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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

ORTHOLOGIC CORP.,
Plaintiff,
vs.
COLUMBIA/HCA HEALTHCARE)
CORP.; SMITH LABORATORIES, INC.;
GALEN OF KENTUCKY, INC.,
Defendants.

No. CIV 01-0006-PHX-SRB

ORDER

This matter comes before the court on the Defendants' Motion to Dismiss the third, fourth, fifth, seventh, and eighth claims of the Plaintiff's first amended complaint pursuant to Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure (Doc. 10). The Plaintiff alleges several claims under both state and federal law for securities fraud, common law fraud, negligent misrepresentation, express and implied indemnity, breach of contract, and contribution.

I. BACKGROUND

This case arises out of the purchase of Sutter Corporation (Sutter) by Plaintiff OrthoLogic Corporation (OrthoLogic) from Defendant Smith Laboratories, Inc. (Smith). The following recitation of the facts is taken mostly from the complaint and is presumed to be true for the purposes of this motion. Sutter manufactures and distributes continuous passive

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1 motion exercise machines (CPMs) and ancillary products, which are used to treat medical
2 conditions such as bone fractures and joint replacements. In August 1996, OrthoLogic,
3 Sutter, and Smith entered into a Stock Purchase Agreement (Agreement) whereby
4 OrthoLogic purchased 100% of Sutter's outstanding shares from Smith. Defendant Smith
5 is owned 100% by Defendant Columbia/HCA Healthcare Corporation (HCA), and HCA
6 employees negotiated and participated in drafting the Agreement on Smith's behalf.
7 Defendant Galen of Kentucky, Inc. (Galen) guaranteed that it would stand behind all the
8 obligations owed to the Plaintiff under the Agreement.

9 As a health care company, Sutter must comply with federal laws which prohibit Sutter
10 from offering any form of "kickbacks" in return for the referral of patients for items that may
11 be reimbursed by Medicare and Medicaid. Federal law further prohibits the making of false
12 statements in connection with claims made to the federal government for reimbursement
13 from such federal programs. After closing on the Stock Purchase Agreement, OrthoLogic
14 discovered that Sutter was named as a defendant in a False Claims Act suit initiated by a
15 private citizen on behalf of the United States and in which the Department of Justice later
16 intervened (the Qui Tam action). In the Qui Tam action, the plaintiff alleges that Sutter
17 knowingly made false statements in connection with the submission of claims for payment
18 to the federal government. The Qui Tam plaintiff further alleges that Sutter knowingly
19 offered and paid remuneration directly and indirectly to physicians and patients in order to
20 induce physicians to refer their patients to Sutter and to induce patients to use Sutter's CPMs
21 and ancillary products. OrthoLogic was later named as a defendant in the Qui Tam action.

22 OrthoLogic alleges that the Stock Purchase Agreement contained material
23 misrepresentations and omissions regarding the illegal practices alleged in the Qui Tam suit.
24 The Plaintiff also claims that the Defendants "had to know" of the illegal practices and
25 identifies an internal audit performed by HCA and distributed in 1993 which allegedly shows
26 the Defendants' awareness of the facts underlying the Qui Tam suit. The Defendants argue
27 that several of the Plaintiff's claims must be dismissed because they fail to meet the
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1 applicable heightened pleading requirements or because they fail to state a claim pursuant
2 to Rule 12(b)(6). At oral argument and without opposition from the Plaintiff, the court
3 dismissed the Plaintiff's third claim for contribution and fourth claim as asserted against
4 Defendants Smith and Galen.

5 II. LEGAL STANDARDS AND ANALYSIS

6 A. Rule 9(b)

7 The Defendants first argue that the Plaintiff's common law fraud, Arizona securities
8 fraud, and section 10(b) claims fail to satisfy the requirements of Rule 9(b). The Federal
9 Rules of Civil Procedure generally require a "short and plain statement of the claim showing
10 that the pleader is entitled to relief." Fed. R. Civ. P. 8; *Gilligan v. Jamco Dev. Corp.*, 108
11 F.3d 246, 248 (9th Cir. 1997). For claims involving fraud, however, Rule 9(b) poses
12 additional pleading requirements. Rule 9(b) provides: "In all averments of fraud or mistake,
13 the circumstances constituting fraud or mistake shall be stated with particularity." Fed. R.
14 Civ. P. 9(b). The heightened pleading requirement of Rule 9(b)

15 serves not only to give notice to defendants of the specific fraudulent conduct
16 against which they must defend, but also "to deter the filing of complaints as
17 a pretext for the discovery of unknown wrongs, to protect [defendants] from
18 the harm that comes from being subject to fraud charges, and to prohibit
19 plaintiffs from unilaterally imposing upon the court, the parties and society
20 enormous social and economic costs absent some factual basis."

