ARIZONA SECURITIES FRAUD LIABILITY: Charting a Non-Federal Path

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Arizona securities fraud decisions frequently cite federal securities precedent,[1] particularly decisions under rule 10b-5.[2] Judicial[3] and legislative statements[4] encouraging use of federal case law exist. Yet despite many parallels, there are important differences between the Arizona and federal securities statutes in their text, legislative history and statutory structure. This article discusses these differences with respect to Arizona's primary antifraud statute, title 44, section 1991 of the Arizona Revised Statutes,[5] and

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1. *See, e.g.*, Trimble v. American Sav. Life Ins. Co., 733 P.2d 1131, 1135-36 (Ariz. Ct. App. 1986); Rose v. Dobras, 624 P.2d 887, 892 (Ariz. Ct. App. 1981); *cf.* Standard Chartered PLC v. Price Waterhouse, 945 P.2d 317, 343-45 (Ariz. Ct. App. 1996) (using rule 10b-5 precedent to explain loss causation required for negligent misrepresentation).

2. 17 C.F.R. § 240.10b-5 (1999) (quoted *infra* note 7).

3. *See e.g.*, State v. Gunnison, 618 P.2d 604, 606-07 (Ariz. 1980); MacCollum v. Perkinson, 913 P.2d 1097, 1104 (Ariz. Ct. App. 1996).

4. Private Securities Litigation, ch. 197, § 11(C), 1996 Ariz. Sess. Laws 1003, 1023 (quoted *infra* note 40).

5. Title 44, section 1991 of the Arizona Revised Statutes provides:

> A. It is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving an offer to sell or buy securities, or a sale or purchase of securities, including securities exempted under § 44-1843 or 44-1843.01 and including transactions exempted under § 44-1844, directly or indirectly to do any of the following:
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> 1. Employ any device, scheme or artifice to defraud.
>
> 2. Make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
>
> 3. Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.
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> B. In a private action brought pursuant to subsection A, paragraph 2 of this section or § 44-1992, if the person who offered or sold the security proves that any portion or all of the amount recoverable under subsection A, paragraph 2 of this Section or § 44-1992 represents an amount other than the depreciation in value of the subject security resulting from the part of the prospectus or oral communication, with respect to the liability of the person is asserted, not being true or omitting to state a material fact required to be stated or necessary to make the statement not misleading, then the amount shall not be recoverable. This subsection does not apply to any actions based on

its federal counterparts, section 10(b)[6] and rule 10b-5[7] of the Securities Exchange Act of 1934 ("1934 Act"). One important difference is that unlike rule 10b-5, under which civil liability is implied, title 44, section 1991 of the Arizona Revised Statutes is supplemented by statutes creating express civil liability for violations of title 44, section 1991.[8] Another difference is that title 44, section 1991 is fortified by a statement of legislative intent directing the courts to construe Arizona's securities statutes liberally.[9] No similar counterpart exists under federal law. Amendments in 1996 to Arizona's securities statutes crafted changes further distancing Arizona from federal law.[10]

Differences in the Arizona and federal statutes have produced a notable expansion of civil liability under state law. Arizona law has grown appreciably more protective of victims of securities abuses. Arizona and

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allegations of activities constituting dishonest or unethical practices in the securities industry.

ARIZ. REV. STAT. ANN. § 44-1991 (West Supp. 1999).

6. Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1994).

7. Rule 10b-5 reads:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1999).

8. *See infra* notes 16-18 and accompanying text.

9. *See* Securities Act of Arizona, ch. 18, § 20, 1951 Ariz. Sess. Laws 46, 75 (quoted *infra* note 40).

10. *See infra* notes 70-75 and accompanying text (discussing statutory exception to loss causation for dishonest and unethical industry practices); *infra* notes 88-90 and accompanying text (discussing statutory recognition of liability based on recklessness).

federal law depart on issues concerning reliance, causation, state of mind, secondary liability and remedies.[11] In each of these areas, Arizona law promotes a more solicitous approach to investor protection.

Part I of this article provides an overview of the legislative origins of title 44, section 1991 of the Arizona Revised Statutes. It shows that title 44, sections 2001(A) and 2002(A) of the Arizona Revised Statutes, the statutes which create civil liability under title 44, section 1991 of the Arizona Revised Statutes, are drawn from the predecessor of what today is section 12(a)(2) of the Securities Act of 1933[12] ("1933 Act")—an important point because in many respects liability is more readily established under section 12(a)(2) than under rule 10b-5. Part II examines the legislature's intent regarding title 44, section 1991 of the Arizona Revised Statutes and shows that Arizona's lawmakers intended a liberal, remedial construction. Part III analyzes the law under title 44, section 1991 of the Arizona Revised Statutes regarding reliance, causation, state of mind, secondary liability and remedies. In each area, Arizona law departs from rule 10b-5 jurisprudence and eliminates impediments to proving civil liability that have developed under federal law. The article concludes that the divergence of Arizona and federal law is an understandable outgrowth of statutory differences. Arizona and federal antifraud statutes reflect differences in language, legislative history and statutory structure that have made Arizona's statutes a more versatile tool for remedying securities fraud.

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11. *See* discussion *infra* Part III.
12. Section 12(a)(2) provides:

> Any person who . . .
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> . . . .
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> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable, subject to subsection (b) of this section, to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 77*l*(a)(2) (Supp. I 1995).

I. LEGISLATIVE ORIGINS OF ARIZONA'S ANTIFRAUD STATUTES

Arizona's primary securities fraud statute is title 44, section 1991, of the Arizona Revised Statutes, enacted in 1951. Although Arizona has not adopted the Uniform Securities Act, portions of the state's securities statutes parallel the Uniform Act.[13] Title 44, section 1991 of the Arizona Revised Statutes is an example. It tracks the language of section 101 of the 1956 version of the Uniform Act,[14] which is itself modeled on rule 10b-5 of the 1934 Act, which in turn is derived from section 17(a) of the 1933 Act.[15]

By itself title 44, section 1991 of the Arizona Revised Statutes, like rule 10b-5, does not create civil liability.[16] Civil liability follows from the remedies expressed in title 44, sections 2001(A)[17] and 2002(A) of the

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13. The Uniform Securities Act was promulgated in 1956 by the National Conference of Commissioners on Uniform State Laws and the American Bar Association. *See* UNIF. SECURITIES ACT (1956), 7B U.L.A. 509, 510 (1985) (historical note). The 1956 version of the Uniform Act was superseded in 1985 by a replacement version. *See* UNIF. SECURITIES ACT (1985), 7B U.L.A. 149 (Supp. 1999) (historical notes).

14. Section 101 reads:

> It is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly
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> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, . . . not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

UNIF. SECURITIES ACT (1956) § 101 (superseded 1985), 7B U.L.A. 516 (1985).

15. *See* 15 U.S.C. § 77q(a) (1994). Section 17(a) is the forefather of all the federal securities antifraud provisions. It provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Id.

16. *See* Standard Chartered PLC v. Price Waterhouse, 945 P.2d 317, 333 (Ariz. Ct. App. 1996).

17. Section 44-2001(A) provides:

> A sale or contract for sale of any securities to any purchaser in violation of any provision of § 44-1841 or 44-1842 or article 13 of this chapter is voidable at the election of the purchaser, who may bring an action in a court of competent jurisdiction to recover the consideration paid for the securities, with interest thereon, taxable court costs and reasonable attorneys' fees, less the

Arizona Revised Statutes.[18] Those statutes trace their origins to the rescissory measure of damages in section 12(a)(2) of the 1933 Act.[19]

Title 44, section 1991's ties to section 12(a)(2) of the 1933 Act account to a considerable degree for differences between liability under title 44, section 44-1991 and rule 10b-5. Section 12(a)(2) does not require reliance[20] or intent to defraud.[21] Until 1995, there was no loss causation requirement under section 12(a)(2),[22] and the remedy for a section 12(a)(2) violation is rescissory.[23] Although the historical and textual links between section 12(a)(2) and title 44, section 1991 of the Arizona Revised Statutes have gone unnoticed in the Arizona decisions, case law under the two statutes has developed symmetrically. Like section 12(a)(2) claims, reliance is not required for liability under title 44, section 1991,[24] nor is proof of

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> amount of any income received by dividend or otherwise from ownership of the securities, upon tender of the securities purchased or the contract made, or for damages if he no longer owns the securities.

ARIZ. REV. STAT. ANN. § 44-2001(A) (West 1994) (footnote omitted).

18. Title 44, section 2002(A) provides:

> A purchase or contract for purchase from a seller of securities made in violation of § 44-1842, 44-1991, or 44-1994 is voidable at the election of the seller of such securities, who may bring an action in a court of competent jurisdiction to recover the amount of his damages, with interest thereon, taxable court costs and reasonable attorneys' fees.

ARIZ. REV. STAT. ANN. § 44-2002(A) (West 1994).

19. *Compare* ARIZ. REV. STAT. ANN. § 44-2001(A) (West 1994) (sales in violation of ARIZ. REV. STAT. ANN. § 44-1991(A) are "voidable at the election of the purchaser, who may bring an action . . . to recover the consideration paid for the securities, with interest thereon, taxable court costs and reasonable attorneys' fees, less the amount of any income received by dividend or otherwise") *and* ARIZ. REV. STAT. ANN. § 44-2002(A) (West 1994) (similar remedy for sellers), *with* Securities Act of 1933, § 12(a)(2), 15 U.S.C. § 77*l*(a)(2) (Supp. IV 1998) (purchaser may "sue . . . to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon"). The rescissory format followed under Arizona's Securities Act is typical of securities laws in other states modeled on former section 12(2) of the 1933 Act. *See, e.g.*, UNIF. SECURITIES ACT (1956) § 410 (superseded 1985), 7B U.L.A. 644 cmt. (1985) (discussing parallels between liability under section 410(a) and section 12(2) of the 1933 Act); 69A AM. JUR. 2D *Securities Regulation—State* § 168, at 904 (1993) (discussing federal origins of civil liability provisions of state securities laws).

20. *See* 9 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4202 & n.43 (3d ed. 1992) (collecting cases).

