.1980) (house trailers received by the plaintiff sold, rescission available, but plaintiff must account for value); 1 G. Palmer, Law of Restitution § 3.12 (1978); Restatement Second of Contracts § 384 (1981). When the plaintiff's complaint is contract breach rather than fraud, such restoration may be deemed inadequate. See Continental Jewelry Co. v. Pugh Bros., 168 Ala. 295, 53 So. 324 (1910).

21. See Henson v. James M. Barker Co., 555 So.2d 901, 908 (Fla.App.1990) (exception "where the inability of one party to restore is caused by the fraud perpetrated by the other party").

22. Sipola v. Winship, 74 N.H. 240, 66 A. 962 (1907).

23. Market depreciation of the property received by the plaintiff may be a result of factors misrepresented by the defendant, as where the defendant misrepresents significant facts about the market itself. The rule is that the plaintiff is not required to make specie restoration to the extent that the fraud itself prevents the restoration. See Mulle v. Scheiler, 484 So.2d 47 (Fla. App.1986), rev. denied, 492 So.2d 1334 (Fla. 1986); Liland v. Tweto, 19 N.D. 551, 125 N.W. 1032 (1910).

24. Robison v. Katz, 94 N.M. 314, 610 P.2d 201 (App.1980).

The house might be worth $5,000 less than it would have been if the representations had been true. If the property depreciates in value by an additional $20,000 because the neighborhood deteriorates or because a fire burns the property down, however, a return of the depreciated property and restitution of the plaintiff's purchase price would shift losses to the defendant not "proximately caused" by his fraud. Some courts would deny the plaintiff's claim for damages resulting from the fire or neighborhood deterioration for this reason.[25] If that is the right solution in the damages claim, then the same principle would require the court to hold that the plaintiff cannot have restitution merely by returning the depreciated property.

But in such cases there seems to be no objection to a combination of specie and substitutionary restoration. If the plaintiff received land and buildings worth $100,000, but the buildings were later destroyed by fire, leaving land worth $50,000, then the plaintiff should be permitted to have restitution by returning (a) the land in its damaged or depreciated condition plus (b) $50,000 in money.[26]

The solution suggested seems to be a logical one for courts that limit *damages* to those proximately resulting from the fraud. Some courts would apparently not observe such a limitation, however, and would allow the plaintiff to make restoration by returning the damaged or depreciated property, even when the devaluation resulted from forces extraneous to the fraud.[27] Professor Palmer supports this view.[28] Such an approach seems most clearly justified where the defendant's intentional fraud can be understood as inducing a transaction that the plaintiff would not have entered at any price if he had known the truth. When the fraud seems more likely to have affected only the price a buyer would pay, however, the "proximate cause" limitation seems sound, and with it the requirement of full-value restoration.

Innocent and negligent misrepresentation. When the purchaser is misled by innocent or merely negligent misrepresentations and the property depreciates in value through neutral forces, more stringent rules for restoration are justified. In these cases, if the plaintiff is to be permitted restitution at all, the plaintiff should not be entitled to restitution merely upon restoration of the depreciated property. Much the same can be said when the purchaser's complaint is based on mistake or breach of contract rather than on fraud.[29]

25. See §§ 9.2(6) and 9.3(2) above.

26. See Restatement of Restitution § 66 (1937).

27. See, apparently but not certainly involving depreciation from extraneous factors, Barron v. Myers, 146 Mich. 510, 109 N.W. 862 (1906); Brown v. Featherstone, 202 N.C. 569, 163 S.E. 558 (1932). The plaintiff's motive to avoid a bad bargain by this means has been held immaterial. Farnsworth v. Feller, 256 Or. 56, 471 P.2d 792 (1970).

28. 1 George Palmer, Law of Restitution § 3.12, p. 306 (1978).

29. See 1 George Palmer, Law of Restitution § 3.12, pp. 307–08 (1978).