21 *Bly-Magee v. State of California*, 236 F.3d 1014, 1018 (9th Cir. 2001) (quoting *In re Stac*
22 *Elec. Sec. Litig.*, 89 F.3d 1399, 1405 (9th Cir. 1996)). To meet the Rule 9(b) particularity
23 requirement,

24 a plaintiff must set forth more than the neutral facts necessary to identify the
25 transaction. The plaintiff must set forth what is false or misleading about a
26 statement, and why it is false. In other words, the plaintiff must set forth an
27 explanation as to why the statement or omission complained of was false or
28 misleading.

29 *Yourish v. California Amplifier*, 191 F.3d 983, 993 (9th Cir. 1999) (quoting *In re GlenFed*
30 *Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir. 1994) (en banc)). In addition, the plaintiff must
31 "set forth, as part of the circumstances constituting fraud, an explanation as to why the
32 disputed statement was untrue or misleading when made." *Id.* (quoting *GlenFed*, 42 F.3d

1 at 1549). The falsity of the challenged representation may be proven “by pointing to
2 inconsistent contemporaneous statements or information (such as internal reports) which
3 were made by or available to the defendants.” *Id.* (quoting *GlenFed*, 42 F.3d at 1549). In
4 *GlenFed*, the United States Court of Appeals for the Ninth Circuit explained that the
5 “plaintiff must include statements regarding the time, place, and nature of the alleged
6 fraudulent activities, and that ‘mere conclusory allegations of fraud are insufficient.’”
7 *GlenFed*, 42 F.3d 1541, 1548 (9th Cir. 1994) (en banc) (quoting *Moore v. Kayport Package*
8 *Express, Inc.*, 885 F.2d 531, 540 (9th Cir. 1989)), *superseded by statute on other grounds*,
9 Private Securities Litigation Reform Act of 1995, Public Law 104-67 (codified at 15 U.S.C.
10 § 78u-4 (1995)).

11 In the present case, the Plaintiff’s fifth, seventh, and eighth causes of action are based
12 on allegations that the Defendants fraudulently misrepresented or omitted material
13 information regarding the facts alleged in the Qui Tam suit. The complaint lists the allegedly
14 misleading provisions of the Stock Purchase Agreement which represented to the Plaintiff
15 that Sutter had disclosed all liabilities and obligations, that there had been no material
16 adverse change in the business since the date of the Interim Balance Sheet, that Sutter was
17 in material compliance with all legal requirements, that all pending legal proceedings that
18 could affect the business had been disclosed, that Sutter had not made any illegal bribes or
19 kickbacks, and that Smith had disclosed all material facts.

20 The Plaintiff argues that the provisions listed in the complaint contain
21 misrepresentations because the Defendants “had to know of the facts alleged as ‘standard
22 practices’ in the Qui Tam Action or that allegations of such actions had been made.” To
23 support its allegations of intentional fraud, the complaint refers only to a 1993 audit
24 completed by HCA which allegedly demonstrates the Defendants’ awareness of the facts
25 alleged in the Qui Tam suit. This 1993 audit found that Sutter had an inadequate system of
26 internal controls and systems and that improvements were needed in Sutter’s billing and
27 accounting procedures. The complaint specifically refers to the audit’s finding that sales
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1 representatives were responsible for substantial write-offs of amounts owed for CPMs
2 because the sales representatives “did not want these amounts collected from the patient
3 because to do so would jeopardize the representative’s relationship with the physicians.” The
4 need for tighter accounting and the sales representatives’ concerns about preserving their
5 relationships with physicians are not necessarily inconsistent with any of the representations
6 made in the Stock Purchase Agreement. The complaint fails to state how the “inadequate
7 system of internal controls and systems” and the “substantial write-offs” show that Sutter
8 employees were providing illegal kick-backs to patients and physicians or which legal
9 requirements, if any, were violated by conduct revealed in the 1993 audit. The Plaintiff’s
10 complaint does not satisfy the heightened pleading requirements of Rule 9(b).