21. *See* Wigand v. Flo-Tek, Inc., 609 F.2d 1028, 1034 (2d Cir. 1979); Martin I. Kaminsky, *An Analysis of Securities Litigation Under Section 12(2) and How It Compares with Rule 10b-5*, 13 HOUS. L. REV. 231, 233 (1976) (Section 12(a)(2) "is often described and may be regarded as a 'negligence' or 'no-fault' (rather than an 'antifraud') statute").

22. *See infra* notes 52-53 and accompanying text.

23. *See* LOSS & SELIGMAN, *supra* note 20, at 4199; Kaminsky *supra*, note 21, at 233 (Section 12(2) (now section 12(a)(2)) "is a rescission statute, seeking to achieve a refund to the purchaser of the consideration he paid for the security in exchange for return to the seller of the security").

24. *See* discussion *infra* Part III.A.

scienter required.[25] Title 44, section 1991 of the Arizona Revised Statutes did not require loss causation until amendments in 1996,[26] and the core measure of relief for violations of title 44, section 1991(A) is a rescissory measure intended to return the investor's principal with interest.[27]

II. LEGISLATIVE INTENT

Over the last thirty years, United States Supreme Court decisions interpreting rule 10b-5 have been decidedly restrictive. The scope of civil liability for violations of rule 10b-5 has been repeatedly narrowed.[28] The Private Securities Litigation Reform Act of 1995[29] ("PSLRA") added sweeping amendments that further curtailed damage claims under rule 10b-5. New requirements for heightened pleading, loss causation and limitations on joint and several liability are examples.[30]

Liability under title 44, section 1991 of the Arizona Revised Statutes has not tracked the retrenchment in rule 10b-5 liability. While federal developments have had their influence,[31] the path of Arizona securities law has been shaped by a remedial view of title 44, section 1991 of the Arizona Revised Statutes that has promoted investor protection more so than federal law.[32] This remedial view of the Arizona Securities Act has been expressed judicially,[33] administratively[34] and legislatively.[35]

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25. *See* discussion *infra* Part III.C.

26. *See* discussion *infra* Part III.B.

27. *See* discussion *infra* Part III.E.

28. *See, e.g.*, Central Bank v. First Interstate Bank, 511 U.S. 164, 175-76 (1994) (eliminating aiding and abetting liability); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193-94 (1976) (imposing scienter requirement for rule 10b-5 claims); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 731-32 (1975) (finding that only purchasers and sellers have standing to sue under rule 10b-5); *cf.* Gustafson v. Alloyd Co., 513 U.S. 561, 569 (1995) (limiting section 12(2) (now section 12(a)(2)) claims to initial public offerings).

29. Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C. and 18 U.S.C. § 1964(c)).

30. *See* 15 U.S.C. § 78u-4(b)(1)-(2) (Supp. I 1995) (heightened pleading); 15 U.S.C. § 78u-4(b)(4) (Supp. I 1995) (loss causation); 15 U.S.C. § 78u-4(f)(2)(A) (Supp. IV 1998) (joint and several liability).

31. For example, many of the legislative changes that were part of the federal 1995 Reform Act were enacted in Arizona in 1996. *See* Richard M. Weinroth et al., *Reformation of the Arizona Securities Act: A Brief Summary*, ARIZ. ATT'Y, Aug.-Sept. 1996, at 25.

32. The United States Supreme Court emphasizes statutory language, legislative history and the legislative scheme, rather than remedial goals, in construing rule 10b-5. *See, e.g., Central Bank*, 511 U.S. at 173.

33. *See* Bullard v. Garvin, 401 P.2d 417, 419 (Ariz. Ct. App. 1965).

34. *See, e.g., In re* Woodington Group, Inc., Docket No. S-2798-I, 1992 Ariz. Sec. LEXIS 109, at *15 (Ariz. Corp. Comm'n Dec. 10, 1992).

Unlike rule 10b-5, civil liability for violations of title 44, section 1991 of the Arizona Revised Statutes is explicit. Title 44, sections 2001(A) and 2002(A) create legislatively defined remedies for violations of title 44, section 1991(A).[36] These statutory remedies have no analogs under section 10(b) or rule 10b-5 of the Exchange Act. Recovery of damages under rule 10b-5 has developed as an implied right to sue which has been influenced by the common-law tort of deceit.[37] The limitations of common-law fraud are not imputed into Arizona's express liability statutes.[38] The existence of express statutory remedies has encouraged Arizona courts to construe title 44, section 1991 of the Arizona Revised Statutes in a manner that ensures injured investors receive the relief the legislature provided.[39]

The remedial nature of title 44, section 1991 is bolstered by a strong statement of legislative intent.[40] The drafters of Arizona's Securities Act

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35. *See* Securities Act of Arizona, ch. 18, § 20, 1951 Ariz. Sess. Laws 46, 75 (quoted *infra* note 40).

36. *See* ARIZ. REV. STAT. ANN. §§ 2001(A) and 2002(A) (West 1994) (quoted *supra* notes 17 and 18).

37. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 231 (1988) (referring to "positive and common-law requirements for a violation of [section] 10(b) or of Rule 10b-5"); LOSS & SELIGMAN, *supra* note 20, at 4384; Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 919 (describing section 10(b) as "parasitic on other law, often including state-law principles of fiduciary obligation").

38. *See* Rose v. Dobras, 624 P.2d 887, 892 (Ariz. Ct. App. 1981) (noting that title 44, section 1991 of the Arizona Revised Statutes is not governed by the elements of common-law fraud). Because so much of the rule 10b-5 damage action has been shaped by elements of common-law fraud like scienter and reliance, care must be taken in using rule 10b-5 decisions to interpret section 44-1991; *cf.* Martin C. McWilliams, Jr., *Thoughts on Borrowing Federal Securities Jurisprudence Under the Uniform Securities Act*, 38 S.C. L. REV. 243, 245 (1987) (arguing against automatic use of federal statutory constructions to interpret similarly worded state securities statutes).

39. *See* Bullard v. Garvin, 401 P.2d 417, 419 (Ariz. Ct. App. 1965) (stating that the fraud provisions are "liberally construed in favor of the persons they are designed to protect"); *see also* State v. Baumann, 610 P.2d 38, 45-46 (Ariz. 1980) (explaining protective purpose of securities registration requirements).

40. When Arizona's Securities Act was enacted in 1951, the drafters included the following statement of legislative intent:

> Sec. 20. INTENT AND CONSTRUCTION. The intent and purpose of this Act is for the protection of the public, the preservation of fair and equitable business practices, the suppression of fraudulent or deceptive practices in the sale or purchase of securities, and the prosecution of persons engaged in fraudulent or deceptive practices in the sale or purchase of securities. This Act shall not be given a narrow or restricted interpretation or construction, but shall be liberally construed as a remedial measure in order not to defeat the purpose thereof.

Securities Act of Arizona, ch. 18, § 20, 1951 Ariz. Sess. Laws 46, 75.

A second statement of legislative intent accompanied amendments in 1996 to the Arizona Securities Act. *See* Private Securities Regulation, ch. 197, § 11(C), 1996 Ariz. Sess. Laws 1003,

included with it a directive that the "Act shall not be given a narrow or restricted interpretation or construction, but shall be liberally construed as a remedial measure . . . ."[41] This expression of legislative intent is frequently cited in administrative decisions by the Arizona Corporation Commission,[42] where it is advanced as a reason explaining why civil liability under Arizona's securities laws is broader than under federal law.[43]

III. DIFFERENCES BETWEEN ARIZONA AND FEDERAL LAW

A. Reliance

Although subject to presumptions that shift the burden of proof, reliance is an element of rule 10b-5 actions.[44] Reliance is one of several common-law

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1023. "[T]he courts may use as a guide the interpretations given by *the securities and exchange commission* and the federal or other courts in construing substantially similar provisions in the federal securities laws of the United States." *Id.* (emphasis added). This authorization to cite SEC precedent is unusual but consistent with the remedial background of Arizona's statutes. *See supra* notes 32-39 and accompanying text. Much more so than federal case law, SEC decisions reflect an investor-oriented, remedial view of the securities laws. *See, e.g.*, the SEC precedent collected in Timothy J. Connor, *The Use of Securities and Exchange Commission Precedent in Arbitration Proceedings, in* SECURITIES ARBITRATION 1997: ARBITRATION COMES OF AGE 2, at 471 (PLI Corp. Law & Practice Course Handbook Series No. B4-7195, 1997), *available in* WESTLAW, 999 PLI/Corp. 471; *see also In re* Olde Discount Corp., No. 3-9699, 1998 SEC LEXIS 1914 (SEC Sept. 10, 1998) (holding broker-dealer and three senior firm officials liable for civil penalties totaling $5 million plus other sanctions because the firm's compensation, production, hiring and training practices created an "environment" that fostered sales practices violating section 10(b) and rule 10b-5); *In re* PaineWebber, Inc., No. 3-8928, 1996 SEC LEXIS 143 (SEC Sept. 17, 1996) (requiring payment of $292.5 million in customer restitution based upon suitability violations and other misconduct in selling limited partnerships).

41. Securities Act of Arizona, ch. 18, § 20, 1951 Ariz. Sess. Laws 46, 75.

42. *See, e.g.*, *In re* Lost Dutchman Invs., Inc., No. S-2299-I, 1993 Ariz. Sec. LEXIS 20, at *19 (Ariz. Corp. Comm'n Apr. 8, 1993); *In re* American Microtel, No. S-2876-I, 1992 Ariz. Sec. LEXIS 111, at *24 (Ariz. Corp. Comm'n Dec. 9, 1992).

43. *See, e.g.*, *In re* Woodington Group, Inc., No. S-2798-I, 1992 Ariz. Sec. LEXIS 109, at *15 ("Because state securities laws should be more broadly construed than federal securities laws, and because of our legislative mandate, this Commission must broadly interpret the Act as a remedial measure to ensure the protection of Arizona investors.").

44. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 242-47 (1988) (finding reliance necessary but adopting fraud on market theory to create rebuttable resumption of reliance); Affiliated Ute Citizens v. United States, 406 U.S. 128, 152-53 (1972) (deciding not to require positive proof of reliance in omission cases because materiality creates an inference that a reasonable investor would consider an omission important).

tort concepts used to limit the scope of liability under rule 10b-5.[45] By contrast, civil liability under title 44, section 1991 of the Arizona Revised Statutes is a matter of statutory construction rather than one of judicially shaping an implied damage action. Thus, unlike federal decisions, Arizona courts have declined to read the common-law fraud requirement of reliance into title 44, section 1991.[46]

Paradoxically, Arizona decisions finding reliance unnecessary have cited rule 10b-5 precedent.[47] Because reliance is a rule 10b-5 requirement, use of rule 10b-5 precedent by these Arizona courts is analytically confusing. The breakdown in analysis stems from the failure to realize that civil liability for violations of title 44, section 1991(A) of the Arizona Revised Statutes is implemented by the remedy provisions of title 44, sections 2001(A) and 2002(A), which are modeled on the predecessor of section 12(a)(2) of the 1933 Act.[48] Under section 12(a)(2) the federal courts have uniformly rejected any requirement of reliance.[49] The weight of authority construing state securities statutes analogous to Arizona's statutes also holds reliance

45. *See* Louis Loss, *The Assault on Securities Act Section 12(2)*, 105 HARV. L. REV. 908, 910 (1992) ("In the common law tradition, the courts have read into rule 10b-5 not only scienter, but also the elements of justifiable reliance and causation.").

46. *See* Trimble v. American Sav. Life Ins. Co., 733 P.2d 1131, 1135-36 (Ariz. Ct. App. 1986) (enforcement action); Rose v. Dobras, 624 P.2d 887, 892 (Ariz. Ct. App. 1981) (civil damage action); Washington Nat'l Corp. v. Thomas, 570 P.2d 1268, 1274-75 (Ariz. Ct. App. 1977) (by implication); *cf.* Rosier v. First Fin. Capital Corp., 889 P.2d 11, 15 (Ariz. Ct. App. 1994) (not requiring causation and finding even innocent misrepresentations actionable). *But see* McDaniel v. Compania Minera Mar de Cortes, 528 F. Supp 152, 166-67 (D. Ariz. 1981) (requiring reasonable reliance and citing rule 10b-5 precedent to interpret title 44, section 1991 of the ARIZ. REV. STAT.).

47. *See Trimble*, 733 P.2d at 1136; *Rose*, 624 P.2d at 892.

48. *See* MidAmerica Fed. Sav. & Loan Ass'n v. Shearson/American Express, Inc., 886 F.2d 1249, 1255-57 (10th Cir. 1989) (distinguishing rule 10b-5 precedent and following section 12(2) (now section 12(a)(2)) case law as to Oklahoma counterpart of title 44, section 1991(A)(2))); E.F. Hutton & Co. v. Rousseff, 537 So. 2d 978, 981 (Fla. 1989) (similar); Gohler v. Wood, 919 P.2d 561, 565 (Utah 1996) (similar).

49. *See, e.g.*, Smolen v. Deloitte, Haskins & Sells, 921 F.2d 959, 965 (9th Cir. 1990); LOSS & SELIGMAN, *supra* note 20, at 4202 & n.43 (collecting cases). On the related issue of contributory fault, the federal courts have concluded that this is not a defense to a section 12(a)(2) claim. *See* LOSS & SELIGMAN, *supra* note 20, at 4202; Kaminsky *supra* note 21, at 267-68. Arizona courts have reached the same conclusion regarding title 44, section 1991(A) of the Arizona Revised Statutes. *See* State v. Superior Court, 599 P.2d 777, 784 (Ariz. 1979), *overruled in part on other grounds by* State v. Gunnison, 618 P.2d 604, 607 (Ariz. 1980); *Trimble*, 733 P.2d at 1136; *Washington Nat'l Corp.*, 570 P.2d at 1275; *see also* Nutek Info. Sys., Inc. v. Arizona Corp. Comm'n, 977 P.2d 826, 833 (Ariz. Ct. App. 1998) ("The securities laws are designed to protect less-than-prudent investors from giving their money to irresponsible or unscrupulous businessmen.").

unnecessary.[50] The Arizona appellate courts have reached the correct result—reliance is not required for section 44-1991 civil liability. Their reasoning would, however, be on sounder footing had the courts cited precedent under section 12(a)(2) and similar state statutes.

B. Causation

The need for evidence of causation in rule 10b-5 actions has historically differed from what is required in litigation under section 12(a)(2) of the 1933 Act. Causation has always been required for liability under rule 10b-5.[51] On the other hand, until it was amended in 1995 to create an affirmative defense based upon lack of loss causation,[52] section 12(a)(2) did not require causation.[53] A seller who made a misleading statement was liable to the

50. *See, e.g.*, Connecticut Nat'l Bank v. Giacomi, 699 A.2d 101, 120 n.37 (Conn. 1997); Arnold v. Dirrim, 398 N.E.2d 426, 435 (Ind. Ct. App. 1979); Everts v. Holtmann, 667 P.2d 1028, 1033-35 (Or. Ct. App. 1983); 12A JOSEPH LONG, BLUE SKY LAW § 7.01 [2][b], at 7-15 (1999); 69A AM. JUR. 2D *Securities Regulation—State* § 191, at 927 (1993); Jared S. Goff, Note, *There Should Be No Reliance in the "Blue Sky,"* 1998 BYU L. REV. 177, 194 n.95 (collecting cases). *But see* Hines v. Data Line Sys., Inc., 787 P.2d 8, 12 (Wash. 1990) (stating without analysis that reliance is required under Washington's Securities Act); Carney v. Mantuano, 554 N.W.2d 854, 857 (Wis. Ct. App. 1996) (citing rule 10b-5 precedent and holding that reliance is required under Wisconsin's Securities Act).

51. *See* LOSS & SELIGMAN, *supra* note 20, at 4404 n.480.

52. Section 12 of the 1933 Act was amended in 1995 to add the following:

> (b) Loss causation
>
> In an action described in subsection (a)(2) of this section, if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) of this section represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.

Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, sec. 105, § 12, 109 Stat. 737, 757 (codified as amended at 15 U.S.C. § 77*l*(b) (Supp. I 1995)).

53. *See, e.g.*, Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 696 (5th Cir. 1971) ("A causation test should not be read into this Section [12(2)]. A plaintiff does not have to prove that the sale would not have occurred absent the misrepresentation or omission."); LOSS & SELIGMAN, *supra* note 20, at 4203; *see also* Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225-26 (7th Cir. 1980) (finding that plaintiffs could recover under section 12(2) (now section 12(a)(2)) even though they did not receive the prospectus containing the misstatements); *cf.* E.F. Hutton & Co. v. Rousseff, 537 So. 2d 978, 981 (Fla. 1989) (finding rule 10b-5 precedent inapposite and reasoning by analogy to section 12(2) (now section 12(a)(2)) that Florida's securities fraud statute does not require loss causation).

purchaser under section 12(a)(2) regardless of whether the statement caused the purchaser's loss.[54]

The element of causation in rule 10b-5 litigation was judicially created in the course of defining the elements of the implied rule 10b-5 cause of action.[55] Because section 12(a)(2) liability is express, the federal courts, until the 1995 amendment, approached causation as a matter of statutory construction and found nothing to require it.[56] In the same vein, Arizona courts interpreting the pre-1996 version of title 44, section 1991 of the Arizona Revised Statutes found nothing in the statutory text to require causation and held it unnecessary.[57]

Amendments to Arizona's Securities Act in 1996 introduced the rule 10b-5 concept of loss causation. Loss causation requires that the plaintiff prove the loss was proximately caused by the defendant's fraud.[58] If the loss is due to market decline caused by business conditions or other factors unrelated to the defendant's misstatements, the plaintiff is not entitled to recover.[59]

The 1996 amendments add references to loss causation to two parts of the statutes. Subsection (B) of title 44, section 1991 of the Arizona Revised Statutes creates a loss causation defense for claims under clause (2) of title

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54. *See* sources cited *supra* note 53.

55. *See* LOSS & SELIGMAN, *supra* note 20, 4404-05 n.480 ("[T]he concept of proximate cause is so integral a part of the law of torts generally that the courts have long assumed the requirement in actions under Rule 10b-5."); Loss, *supra* note 45, at 910.

56. *See* sources cited *supra* note 53. Section 12(a)(2) imposes liability on persons who sell a security "by means of" an untrue statement. *See* 15 U.S.C. § 77*l*(a)(2) (Supp. IV 1998). The courts have occasionally struggled to give meaning to the "by means of" phrase, but efforts to convert it into a causation requirement have been rebuffed. *See* LOSS & SELIGMAN, *supra* note 20, at 4203-04 & n.48; Therese H. Maynard, *The Affirmative Defense of Reasonable Care Under Section 12(2) of the Securities Act of 1933*, 69 NOTRE DAME L. REV. 57, 84 (1993) ("The courts and commentators have consistently rejected defendants' attempts to introduce some type of causation requirement into plaintiffs' case-in-chief.").

57. *See* Rosier v. First Fin. Capital Corp., 889 P.2d 11, 15 (Ariz. Ct. App. 1994) (holding that causation is not required under clause (2), and that "even an innocent" misstatement can violate the statute). Whether causation was required for clauses (1) and (3) was undecided. *See* Trimble v. American Sav. Life Ins. Co., 733 P.2d 1131, 1136 (Ariz. Ct. App. 1986) ("It is unclear from the statutory language whether causation is an element of [ARIZ. REV. STAT. ANN. §] 44-1991(1) . . . .").

58. *See* Standard Chartered PLC v. Price Waterhouse, 945 P.2d 317, 344 (Ariz. Ct. App. 1996) (quoting federal precedent).

59. *Cf. Standard Chartered*, 945 P.2d at 343-44 (discussing proximate cause for purposes of negligent misrepresentation); *Rosier*, 889 P.2d at 15 (explaining proximate cause under Arizona's racketeering act); W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 110, at 767 (5th ed. 1984) (stating that such losses do "not afford any basis for recovery").