11 The Defendants also argue that the complaint fails to plead with particularity
12 regarding each Defendant’s alleged conduct and that general allegations against all the
13 Defendants collectively does not meet the pleading requirements of Rule 9(b). A plaintiff
14 pleading fraud against multiple defendants must provide reasonable notice to each defendant
15 of the conduct alleged to constitute fraudulent behavior. *See Brooks v. Blue Cross and Blue*
16 *Shield of Florida, Inc.*, 116 F.3d 1364, 1381 (11th Cir. 1997) (dismissing the plaintiff’s
17 Amended Complaint pursuant to Rule 9(b) because the Amended Complaint was “devoid of
18 specific allegations with respect to the separate Defendants”); *DiVittorio v. Equidyne*
19 *Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2nd Cir. 1987) (“Where multiple defendants
20 are asked to respond to allegations of fraud, the complaint should inform each defendant of
21 the nature of his alleged participation in the fraud.”). In the present case, the complaint
22 alleges that Smith made fraudulent representations as a signatory to the Stock Purchase
23 Agreement, that HCA employees negotiated and participated in drafting the Agreement on
24 Smith’s behalf, and that Galen explicitly guaranteed all of the obligations owed to the
25 Plaintiff under the Agreement. The court finds that the Plaintiff has pleaded sufficient facts
26 to provide notice to Defendants Smith and HCA regarding the basis for the Plaintiff’s claims.

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1 Regarding Defendant Galen, however, the Plaintiff does not provide sufficient facts
2 to discern whether Galen made or adopted any of the alleged misrepresentations. Secondary
3 actors are not liable under section 10(b) of the Securities Exchange Act as aiders and abettors
4 to securities fraud. *See Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S.
5 164, 191, 114 S. Ct. 1439, 1455 (1994). *Central Bank of Denver* involved alleged fraud in
6 connection with the sale of public bonds. *Id.* at 167, 1443. In *Central Bank of Denver*, the
7 plaintiff alleged that Defendant Central Bank, who was the indenture trustee for the bond
8 issues, was aware of concerns about the inaccuracy of an appraisal of the land securing the
9 bonds and that Central Bank rendered substantial assistance to the primary violators by
10 delaying the independent review of the allegedly inaccurate appraisal. *Id.* at 168, 1443-44.
11 Despite the Court of Appeals's finding that a material issue of fact existed regarding the truth
12 of these allegations, *id.* at 168, 1444, the United States Supreme Court found that Central
13 Bank could not be liable under § 10(b) when the plaintiffs conceded that Central Bank did
14 not directly commit "a manipulative or deceptive act within the meaning of § 10(b)." *Id.* at
15 191, 1455. In the present case, the Plaintiff does not deny that Galen's liability is premised
16 solely on the allegation that "Galen explicitly guaranteed that it would stand behind the
17 indemnification provision and all of the obligations owed to OrthoLogic under the Stock
18 Purchase Agreement." Furthermore, the Plaintiff does not allege that Galen directly
19 committed a fraudulent act by providing material misrepresentations or omissions or that
20 Galen explicitly guaranteed that the representations contained in the Agreement were true.
21 Thus, the court finds that the Plaintiff's § 10(b) claim against Defendant Galen fails to meet
22 the applicable pleading requirements.

23 Pursuant to the Arizona Securities Act, liability may be imposed on certain secondary
24 actors. A.R.S. § 44-2001 permits a claim for rescission or damages pursuant to liability
25 under § 1991. A.R.S. § 44-2003 imposes liability for actions brought under § 2001 to those
26 who "made, participated in or induced the unlawful sale or purchase" of the securities.
27 Arizona Revised Statutes (A.R.S.) § 44-2003(A) (West 1994 & Supp. 2000). It is clear,
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1 however, that § 2003 does not impose liability on all collateral parties no matter how
2 remotely connected to the securities transaction. *See Standard Chartered PLC v. Price*
3 *Waterhouse*, 945 P.2d 317, 332-33 (Ariz. Ct. App. 1997) (finding that collateral actors who
4 “neither financially participate, nor promote or solicit the transaction, but merely provide
5 information that contributes to a buyer or seller’s decision to close the deal” cannot be held
6 liable under § 2003). Although in *State of Arizona v. Superior Court of Maricopa County*,
7 599 P.2d 777 (Ariz. 1979) (en banc), the Arizona Supreme Court denied a motion to dismiss
8 a § 1991 claim against parties collateral to the securities transaction, the plaintiffs in *State*
9 *v. Superior Court* cited “specific omissions and representations” made by the collateral
10 parties which induced the plaintiffs to engage in the transaction at issue, *id.* at 783-84. In the
11 present case, the Plaintiff argues that Galen “assumed responsibility” for the representations
12 made in the Stock Purchase Agreement but fails to provide detailed pleadings which show
13 that Galen actually adopted the representations made in the Agreement. Thus, the court finds
14 that to meet the Rule 9(b) requirements regarding the § 10(b) and the § 1991 claims against
15 Defendant Galen, the Plaintiff must specify how Galen explicitly adopted the alleged
16 omissions or misrepresentations made in the Stock Purchase Agreement.

17 B. A.R.S. § 44-2082

18 The Defendants also assert that the Plaintiff’s claim under § 1991 should be dismissed
19 because the Plaintiff has failed to meet Arizona’s heightened pleading requirements for the
20 factual basis of the alleged fraud and for the Defendants’ state of mind. For claims arising
21 under § 1991,

22 the complaint must specify each alleged untrue statement or material omission
23 and the reason or reasons why the statement or omission is misleading or the
24 omission is material and, if an allegation regarding the statement or omission
is made on information and belief, the complaint shall state with particularity
all facts on which that belief is formed.

25 A.R.S. § 2082(A). As noted above, the court finds that the Plaintiff must plead the factual
26 circumstances of the alleged fraud with greater particularity and grants the Plaintiff leave to
27 amend the complaint in this regard.

1 In terms of the pleading requirement related to the Defendants' state of mind, A.R.S.
2 § 2082 sets forth a heightened pleading standard under certain circumstances. A.R.S. §
3 2082(B) provides:

4 In any private action arising under § 44-1991 or 44-1992 in which the plaintiff
5 may recover money damages only on proof that the defendant acted with a
6 particular state of mind, for each act or omission that allegedly violates § 44-
1991 or 44-1992, the complaint shall state with particularity facts giving rise
to a strong inference that the defendant acted with the required state of mind.

7 A.R.S. § 2082(B). The Plaintiff argues that this heightened pleading standard does not apply
8 to the present case because liability under § 1991 does not require proof of a particular state
9 of mind. The case law, however, only partially supports the Plaintiff's argument.

10 As the interpretation of § 1991 has evolved, Arizona courts have reached different
11 conclusions regarding whether scienter is required for § 1991 liability. *See, e.g., Baker v.*
12 *Walston & Co., Inc.*, 442 P.2d 148, 151 (Ariz. Ct. App. 1968) (finding that knowledge of
13 falsity is not a necessary element of § 1991); *Greenfield v. Cheek*, 593 P.2d 280, 296 (Ariz.
14 Ct. App. 1978), *approved and adopted*, 593 P.2d 280 (Ariz. 1979) (finding that intent to
15 deceive, or scienter, is necessary to sustain a claim under § 1991); *State v. Superior Court*,
16 599 P.2d at 788 (acknowledging in a supplemental opinion that its original finding that
17 knowledge of falsity was not required for a § 1991 claim was erroneous).