44, section 1991(A) of the Arizona Revised Statutes.[60] The defendant is entitled to reduce the plaintiffs' damages to the extent the defendant proves the amount otherwise recoverable "represents an amount other than depreciation in value" caused by the misleading information on which the plaintiff's clause (2) claim is based.[61] Title 44, section 2082(E) of the Arizona Revised Statutes contains a broader rule of loss causation. It provides that "the plaintiff has the burden of proving that the act or omission of the defendant alleged to violate the section under which the private action is brought caused the loss for which the plaintiff seeks to recover damages."[62]

Two aspects of these statutory rules on loss causation warrant comment. First, the burdens of proof imposed by title 44, sections 1991(B) and 2082(E) of the Arizona Revised Statutes are opposite one another. Title 44, section 1991(B) creates a loss causation defense on which the defendant has the burden of proof.[63] Title 44, section 2082(E) reverses field and places the burden on the plaintiff.[64] Because title 44, section 1991(B) deals specifically with clause (2) of title 44, section 1991(A), it presumably controls over the more general title 44, section 2082(E) in cases arising under clause (2). Thus, defendants have the burden of proof as to loss causation under clause (2) and plaintiffs the burden under clauses (1) and (3).

The reason for the difference in proof burdens is unclear. It appears, however, that the Arizona legislature followed statutory distinctions in loss causation that Congress adopted as part of the PSLRA.[65] Section 105 of the PSLRA treats loss causation as an affirmative defense which a defendant may raise to defeat all or part of a plaintiff's claim under section 12(a)(2) of the 1933 Act.[66] On the other hand, section 101(b) of the PSLRA amended the 1934 Act to require a rule 10b-5 plaintiff to prove that "the act or omission of the defendant alleged to violate [the Act] caused the loss for which the

60. *See* ARIZ. REV. STAT. ANN. § 44-1991(A)(2) (West. Supp. 1999) (quoted *supra* note 5). The causation defense under title 44, section 1991(B) parallels amendments in 1995 to section 12(a)(2) of the 1933 Act. *See supra* notes 52-53 and accompanying text. This symmetry between clause (2) of title 44, section 1991(A) and section 12(a)(2) is further evidence that precedent under section 12(a)(2) rather than section 10(b) should be used in construing title 44, section 1991(A)(2).

61. § 44-1991(B) (quoted *supra* note 5).

62. ARIZ. REV. STAT. ANN. § 44-2082(E) (West Supp. 1999).

63. *See* § 44-1991(B).

64. *See* § 44-2082(E).

65. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C. and 18 U.S.C. § 1964(c)).

66. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, sec. 105, § 12, 109 Stat. 737, 757 (codified as amended at 15 U.S.C. § 77*l* (b) (Supp. I 1995).

plaintiff seeks to recover damages."[67] The Arizona legislature apparently adopted section 12(a)(2)'s affirmative defense approach to loss causation for violations of clause (2) of title 44, section 1991(A) of the Arizona Revised Statutes, while adhering to the rules for loss causation under rule 10b-5 for violations of clauses (1) and (3) of title 44, section 1991(A).

There is logic in this distinction. Section 12(a)(2) of the 1933 Act and clause (2) of title 44, section 1991(A) of the Arizona Revised Statutes use parallel language to prohibit misstatements and misleading omissions.[68] On the other hand, clauses (1) and (3) of both title 44, section 1991(A) of the Arizona Revised Statutes and rule 10b-5, which have no counterpart in section 12(a)(2), police a wider range of fraud, broadly prohibiting all deception by schemes, artifices and misleading practices.[69] By making loss causation an affirmative defense under clause (2) of title 44, section 1991(A) of the Arizona Revised Statutes, the legislature aligned clause (2) of the statute with its textual counterpart under section 12(a)(2) and left the remainder of title 44, section 1991(A) to follow the rules for loss causation in rule 10b-5 litigation.

A second point of note regarding Arizona's loss causation statutes is that they are subject to a major exception. At the insistence of the Arizona Corporation Commission Securities Division, "actions based on allegations of activities constituting dishonest or unethical practices in the securities industry"[70] were excluded from the loss causation defense.[71] "Dishonest or unethical practices"[72] are administratively defined in rule R14-4-130 of the

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67. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, sec. 101(b), § 21D(b)(4), 109 Stat. 737, 747 (codified as amended at 15 U.S.C. § 78u-4(b)(4) (Supp. I 1995)).

68. *Compare* ARIZ. REV. STAT. ANN. § 44-1991 (West Supp. 1999) (quoted *supra* note 5), *with* 15 U.S.C. § 77*l*(a)(2) (Supp. I 1995) (quoted *supra* note 12).

69. *Compare* § 44-1991 (quoted *supra* note 5), *with* 17 C.F.R. § 240.10b-5 (1999) (quoted *supra* note 7).

70. § 44-1991(B) (last sentence).

71. *See* Memorandum from Richard Weinroth, General Counsel, Arizona Corporation Commission Securities Division, to the Members of the House Commerce Committee 4 (Mar. 18, 1996) (on file with the author).

72. The "dishonest or unethical" language derives from ARIZ. REV. STAT. ANN. §§ 44-1961(A)(13) and 44-1962(10), which authorize the Corporation Commission to deny, revoke or suspend the registration of a dealer or salesperson who engages in dishonest or unethical practices in the securities industry. *See* ARIZ. REV. STAT. ANN. §§ 44-1961(A)(13), 44-1962(10) (West 1994). The Uniform Act (1956) contains a similar provision in section 204(a)(2)(G). *See* UNIF. SECURITIES ACT (1956), § 204(a)(2)(G) (superseded 1985), 7B U.L.A. 509, 542 (1985). *See generally* 69A AM. JUR. 2D *Securities Regulation—State* § 68 (1993) (discussing case law concerning dishonest and unethical sales practices); North American Securities Administrators Association, Inc., *Policy Statement on Dishonest and Unethical Business Practices*, N. Am. Sec. Admin. Ass'n Rep. (CCH) ¶ 1402, at 901 (Apr. 23, 1983).

Corporation Commission.[73] That rule contains a nonexclusive list of twenty activities ranging from misleading sales presentations to suitability violations that are deemed "dishonest or unethical."[74]

This exception to loss causation for "dishonest or unethical practices" creates a stricter standard of liability for securities professionals such as brokers, dealers and investment advisers. Because these professionals are members of a regulated industry, a higher standard of conduct is reasonable.[75] Strict, rescissory damages undiminished by a loss causation defense are calculated to deter fraud by brokers, money managers and other securities professionals. Through the "dishonest or unethical practices" exception, members of the securities industry will remain strictly liable for material misstatements and other misleading acts and omissions. An investor will be able to recover from these industry professionals even when the cause of the investor's loss is market forces or other events unrelated to the conduct which violates title 44, section 1991(A) of the Arizona Revised Statutes.

C. Scienter

The state of mind required for violations of Arizona's securities statutes departs sharply from federal law. In *Ernst & Ernst v. Hochfelder*[76] the U.S. Supreme Court held that scienter, i.e., "intent to deceive, manipulate or defraud," is required for a violation of rule 10b-5.[77] In 1980, the Arizona Supreme Court interpreted title 44, section 1991 of the Arizona Revised Statutes on the basis of precedent under section 17(a) of the 1933 Act and reached a different conclusion.[78] With respect to clause (2), title 44, section 1991(A) does not require scienter.[79] A misleading statement, even if innocent, is actionable so long as the statement is material.[80]

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73. ARIZ. ADMIN. CODE R14-4-130 (Supp. Sept. 30, 1999).

74. *Id.*

75. Recognizing the vulnerability of investors who seek financial advice from securities professionals, the law has long imposed heightened duties and special fraud concepts on these professionals. *See* 8 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3770-71 & n.1 (3d ed. 1991); NORMAN S. POSER, BROKER-DEALER LAW AND REGULATION § 2.01, at 2-4 to 2-5 (3d ed. 1999).

76. 425 U.S. 185 (1976).

77. *Id.* at 188.

78. *See* State v. Gunnison, 618 P.2d 604, 606-07 (Ariz. 1980).

79. *See id.* at 607.

80. *See* Rosier v. First Fin. Capital Corp., 889 P.2d 11, 15 (Ariz. Ct. App. 1994) ("A misrepresentation in the sale of securities, even an innocent one, can be a violation of the securities statute.").

Cases in this state have not definitively ruled on the mental state needed for violations of subsections (1) and (3).[81] There is, however, relevant precedent from the United States Supreme Court. The text of title 44, section 1991 is patterned after section 17(a) of the 1933 Securities Act.[82] The mental state required for a violation of section 17(a) was explained in *Aaron v. SEC*.[83] With respect to subsection (3), *Aaron* holds that there is no scienter requirement.[84] Subsection (3) looks to whether the investor would be misled. The defendant's intent is irrelevant. The court explained:

> [T]he language of [section] 17(a)(3), under which it is unlawful for any person "to engage in any transaction, practice, or course of business which *operates* or *would operate* as a fraud or deceit," . . . quite plainly focuses upon the *effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible.

and immediately concluded:

> This reading follows directly from *Capital Gains*, which attributed to a similarly worded provision in [section] 206 (2) of the Investment Advisers Act of 1940 a meaning that does not require a "showing [of] deliberate dishonesty as a condition precedent to protecting investors."[85]

This is a logical way to read parallel language in title 44, section 1991(A)(3) of the Arizona Revised Statutes.[86]

Aaron also interpreted the "device, scheme, or artifice to defraud" language in section 17(a)(1) and concluded that knowing or intentional misconduct is required.[87] This too is logical, but it cannot be applied literally to title 44, section 1991(A)(1). Through title 44, section 2003(B), Arizona's Securities Act permits the imposition of joint and several liability for reckless conduct.[88] This is a departure from federal law, under which there is no

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81. *See Gunnison*, 618 P.2d at 607 (stating that scienter may be an element of former section 44-1991(1)).

82. *Compare* ARIZ. REV. STAT. ANN. § 44-1991(A) (West Supp. 1999) (quoted *supra* note 5), *with* 15 U.S.C. § 77q(a) (1994) (quoted *supra* note 15).

83. 446 U.S. 680 (1980).

84. *See id.* at 697.

85. *Id.* at 696-97 (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 200 (1963)) (alterations in original).

86. *Compare* ARIZ. REV. STAT. ANN. § 44-1991(A)(3) (West Supp. 1999) (quoted *supra* note 5), *with* 15 U.S.C. § 77q(a) (1994) (quoted *supra* note 15).

87. *Aaron*, 446 U.S. at 696.

88. *See* ARIZ. REV. STAT. ANN. § 44-2003(B) (West Supp. 1999).

statutory expression of liability based upon recklessness.[89] In rule 10b-5 litigation, the acceptance of recklessness as a form of scienter occurred purely as a matter of case law.[90] By contrast, because the Arizona legislature codified a recklessness standard, fraud victims suing under clause (1) of title 44, section 1991(A) are assured that the required state of mind will not escalate beyond recklessness to, say, knowing or intentional misconduct.

D. Extended Primary and Secondary Liability

Securities law has traditionally distinguished between primary and secondary liability.[91] Primary liability arises when an actor's own conduct, without regard for that of anyone else, is culpable. Secondary liability is derivative liability in which the secondary party's status or interaction with the primary wrongdoer renders the secondary actor jointly liable with the primary violator.

The range of primary and secondary liability under title 44, section 1991 of the Arizona Revised Statutes is considerably broader than that under rule 10b-5. Primary liability for violations of title 44, section 1991(A) extends by statute, not only to those who directly misrepresent or mislead, but to all persons who make, participate in or induce a prohibited sale.[92] Secondary liability under Arizona's securities statutes may be established under any of five theories: respondeat superior,[93] aiding and abetting,[94] conspiracy,[95] indirect fraud[96] and controlling person liability.[97] In the federal courts there is no statutory counterpart to Arizona's statutory concept of participant liability. Federal law does not permit secondary liability for rule 10b-5

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89. *See* Weinroth, et al., *supra* note 31, at 26.

90. *See, e.g., In re* Comshare, Inc. Sec. Litig., 183 F.3d 542, 550 (6th Cir. 1999) ("[I]t is clear that recklessness, understood as a mental state apart from negligence and akin to conscious disregard, may constitute scienter . . . ."); *In re* Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 977 (9th Cir. 1999) ("[R]ecklessness only satisfies scienter under [section] 10(b) to the extent that it reflects some degree of intentional or conscious misconduct."). *See generally* William H. Kuehnle, *On Scienter, Knowledge and Recklessness Under the Federal Securities Laws*, 34 HOUS. L. REV. 121 (1997).

91. The seminal discussion is David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy,* In Pari Delicto, *Indemnification, and Contribution*, 120 U. PA. L. REV. 597 (1972).

92. *See* ARIZ. REV. STAT. ANN. § 44-2003(A) (West Supp. 1999) and discussion *infra* Part III.D.1.

93. *See infra* Part III.D.2.a.

94. *See infra* Part III.D.2.b.

95. *See infra* Part III.D.2.c.

96. *See infra* Part III.D.2.d.

97. *See infra* Part III.D.2.e.

violations based on aiding and abetting or conspiracy.[98] Some federal courts have questioned the viability of respondeat superior in rule 10b-5 litigation[99] and the scope of liability for indirect rule 10b-5 violations is uncertain.[100] Controlling person liability is the only settled theory of secondary securities fraud liability in the federal landscape.[101]

1. Title 44, Section 2003(A) of the Arizona Revised Statutes: Extended Primary Liability

Title 44, section 2003(A) of the Arizona Revised Statutes is broadly worded to impose primary civil liability on "any person, including any dealer, salesman or agent, who made, participated in or induced the unlawful sale or purchase."[102] Nothing similar to title 44, section 2003(A) of the Arizona Revised Statutes exists under federal securities law.[103] Instead, federal plaintiffs seeking to broaden the range of actors subject to liability have relied principally on secondary theories of liability like that imposed by the controlling persons statutes.[104]

However, the scope of title 44, section 2003(A) of the Arizona Revised Statutes was narrowed by two events. The first was through changes under the 1996 amendments to Arizona's Securities Act. The second was the court of appeals decision in *Standard Chartered PLC v. Price Waterhouse*.[105]

The 1996 amendments made sweeping changes to liability under title 44, section 2003 of the Arizona Revised Statutes. The foremost changes are:

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98. *See infra* text accompanying notes 126-127 and 138-139.

99. *See infra* note 122 and accompanying text.

100. *See infra* notes 142-143 and accompanying text.

101. *See infra* notes 151-155 and accompanying text.

102. ARIZ. REV. STAT. ANN. § 44-2003(A) (West 1994 & Supp. 1999). The origins of blue sky participant liability are traced in Douglas E. Abrams, *The Scope of Liability Under Section 12 of the Securities Act of 1933: "Participation" and the Pertinent Legislative Materials*, 15 FORDHAM URB. L.J. 877, 925-28 (1987). States with participant liability statutes are collected in *id.*, at 927 n.294.

103. *See* Standard Chartered PLC v. Price Waterhouse, 945 P.2d 317, 329 (Ariz. Ct. App. 1996).

104. Because of the elimination of conspiracy and aiding and abetting liability under rule 10b-5 (*see infra* Parts III.D.2.b-c), federal courts are beginning to explore the limits of primary liability. *See, e.g.*, Cooper v. Pickett, 137 F.3d 616, 624-25 (9th Cir. 1997) (distinguishing conspiracy from primary liability for perpetrating a "scheme"); SEC v. First Jersey Sec., Inc., 101 F.3d 1450, 1471 (2d Cir. 1996) (holding that primary liability may be imposed on those who knowingly assist fraud).

105. 945 P.2d 317 (Ariz. Ct. App. 1996).

- Joint and several liability was eliminated except for those defendants who act knowingly or recklessly.[106]
- Defendants who do not act knowingly or recklessly are liable only for their percentage of responsibility.[107]
- The meaning of "participation" was clarified to provide that "[n]o person shall be deemed to have participated in any sale or purchase solely by reason of having acted in the ordinary course of that person's professional capacity in connection with that sale or purchase."[108]

In *Standard Chartered* the Arizona Court of Appeals read title 44, section 2003(A) of the Arizona Revised Statutes to require that the defendant either: (i) take part in the sale; or (ii) promote or solicit the plaintiff's investment.[109] The court adopted a restrictive reading of the words "participated in" and "induced." On their face, these words can reasonably be read to impose liability on anyone who provides misleading information to the purchaser or seller of a security. But the court concluded that merely making a misstatement that contributes to a purchaser or seller's investment decision is not sufficient to create liability.[110] The court conceded that an earlier decision by the Arizona Supreme Court[111] can be interpreted to impose liability even though the defendant "take[s] no active part in bringing about the transaction and receive[s] no consideration from it."[112] The Arizona Court of Appeals was concerned that this reading was calculated to

106. *See* ARIZ. REV. STAT. ANN. § 44-2003(B) (West Supp. 1999).

107. *See* § 44-2003(B)-(C).

108. § 44-2003(A). For discussion of case law concerning routine professional services by attorneys, see Douglas M. Branson, *Collateral Participant Liability Under State Securities Laws*, 19 PEPP. L. REV. 1027, 1059-62 (1992); Richard M. Weinroth, *Overview of Civil and Criminal Liability of Clients and Attorneys for Federal and Arizona Securities Violations*, 26 ARIZ. ST. L.J. 1, 11-12 & n.64 (1994). If an attorney volunteers information about a securities transaction, "he assumes a duty to provide complete and nonmisleading information with respect to the subjects on which he undertakes to speak." Rubin v. Schottenstein, Zox & Dunn, 143 F.3d 263, 268 (6th Cir. 1998) (en banc).

109. *See Standard Chartered*, 945 P.2d at 332-33. A person may take part in a sale in a variety of ways. One way is to share in the sale proceeds. *See id.* (implying that accounting firm would have been liable if it had financially participated). Another is by taking part in the fraud that taints the sale. *See* Little v. First Cal. Co., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,226, at 92,561 (D. Ariz. Oct. 17, 1977) (suggesting that liability may be based on "direct or indirect participation in specific act of fraud"). Another is by creating written misrepresentations which are used to induce the sale. *See* Strom v. Black, 523 P.2d 1339, 1340-41 (Ariz. Ct. App. 1974) (holding business broker who created misleading advertising liable as statutory participant).

110. *See id.*

111. *See* State v. Superior Court, 599 P.2d 777 (Ariz. 1979), *overruled in part on other grounds by* State v. Gunnison, 618 P.2d 604 (Ariz. 1980).

112. *Standard Chartered*, 945 P.2d at 330.

ensnare professionals and collateral participants who are only remotely involved.[113] Using dictionary definitions, the court of appeals cabined the statute's reach.[114] It read "participate" to require that the defendant take part in or share in the sale.[115] Because the defendant accounting firm had no stake in the sale, the court concluded it did not participate in the sale.[116] "Induce" was also read narrowly to require that the defendant "persuade" or "prevail" upon the plaintiff to make the transaction.[117] According to the court, title 44, section 2003 does not impose liability on collateral actors "who neither financially participate, nor promote or solicit the transaction, but merely provide information that contributes to a buyer or seller's decision to close the deal."[118]

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113. *See id.* at 333.

114. *See id.* at 330-33.

115. *See id.* at 332.

116. *See id.* The concept of participation has been used to extend liability for common-law fraud beyond the person directly inducing the sale. *See, e.g.*, Schwartz v. Tanner, 576 P.2d 873, 875 (Utah 1978) ("[T]he circumstances may be such as to impose liability for representations made by others as where parties jointly participate in fraud."). The court of appeals' construction of participation in *Standard Chartered* reflects a more restrictive reading of participant liability than many courts have followed in imposing common-law liability. *See, e.g., id.* at 876 (holding purchaser, purchaser's agent and purchaser's son liable to defrauded seller of house); Kaas v. Privette, 529 P.2d 23, 29 (Wash. Ct. App. 1974) (finding seller, secured party and a stockholder liable to defrauded stock purchaser).

117. *See Standard Chartered*, 945 P.2d at 332-33.

118. *Id.* at 333. As a matter of statutory construction, *Standard Chartered* is problematic. The court's use of restrictive dictionary definitions rather than more investor-protective interpretations is questionable. *See, e.g.*, Little v. First Cal. Co., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,226, at 92, 561 (D. Ariz. Oct. 17, 1977) (reasoning that direct or indirect participation in an act of fraud creates liability under title 44, section 2003 of the Arizona Revised Statutes (now title 44, section 2003(A)); LONG, *supra* note 50, § 707[2][c] (discussing proximate cause, but for causation, substantial factor and point of sale conduct as standards for determining when an actor culpably participates in a prohibited securities sale). The court's narrow reading of title 44, section 2003(A) is all the more suspect in view of the legislature's directive to avoid "narrow or restrictive interpretations." *See supra* note 40 (quoting 1951 statement of legislative intent); *see also* Branson, *supra* note 108, at 1052-53 (explaining that state courts frequently adopt expanded theories of participation liability because they view their securities statutes as remedial legislation to be broadly construed).