18 The Arizona Supreme Court has since provided useful guidance in resolving the
19 scienter requirement controversy. In *State v. Gunnison*, 618 P.2d 604, 606-07 (Ariz. 1980),
20 the Arizona Supreme Court reviewed the cases interpreting § 1991 and concluded that it
21 would adopt the reasoning set forth by the United States Supreme Court in interpreting the
22 federal counterpart to § 1991, section 17(a) of the Securities Act of 1933 (the 1933 Act), 15
23 U.S.C. § 77q(a) (1994). The *Gunnison* court explained: "Although we are not bound by the
24 interpretation placed by the United States Supreme Court on the federal statute, it is helpful,
25 for consistency in the application of the law, to be harmonious with the United States
26 Supreme Court." *Gunnison*, 618 P.2d at 606. After considering the analysis of the United
27 States Supreme Court in *Aaron v. SEC*, 446 U.S. 680, 696, 100 S. Ct. 1945, 1955 (1980), the
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1 *Gunnison* court ultimately held that “scienter is not an element of a violation of A.R.S. § 44-
2 1991(2), even though it may be an element of A.R.S. § 44-1991(1).” *Gunnison*, 618 P.2d at
3 607. Although the *Gunnison* court limited its holding to an interpretation of A.R.S. § 44-
4 1991(2), the *Gunnison* court clearly subscribed to the reasoning provided by the *Aaron* Court.
5 In *Aaron*, the United States Supreme Court carefully analyzed the statutory language of
6 §17(a) of the 1933 Act, which contains an identical structure and substantially similar
7 language to Arizona’s § 1991,¹ and determined that “the language of §17(a) requires scienter²
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9 ¹ Section 17(a) of the 1933 Act provides, in its entirety:

10 It shall be unlawful for any person in the offer or sale of any securities
11 or any security-based swap agreement (as defined in section 206B of the
12 Gramm-Leach-Bliley Act) by the use of any means or instruments of
13 transportation or communication in interstate commerce or by use of the mails,
14 directly or indirectly

- 15 (1) to employ any device, scheme, or artifice to defraud, or
16 (2) to obtain money or property by means of any untrue statement of
17 a material fact or any omission to state a material fact necessary in
18 order to make the statements made, in light of the circumstances
19 under which they were made, not misleading; or
20 (3) to engage in any transaction, practice, or course of business
21 which operates or would operate as a fraud or deceit upon the
22 purchaser.

23 15 U.S.C. § 77q(a). Similarly, § 1991 of the Arizona Securities Act states:

24 A. It is a fraudulent practice and unlawful for a person, in connection
25 with a transaction or transactions within or from this state involving an offer
26 to sell or buy securities, or a sale or purchase of securities, including securities
27 exempted under § 44-1843 or 44-1843.01 and including transactions exempted
28 under § 44-1844, directly or indirectly to do any of the following:

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.

1 under § 17(a)(1), but not under § 17(a)(2) or § 17(a)(3).” *Aaron*, 446 U.S. at 697, 100 S. Ct.
2 at 1956. Because the language of § 17(a) of the 1933 Act and § 1991 of the Arizona
3 Securities Act are identical in all relevant respects and because the Arizona Supreme Court
4 has acknowledged its concurrence with the United States Supreme Court’s interpretation of
5 § 17(a), this court finds that proof of scienter is required to succeed on a claim under §
6 1991(A)(1), but not under § 1991(A)(2) or § 1991(A)(3).

7 In the present case, the Plaintiff, in its seventh claim for relief, asserts claims of fraud
8 against all three Defendants under §§ 1991(A)(1), (A)(2), and (A)(3). Because scienter is
9 not a required element of claims under §§ 1991(A)(2) or (A)(3), the court finds no basis to
10 dismiss these claims for defects in the Plaintiff’s pleadings regarding state of mind. The
11 court proceeds to determine the sufficiency of the Plaintiff’s state of mind pleading only with
12 respect to the § 1991(A)(1) claim. The complaint generally pleads scienter by stating:

13 The alleged facts in the Qui Tam Action, if established, and the information
14 combined in the 1993 Audit demonstrate that defendants knowingly and/or
15 intentionally misrepresented the facts about Sutter’s business to OrthoLogic
16 and knowingly and/or intentionally withheld critical information from
OrthoLogic that defendants knew would be of material importance to
OrthoLogic’s decision to buy Sutter stock and the price to be paid for such
stock.

17 This general allegation does not suffice to raise “a strong inference that the defendant acted
18 with the required state of mind.” The problems identified in the 1993 Audit regarding
19 Sutter’s accounting and billing procedures fail to show that the Defendants knew that Sutter
20 was violating the legal requirements alleged in the Qui Tam suit and that the Defendants
21 intentionally withheld this information from OrthoLogic. Moreover, the Plaintiff relies on
22 the same factual allegations on which it relies to establish the existence of fraudulent
23 conduct. As noted above, the allegations regarding the Qui Tam action and the information

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25 A.R.S. § 44-1991(A).