2. Secondary Liability

a. Respondeat Superior

There is no express provision for respondeat superior liability under federal or Arizona law.[119] Despite this, most courts have assumed the applicability of the doctrine.[120] In the aftermath of the United States Supreme Court's decision eliminating aiding and abetting liability under rule 10b-5,[121] some federal courts have struggled with whether respondeat superior is still viable.[122]

Liability on the basis of respondeat superior finds support in Arizona's Securities Act's savings clause, which provides that the securities laws do not "limit any statutory or common-law right of any person in any court for any act involved in the sale of securities."[123] This language weighs against any legislative intent to preempt common-law secondary liability. Similar savings clauses under the federal securities laws have been read to extend common-law liability.[124] It is hard to imagine what policy considerations would motivate law-makers to eliminate respondeat superior liability. If respondeat superior was somehow preempted, "the securities industry alone—which Congress thought required special oversight to protect the

119. *See* Central Bank v. First Interstate Bank, 511 U.S. 164, 200 & n.12 (1994) (Stevens, J., dissenting) (observing that while many courts have imposed secondary liability in rule 10b-5 actions based upon respondeat superior and other agency principles, these doctrines "are not expressly spelled out in the securities statutes").

120. *See, e.g.*, Hall v. Security Planning Servs., Inc., 462 F. Supp. 1058, 1062 (D. Ariz. 1978) (applying respondeat superior to rule 10b-5 claims); Geiler v. Arizona Bank, 537 P.2d 994, 999-1000 (Ariz. Ct. App. 1975) (stating that the "bank may well be liable on basic agency principles" for registration and antifraud violations by its branch manager).

121. *See infra* Part III.D.2.b. (discussing *Central Bank*, 511 U.S. 164).

122. *Compare* Vento & Co. v. Metromedia Fiber Network, Inc., [1999 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 90,460, at 92,162-63 (S.D.N.Y. 1999) (stating that respondeat superior is still viable), *and* Seolas v. Bilzerian, 951 F. Supp. 978, 983-84 (D. Utah 1997) (same), *with In re* Prudential Ins. Co. of Am. Sales Practices Litig., 975 F. Supp. 584, 612-13 (D.N.J. 1997) (denying liability for respondeat superior in view of *Central Bank*); *see also* the pre-*Central Bank* decisions: Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1577 (9th Cir. 1990) (en banc) (stating that control liability does not supplant agency liability); SEC v. Management Dynamics, Inc., 515 F.2d 801, 812 (2d Cir. 1975) ("[G]iven the pervasive applicability of agency principles elsewhere in the law, it would take clear evidence to persuade us that Congress intended to supplant such principles by enacting the 'controlling person' provisions.").

123. ARIZ. REV. STAT. ANN. § 44-2005 (West 1994); *see* Jones v. CPR Div., Upjohn Co., 584 P.2d 611, 617 (Ariz. Ct. App. 1978) ("[T]he remedy [under section 44-2001] is nonexclusive and an action may be maintained for common law fraud as well as statutory securities violation.").

124. *See* LOSS & SELIGMAN, *supra* note 20, at 4477.

public—would be singled out for favored treatment over all [other] persons treated as principals by the law of agency."[125]

b. Aiding and Abetting

Aiding and abetting liability was an accepted part of rule 10b-5 litigation until 1994. Every federal circuit in the country had recognized some form of aiding and abetting liability.[126] Then, in 1994, the United States Supreme Court, in a five-to-four decision, eliminated aiding and abetting liability.[127] The Supreme Court grounded its ruling upon the language of section 10(b) of the 1934 Act, which does not, by all accounts, expressly provide for aiding and abetting liability.[128]

Fifteen years before *Central Bank*, the Arizona Supreme Court recognized liability for aiding and abetting securities violations on the basis of rule 10b-5 precedent.[129] The decision seemed unremarkable at the time. In the wake of *Central Bank,* the decision was questioned.[130]

The matter was presented to the legislature with the 1996 amendments. The initial draft of Senate Bill 1383, which led to the final legislation, would have eliminated liability for aiding and abetting in civil damage actions.[131] In

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125. Loss, *supra* note 45, at 913.

126. *See* Central Bank v. First Interstate Bank, 511 U.S. 164, 192 & n.1 (1994) (Stevens, J., dissenting). Eleven of the federal courts of appeals had recognized a private damage action for aiding and abetting rule 10b-5 violations. *See id.* (Stevens, J., dissenting). Only the District of Columbia Circuit had failed to decide the issue in a private action, and it had upheld aided and abetting liability in an SEC action. *See id.* at 192 (Stevens, J., dissenting).

127. *See id.* at 177.

128. *See* Securities and Exchange Act of 1934, ch. 404, § 101(b), 48 Stat. 881, 891 (codified at 15 U.S.C. § 78j (1994)); *see also* 17 C.F.R. § 240.10b-5 (1999); James D. Cox, *Just Deserts for Accountants and Attorneys After* Bank of Denver, 38 ARIZ. L. REV. 519, 519-20 (1996) (noting the absence of textual support for aiding and abetting liability under section 10(b)).

129. *See* State v. Superior Court, 599 P.2d 777, 784 (Ariz. 1979), *overruled in part on other grounds by* State v. Gunnison, 618 P.2d 604, 607 (Ariz. 1980). Civil liability based upon aiding and abetting has been recognized in other areas of law in Arizona decisions. *See, e.g.*, Prince Dev. Corp. v. Beal, 331 P.2d 1091, 1092 (Ariz. 1958) (conferring liability for aiding and abetting violation of injunction); Rodgers v. Bryan, 309 P.2d 773, 778 (Ariz. 1957) (upholding liability for aiding and abetting assault); Ramirez v. Chavez, 226 P.2d 143, 146 (Ariz. 1951) (same); *see also* cases concerning common-law liability for concerted action cited *infra* note 140.

130. *See, e.g.*, Deana S. Peck & Russell Farr, *After* Central Bank, *Is the Blue Sky Falling, Too?*, ARIZ. ATT'Y, Aug.-Sept. 1994, at 19.

131. The Bill contained a new title 44, section 2042 which (i) permitted the Corporation Commission to bring enforcement actions against those who substantially assisted another's violation of the Act but (ii) expressly eliminated any damage action for such conduct:

> For purposes of any action brought by the Commission under this article, any person who knowingly provides substantial assistance to another person in violation of any provision of this chapter is in violation of the same provision to the same extent as the person to whom the assistance is provided. Nothing

the final bill, this language was eliminated. As passed, the statutory note to 1996 amendments provides that "[n]othing in this act . . . determines whether or in what circumstances aiding and abetting liability exists . . . ."[132] The legislature thus left intact *State v. Superior Court,*[133] leaving it to the appellate courts to decide the viability of aiding and abetting liability.[134]

c. Conspiracy

"When a civil wrong occurs as the result of concerted action, the participants in the common plan are equally liable."[135] The word "conspiracy" is typically used to describe vicarious liability imposed for concerted action.[136] Until *Central Bank,*[137] conspiracy law was a viable means of imposing group liability for rule 10b-5 violations.[138] The federal courts have, however, read *Central Bank* to eliminate conspiracy as a basis for secondary liability under section 10(b).[139]

In view of the substantial body of Arizona law applying conspiracy principles in civil litigation,[140] there is sound reason for continuing

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in this chapter creates a private right of action against a person who substantially assists another person in committing a violation of this chapter.

S.B. 1383, § 10, 42d Leg., 2d Reg. Sess. (Ariz. 1996).

132. Private Securities Regulation, ch. 18, § 11(B), 1996 Ariz. Sess. Laws 1003, 1023.

133. 599 P.2d 777 (Ariz. 1979), *overruled in part on other grounds by* State v. Gunnison, 618 P.2d 604, 607 (Ariz. 1980).

134. The Arizona Court of Appeals reached the issue in *Grubaugh v. DeCosta*, 291 Ariz. Adv. Rep. 11 (App. 1999), *withdrawn, id.*, and explained that there are "important differences" between Arizona's securities laws and federal securities laws, which warrant liability for aiding and abetting. *Id.* ¶ 52. Subsequently, the Arizona Supreme Court, without comment, ordered *Grubaugh* depublished. *See* 1999 Ariz. App. LEXIS 35 (Ariz. Ct. App. Mar. 16, 1999) (indicating in subsequent history that the opinion's publication status changed to unpublished on February 3, 2000).

135. McElhanon v. Hing, 728 P.2d 256, 262 (Ariz. Ct. App. 1985), *aff'd on this point*, 728 P.2d 273, 278 (Ariz. 1986).

136. *See id.*

137. 511 U.S. 164 (1994).

138. *See* LOSS & SELIGMAN, *supra* note 20, at 4488-89 n.68 (collecting cases).

139. A few decisions at the district court level have concluded that conspiracy liability survived *Central Bank*. *See, e.g.*, Wenneman v. Brown, 49 F. Supp. 2d 1283, 1289 n.3 (D. Utah 1999) (treating conspirators as primary violators who fall within rule 10b-5's prohibition on "employing . . . any scheme"); Levine v. Metal Recovery Techs., Inc., 182 F.R.D. 112, 115 (D. Del. 1998). The federal courts of appeals are now in agreement that conspiracy liability was displaced by *Central Bank*. *See, e.g.*, Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfield & Sorkin, 135 F.3d 837, 841 (2d Cir. 1998); *In re* GlenFed, Inc. Sec. Litig., 60 F.3d 591, 592 (9th Cir. 1995).

140. *See* Tovrea Land & Cattle Co. v. Linsenmeyer, 412 P.2d 47, 63 (Ariz. 1966) (denying liability for conspiracy among corporate directors); *cf.* Gemstar, Ltd. v. Ernst & Young, 917 P.2d 222, 227 n.1 (Ariz. 1996) (referencing liability for substantially assisting another's tort pursuant to RESTATEMENT (SECOND) OF TORTS § 876(b) (1979)); Sparks v. Republic Nat'l Life Ins. Co.,

conspiracy liability under title 44, section 1991(A) of the Arizona Revised Statutes. This is especially so in view of the savings statute preserving common-law rights in actions involving securities sales.[141]

d. Indirect Fraud

By its terms, title 44, section 1991(A) of the Arizona Revised Statutes prohibits conduct which "directly" violates its provisions as well as conduct which "indirectly" does. The same "directly or indirectly" language appears in section 17(a) of the 1933 Act and section 10(b) of the 1934 Act. In *Central Bank* the United States Supreme Court rejected a theory of aiding and abetting predicated on the "direct or indirect" language in section 10(b).[142] The Court did, however, implicitly acknowledge a statutory basis for imposing liability on those who engage "indirectly . . . in a proscribed activity" by contrasting the scope of aiding and abetting liability with indirect violations of rule 10b-5.[143]

The Arizona Supreme Court examined liability for indirect fraud in *Barnes v. Vozack*.[144] Through misstatements, a salesman sold stock in a fledgling company, Budget Control ("Budget"), to a widow.[145] The salesman was directly liable under title 44, section 1991 of the Arizona Revised Statutes.[146] The plaintiff went a step further and argued that three additional defendants, who controlled Budget through stock ownership and a management contract, were liable for indirectly violating title 44, section 1991 of the Arizona Revised Statutes.[147] There was insufficient evidence that any of the three personally solicited the plaintiff's

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647 P.2d 1127, 1138 (Ariz. 1982) (recognizing vicarious liability under joint enterprise theory of businesses pursuing concerted action); Gomez v. Hensley, 700 P.2d 874, 876-77 (Ariz. Ct. App. 1984) (similar).

141. *See* ARIZ. REV. STAT. ANN. § 44-2005 (West 1994).

142. *See* Central Bank v. First Interstate Bank, 511 U.S. 164, 176 (1994) (explaining that liability for aiding and abetting, if permitted, would be broader than liability imposed on those who indirectly undertake proscribed conduct).

143. *Id.* at 176; *see also* Carley Capital Group v. Deloittte & Touche, L.L.P., 27 F. Supp. 2d 1324, 1334 (N.D. Ga. 1998) (referencing the "directly or indirectly" language of rule 10b-5 as support for imposing primary liability on secondary actors who create misrepresentations that are publicly distributed by other actors). Historically, rule 10b-5's "directly or indirectly" language has received scant attention. *See* 5B ARNOLD S. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10b-5 § 40.07, at 2-466 (1997).

144. 550 P.2d 1070 (Ariz. 1976); *see also* Little v. First Cal. Co., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,226, at 92,561 (D. Ariz. Oct. 17, 1977) (citing *Barnes* and suggesting that "direct or indirect participation in [a] specific act of fraud" violates title 44, section 2003 (now title 44, section 2003(A)).

145. *See Barnes*, 550 P.2d. at 1072.

146. *See id.* at 1074.

147. *See id.*

investment.[148] The Arizona Supreme Court nevertheless upheld liability because "the three [individual] defendants *indirectly* fraudulently sold stock to" the plaintiff.[149] Decisions in other states have reached similar conclusions.[150]

e. Controlling Person Liability

Controlling person liability is the cornerstone of secondary liability under the federal securities laws.[151] The 1933 and 1934 Acts establish a regime of liability which encompasses liability for persons who control the direct perpetrators of fraudulent conduct.[152] Title 44, section 1999[153] of the 1996 amendments to the Arizona Securities Act embraces the federal concept of control liability by adding a controlling person statute modeled on section 15 of the 1933 Act[154] and section 20(a) of the 1934 Act.[155]

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148. *See id.* (reviewing defendants' testimony about involvement with plaintiff).

149. *Id.* (emphasis added). The court seems to have based its decision on the defendants' control of Budget and the salesman who sold the stock. *See id.* at 1074-75. Although it did not exist at the time, the controlling persons statute enacted by the Arizona legislature in 1996 would have provided an alternative ground for decision. *See* discussion *infra* Part III.D.2.e.

150. *See* People v. Blair, 579 P.2d 1133, 1144-45 (Colo. 1978) (holding defendant liable for indirectly making misrepresentations conveyed by his sales force); Cook v. State, 824 S.W.2d 634, 640-41 (Tex. App. 1991) (same).

151. *See generally* Loftus C. Carson, II, *The Liability of Controlling Persons Under the Federal Securities Acts*, 72 NOTRE DAME L. REV. 263 (1997) (exploring the extent of controlling person liability).

152. *See id.* at 265.

153. Title 44, section 1999 of ARIZ. REV. STAT. ANN. provides:

> Every person who, by or through stock ownership, agency or otherwise or who pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency or otherwise controls any person liable under article 13 of this chapter, other than §§ 44-1991 or 44-1992, shall be liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable, unless the controlling person had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist. Every person who, directly or indirectly, controls any person liable for a violation of § 44-1991 or 44-1992 shall be liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act underlying the action.

ARIZ. REV. STAT. ANN. § 44-1999 (West Supp. 1999).

154. As codified, section 15 provides:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under section [11 or 12 of the Act], shall also be liable jointly and severally with and to the same extent as such

The controlling person provisions reach persons who could not be held accountable under common-law rules. The separate entity status of a corporation positions its officers and directors to claim that any securities violation is the act of the corporation rather than the act of those who formulated the corporation's conduct.[156] Similarly, under traditional agency rules, securities violations by a corporation's agents would be imputed to the corporation as the principal of the agency relationship.[157] Through the concept of controlling person liability, Congress created a mechanism for holding accountable those with the ability to control the securities violator.

The first sentence of title 44, section 1999 tracks the language of section 15 of the 1933 Act and imposes liability on persons who control violators of Arizona's counterparts of sections 11 and 12 of the 1933 Act (i.e., title 44, sections 1997 and 1998 of the Arizona Revised Statutes).[158] The second sentence follows section 20(a) of the 1934 Act and imposes liability on those who control violators of Arizona's counterpart of section 10(b) of the 1934 Act (i.e., title 44, section 1991(A) of the Arizona Revised Statutes).[159] To establish liability under these provisions, three things must be shown: (i) the primary liability of the controlled person;[160] (ii) control by the defendant of the primary violator;[161] and (iii) the

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controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77o (1994).

155. As codified, section 20(a) provides:

(a) Every person who, directly or indirectly, controls any person liable under any provision of this [Act] or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a) (1994).

156. *See* Carson, *supra* note 151, at 269.

157. *See id.* at 269-70.

158. *Compare* ARIZ. REV. STAT. ANN. § 44-1999 (West Supp. 1999) (quoted *supra* note 153), *with* 15 U.S.C. § 77o (1994) (quoted *supra* note 154). *See also* 15 U.S.C. §§ 77k, 77*l* (1994 & Supp. 1998); ARIZ. REV. STAT. ANN. §§ 44-1997, 44-1998 (West Supp. 1999).

159. *Compare* ARIZ. REV. STAT. ANN. § 44-1999 (West Supp. 1999) (quoted *supra* note 153), *with* 15 U.S.C. § 78t (1994) (quoted *supra* note 155). *See also* 15 U.S.C. §§ 78j(b), 78t(a) (1994); ARIZ. REV. STAT. ANN. § 44-1991(A) (West 1997 & Supp. 1999). Control liability for violations of title 44, section 1992 is also referenced in the second sentence of title 44, section 1999. *See* ARIZ. REV. STAT. ANN. § 44-1999 (West Supp. 1999) (quoted *supra* note 153).

160. *See* Paracor Fin., Inc. v. General Elec. Capital Corp., 96 F.3d 1151, 1161 (9th Cir. 1996).

161. *See id.*; *In re* Gupta Corp. Sec. Litig., 900 F. Supp. 1217, 1242-43 (N.D. Cal. 1994) (discussing evidence needed to show control).

defendant's failure to satisfy the statute's defenses,[162] i.e., lack of reasonable care as to the first sentence in title 44, section 1999 and "good faith" and "non-inducement" as to the second sentence.[163]

E. Remedies

Injured parties suing for violations of title 44, section 1991(A) may recover rescissory damages.[164] They may also recover attorneys' fees,[165] prejudgment interest[166] and if the defendant's conduct is sufficiently culpable, punitive damages.[167] The remedies for violations of section 10(b) and rule 10b-5 are not as favorable. There is no provision for attorney fees, prejudgment interest is discretionary,[168] and punitive damages are unavailable.[169]

Liability for violations of title 44, section 1991(A) is implemented through express remedies enumerated in title 44, sections 2001(A) and 2002(A).[170] In contrast, the remedy for violations of rule 10b-5 is implied and therefore judicially defined.[171] Under title 44, section 2001(A), a defrauded purchaser is entitled to rescission if the security is still owned and damages if it is not.[172] A defrauded seller is entitled to damages.[173] Under the rescissory measure, an injured investor is entitled to: (i) the consideration

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162. The defendant has the burden of proof on these defenses. *See Paracor Fin.*, 96 F.3d at 1161; Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1575 (9th Cir. 1990) (en banc) (construing section 20(a) of the 1934 Act); Loss, *supra* note 45, at 912-13 (analyzing section 15 and section 20(a)).

163. *See* ARIZ. REV. STAT. ANN. § 44-1999 (West Supp. 1999) (quoted *supra* note 153).

164. *See infra* notes 172-180 and accompanying text.

165. *See infra* note 174 and accompanying text.

166. *See id.*

167. *See infra* notes 183-187 and accompanying text.

168. *See, e.g.*, Ansin v. River Oaks Furniture, Inc., 105 F.3d 745, 761 (1st Cir. 1997); LOSS & SELIGMAN, *supra* note 20, at 4422 & n.526 (collecting cases).

169. *See infra* notes 184-185 and accompanying text.

170. *See supra* notes 16-18 and accompanying text.

171. *See supra* note 37 and accompanying text.

172. *See* ARIZ. REV. STAT. ANN. § 44-2001(A) (West 1994) (quoted *supra* note 17). Under the statute's rescissory measure, a defrauded buyer who still holds the security is entitled to the amount paid for the investment with interest, reduced by any income received. *See* Standard Chartered PLC v. Price Waterhouse, 945 P.2d 317, 345-46 (Ariz. Ct. App. 1996).