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27 ² The *Aaron* court defined scienter as “a mental state embracing intent to deceive,
28 manipulate, or defraud.” *Aaron*, 446 U.S. at 686 n.1, 100 S. Ct. at 1950 n.1 (internal
citations omitted).

1 contained in the 1993 Audit fail to show the existence of fraudulent conduct, much less the
2 intent to defraud. Thus, the Plaintiff has not met the heightened pleading standard imposed
3 by A.R.S. § 2082(B) on the scienter element of its § 1991(A)(1) claim.

4 Rule 15(a) of the Federal Rules of Civil Procedure states that leave to amend a
5 pleading “shall be freely given when justice so requires.” Fed. R. Civ. P. 15(a). The United
6 States Court of Appeals for the Ninth Circuit has held that “leave to amend should be granted
7 unless the district court ‘determines that the pleading could not possibly be cured by the
8 allegation of other facts.’” *United States v. SmithKline Beecham, Inc.*, 245 F.3d 1048, 1052
9 (9th Cir. 2001) (quoting *Lopez v. Smith*, 203 F.3d 1122, 1127 (9th Cir. 2000)). In the present
10 case, the Plaintiff has not been offered a previous opportunity to amend its complaint to
11 address the Rule 9(b) and A.R.S. § 2082 defects, and there is no evidence showing that
12 allowing the opportunity to amend the complaint would be futile. The Plaintiff’s complaint
13 alleges that the Defendants “had to know the facts” alleged in the Qui Tam suit and lists the
14 1993 audit as an “example.” If the Plaintiff has knowledge of other examples of allegedly
15 inconsistent contemporaneous statements and more information regarding Galen’s
16 participation in the fraud and the Defendants’ state of mind, inclusion of this information in
17 an amended complaint may cure the above-discussed pleading deficiencies.

18 C. Rule 12(b)(6)

19 Dismissal for insufficiency of a complaint is proper if, on its face, the complaint fails
20 to state a claim. *Lucas v. Bechtel Corp.*, 633 F.2d 757, 759 (9th Cir. 1980). A Rule
21 12(b)(6) dismissal for failure to state a claim can be based on either: (1) the lack of a
22 cognizable legal theory; or (2) insufficient facts to support a cognizable legal claim.
23 *Balistreri v. Pacifica Police Dep’t*, 901 F.2d 696, 699 (9th Cir. 1990); *Robertson v. Dean*
24 *Witter Reynolds, Inc.*, 749 F.2d 530, 534 (9th Cir. 1984).

25 In determining whether a complaint states a valid claim, all allegations of material
26 fact are taken as true and construed in the light most favorable to the non-moving party.
27 *Clegg v. Cult Awareness Network*, 18 F.3d 752, 754 (9th Cir. 1994). The complaint should
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1 not be dismissed unless it appears beyond doubt that there are “no set of facts” which would
2 entitle the plaintiff to relief under the asserted claim. *Conley v. Gibson*, 355 U.S. 41, 45-46
3 (1957); *see also Balistreri*, 901 F.2d at 701.

4 1. Section 1998 Claim

5 The Defendants argue that the Plaintiff’s seventh claim pursuant to A.R.S. § 44-
6 1998(A) should be dismissed because § 1998 establishes a right to relief only when material
7 misrepresentations or omissions are made in connection with the sale of securities in either
8 an oral communication or prospectus. The Plaintiff’s complaint does not allege that any
9 misrepresentations or omissions were made in an oral communication or prospectus. Rather,
10 the Plaintiff argues that the misrepresentations and omissions contained in the Stock
11 Purchase Agreement are a proper basis for relief under § 1998 because the term “prospectus”
12 encompasses a private contract for the sale of securities.

13 Section 1998 imposes liability upon

14 any person who offers or sells a security by means of a prospectus or oral
15 communication that includes an untrue statement of a material fact or omits to
16 state a material fact necessary in order to make the statements, in light of the
circumstances under which they were made, not misleading.