173. *See* ARIZ. REV. STAT. ANN. § 44-2002(A) (West 1994) (quoted *supra* note 18). The statute does not define the measure of damages. Federal cases interpreting rule 10b-5 have adopted a flexible approach, accepting a variety of measures tailored to providing fair compensation for the damage done. *See* LOSS & SELIGMAN, *supra* note 20, at 4408-27. Although Arizona law is not well developed, in those cases where damages rather than pure rescission are sought, the courts have adopted an ad hoc, remedial approach comparable to that in rule 10b-5 litigation. *See infra* notes 181-182 and accompanying text.

paid, (ii) with interest, costs and attorneys' fees (iii) less dividends or other income received.[174]

Frequently the rescissory relief available for a violation of title 44, section 1991(A) is more favorable[175] than the out-of-pocket damage measure commonly applied to violations of rule 10b-5.[176] Out-of-pocket damages are measured by the difference between the purchase price of the investment and its value when purchased.[177] Failure to present evidence of the investment's value on the purchase date is fatal to an investor's claim.[178] Rescissory damages are more easily proved. The goal of rescissory relief is to return the injured party to the position the party was in before investing.[179] Rescissory damages are thus measured by the amount paid for the investment, less adjustments for any income produced by the investment.[180] Because they force the securities violator to return the investor's principal outlay, rescissory damages dispense with the need to litigate the value of what the investor received.

The remedy provisions of the Arizona securities statutes have been read to permit damages beyond a strict rescissory return of principal. Lost profits have been allowed,[181] and compensatory damages with rescission are available where rescission alone will not make the plaintiff whole.[182] Recovery of punitive damages is also possible,[183] while in rule 10b-5 litigation, section 28(a) of the 1934 Act limits the remedies for violations of the Act to recovery of "actual damages."[184] Federal decisions have

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174. *See* ARIZ. REV. STAT. ANN. § 44-2001(A) (West 1994); Jones v. CPR Div., Upjohn Co., 584 P.2d 611, 617 (Ariz. Ct. App. 1978); *see also* Trimble v. American Sav. Life Ins. Co., 733 P.2d 1131, 1141 (Ariz. Ct. App. 1986) (reasoning that given the legislative intent to prevent investor fraud, prejudgment interest is "particularly appropriate").

175. *See Standard Chartered*, 945 P.2d at 345 (distinguishing between out-of-pocket and rescissory damages); *see also* Randall v. Loftsgaarden, 478 U.S. 647, 659 (1986) (discussing how rescissory damages shift the "risk of an intervening decline in the value of the security to defendants, whether or not that decline was actually caused by the fraud").

176. A variety of damage measures have been accepted in rule 10b-5 litigation, but the usual measure is an out-of-pocket one. *See* Ambassador Hotel Co. v. Wei-Chuan Inv. 189 F.3d 1017, 1030 (9th Cir. 1999).

177. *See Standard Chartered*, 945 P.2d at 345.

178. *See id.* at 346.

179. *See id.* at 345.

180. *See id.* at 345-46.

181. *See* DeJonghe v. E.F. Hutton & Co., 830 P.2d 862, 865 (Ariz. Ct. App. 1991) (approving damages calculated on the basis of the value the customer's portfolio would have had but for broker's speculative and excessive trading).

182. *See* Washington Nat'l Corp. v. Thomas, 570 P.2d 1268, 1276 (Ariz. Ct. App. 1977) (affirming rescission plus damages for capital gains taxes the plaintiff incurred).

183. *See, e.g.*, sources cited *infra* note 186.

184. 15 U.S.C. § 78bb(a) (1994 & Supp. IV 1998).

consistently interpreted the "actual damages" clause as a bar to punitive damages.[185] There is no actual damages limitation under Arizona's securities statutes. So long as the plaintiff proves the mental state required for punitive damages, punitive damages should be available.[186] Supplementing the base rescissory measure of the Arizona Securities Act's remedy statutes with consequential and punitive damages is consistent with the liberal construction directed by the legislature and the savings clause preserving common-law remedies.[187]

Title 44, sections 44-2001(A) and 44-2001(B) are worded to give the injured party an election whether to treat a prohibited transaction as voidable.[188] Under comparable state securities laws, the courts have held that each sale stands on its own and is voidable at the injured party's election.[189] Where more than one investment is made, the investor may elect to affirm the profitable transactions and void the unprofitable ones without netting

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185. *See* Ambassador Hotel Co. v. Wei-Chuan Inv., 189 F.3d 1017, 1031 (9th Cir. 1999); LOSS & SELIGMAN, *supra* note 20, at 4423-24.

186. Punitive damages claims have been allowed under similar blue sky statutes. *See* Allied Steel & Tractor Prods., Inc. v. First Nat'l City Bank, 54 F.R.D. 256, 260 (N.D. Ohio 1971) (applying Ohio law); LOSS & SELIGMAN, *supra* note 20, at 4426 n.533 (listing cases); *cf.* Hall v. Security Planning Servs., Inc., 462 F. Supp. 1058, 1064-65 (D. Ariz. 1978) (allowing punitive and actual damages assessed on claims based on federal and Arizona securities statutes and common-law fraud). Arizona decisions have allowed recovery of punitive damages as an adjunct of statutory damages. *See* Sellinger v. Freeway Mobile Home Sales, Inc., 521 P.2d 1119, 1123 (Ariz. 1974) (finding punitive damages awardable to buyer who recovers compensatory damages for deceptive practices under consumer fraud statutes); Rhue v. Dawson, 841 P.2d 215, 229 (Ariz. Ct. App. 1992) (stating that Arizona's racketeering statute "is intended to allow successful litigants to receive both treble racketeering damages and punitive damages"). Allowing punitive damages comports with the preservation of common-law rights under the Arizona Securities Act's savings clause. *See* ARIZ. REV. STAT. ANN. § 44-2005 (West 1994).

187. *See* ARIZ. REV. STAT. ANN. § 44-2005 (West 1994) ("Nothing in this article shall limit any statutory or common law right of any person in any court for any act involved in the sale of securities.").

188. *See* ARIZ. REV. STAT. ANN. § 44-2001(A) (West 1994) ("A sale . . . is voidable at the election of the purchaser . . . ."); ARIZ. REV. STAT. ANN. § 44-2002(A) (West 1994) ("A purchase . . . is voidable at the election of the seller . . . .").

189. *See, e.g.*, Kane v. Shearson Lehman Hutton, Inc., 916 F.2d 643, 646-47 (11th Cir. 1990) (interpreting Florida securities statute providing for rescissory remedy like ARIZ. REV. STAT. ANN. section 44-2001); Treider v. Doherty & Co., 527 P.2d 498, 501 (N.M. Ct. App. 1974) (stating that because of violations of New Mexico securities registration statute, plaintiff "is entitled to void any sale entered into in violation of [the statute] regardless of the profits made on other sales"); Piantes v. Hayden-Stone, Inc., 514 P.2d 529, 530 (Utah 1973) (finding the same result for violations of Utah statute prohibiting sales by unregistered securities broker); *see also In re* Cannon, 230 B.R. 546, 594-95, *modified*, 232 B.R. 701 (W.D. Tenn. 1999) (awarding gross trading losses for commodities fraud); *In re* Clinton Oil Co. Sec. Litig., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,016 (D. Kan. Mar. 22, 1977) (noting that under rule 10b-5, "profit/loss margins on sales of shares obtained in separate and independent purchase transactions should not be offset for the purpose of reaching a net figure").

losses against earlier profits.[190] This has the effect of putting the injured party in a better position than the party would have enjoyed but for the fraud. This is justified to further the policy of deterring fraud.[191]

IV. CONCLUSION

Liability for securities fraud has followed different paths under federal and Arizona law. Liability under rule 10b-5 has become increasingly difficult to establish. The need for proof of scienter, reliance and loss causation, coupled with the elimination of secondary liability for conspiracy and aiding and abetting, has diminished the efficacy of rule 10b-5 as a remedy for injured plaintiffs. Complicating matters still more for rule 10b-5 plaintiffs is the absence of a basis for attorney fees or punitive damages and uncertainty as to prejudgment interest. Arizona's securities laws are substantially more protective of defrauded investors. Injured parties suing under title 44, section 1991(A) of the Arizona Revised Statutes can prove liability on the basis of negligent or even innocent misstatements or omissions, so long as they are material. Through statutory participant and control liability, and a panoply of secondary theories of liability—agency, aiding and abetting, conspiracy and indirect fraud—injured investors enjoy a versatile array of theories to reach securities violators. Loss causation is unnecessary where the defendants' conduct falls within the statutory exception for dishonest or unethical conduct within the securities industry. The remedy for a title 44, section 1991(A) violation is an easily proved rescissory calculation that returns the investor's full principal loss with interest, attorney fees and punitive damages if the defendant's conduct is sufficiently egregious. All in all, the advantages offered to securities fraud victims by Arizona law have reduced rule 10b-5 claims to a decidedly second tier theory of liability.

The divergence of Arizona and federal securities fraud law is unlikely to change. Different statutory interpretations are required for at least three reasons. First, the express remedy features of Arizona's securities statutes require the courts to implement the remedies the legislature enacted. Use of common-law remedy restrictions like those federal courts use in interpreting rule 10b-5 is inconsistent with sound statutory construction of Arizona

190. *See In re* Cannon, 230 B.R. at 594-94.

191. *See Kane*, 916 F.2d at 646 (applying Florida law); *see also* Randall v. Loftsgaarden, 478 U.S. 647, 664 (1986) (finding that with respect to section 12(2) claims, the deterrent purpose of securities laws is "ill served by a too rigid insistence on limiting plaintiffs to recovery of their 'net economic loss'") (quoting Salcer v. Envicon Equities Corp., 744 F.2d 935, 940 (2d Cir. 1984)).

securities laws. Second, Arizona's legislature has directed the courts to employ a liberal, remedial interpretation of the state's securities statutes. Comparable legislative guidance is absent at the federal level. Third, the Arizona legislature has exercised its law-making prerogatives to enact unique statutes, which depart from federal law on matters like participant liability and loss causation. These differences in legislative remedies, intent and statutory content have produced distinct regimes of civil liability for securities fraud under Arizona and federal law.