17 A.R.S. § 44-1998(A). The parties have not identified and the court has not uncovered any
18 binding precedent which controls whether a private contract for the sale of stock is a
19 “prospectus” within the terms of § 1998. The United States Supreme Court, however, has
20 considered this precise issue in interpreting the federal counterpart to § 1998, §12(2) of the
21 1933 Act, 15 U.S.C. § 77l(2) (1994 & Supp. 1999).³ *See Gustafson v. Alloyd Co., Inc.*, 513

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23 ³ Section 12(2) of the 1933 Act imposes liability on any person who

24 offers or sells a security . . . by the use of any means or instruments of
25 transportation or communication in interstate commerce or of the mails, by
26 means of a prospectus or oral communication, which includes an untrue
27 statement of a material fact or omits to state a material fact necessary in order
28 to make the statements, in the light of the circumstances under which they
were made, not misleading.

1 U.S. 561, 115 S. Ct. 1061 (1995). After an extensive review of the statutory language and
2 the legislative history of § 12(2), the *Gustafson* Court held that “the word ‘prospectus’ is a
3 term of art referring to a document that describes a public offering of securities by an issuer
4 or controlling shareholder” and that the contract of sale at issue in *Gustafson* was not a
5 prospectus within the meaning of § 12(2). *Id.* at 584, 1073-74. Although unlike its federal
6 counterpart, the Arizona Securities Act does not contain a statutory definition of the term
7 “prospectus,” the language of § 12(2) is identical in all relevant respects to the language of
8 § 1998(A).

9 The Plaintiff argues that the absence of a statutory definition for the term “prospectus”
10 in the Arizona Securities Act provides a meaningful distinction from § 12(2) which makes
11 the *Gustafson* analysis inapplicable to the present case. However, the definition of a
12 “prospectus” provided in § 2(10) of the 1933 Act, 15 U.S.C. § 77b(10), serves to potentially
13 broaden the types of documents which fall within its reach. Section 2(10) defines a
14 “prospectus” as “any prospectus, notice, circular, advertisement, letter, or communication,
15 written or by radio or television, which offers any security for sale or confirms the sale of any
16 security.” 15 U.S.C. § 77b(10). The plaintiff in *Gustafson* argued that this statutory
17 definition supported a finding that any written communication offering a security for sale is
18 a “prospectus.” *Gustafson*, 513 U.S. at 574, 115 S. Ct. at 1069. In response, the *Gustafson*
19 Court conducted an extensive analysis, ultimately concluding that a contract of sale was not
20 a “communication” within the meaning of § 2(10). *Id.* at 574-75, 1069-70. The absence of
21 a definition of “prospectus” in the Arizona statutes suggests that the term “prospectus” was
22 not intended to be interpreted beyond its commonly understood meaning and usage as a term
23 of art. Given the Arizona Supreme Court’s comment that “it is helpful, for consistency in
24 the application of the law, to be harmonious with the United States Supreme Court,”
25 *Gunnison*, 618 P.2d at 606, this court finds that the term “prospectus,” as it is used in §
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27 15 U.S.C. § 77l(2).
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1 1998(A), is a term of art that does not include a contract for the sale of stock. Because the
2 Plaintiff does not deny the absence of a public offering in the present case, the court finds
3 that the Plaintiff's claim pursuant to § 1998 must be dismissed.

4 2. Implied Indemnity Claim

5 Regarding the Plaintiff's fourth claim for relief, the court at oral argument dismissed
6 the implied indemnity claim against Defendants Smith and Galen without opposition from
7 the Plaintiff. Thus, the instant Motion to Dismiss regarding the fourth cause of action applies
8 only to Defendant HCA. Defendant HCA argues that the implied indemnity claim must be
9 dismissed because the express indemnity provision of the Stock Purchase Agreement
10 supersedes any right to implied indemnity. In Arizona, if an express indemnity provision
11 binds the parties, this provision will determine the extent of the duty to indemnify. *INA Ins.*
12 *Co. of N. Amer. v. Valley Forge Ins. Co.*, 722 P.2d 975, 979 (Ariz. Ct. App. 1986); *see also*
13 *Schweber Elecs. v. Nat'l Semiconductor Corp.*, 850 P.2d 119, 123 (Ariz. Ct. App. 1992).
14 The *INA* court reasoned: "Recovery under a contract providing for indemnity obviates any
15 right to recover under the common law theory of implied indemnity since by such an express
16 contract the parties have already themselves determined how and under what circumstances
17 losses shall be allocated." *INA*, 722 P.2d at 979.

18 Section 12.2 of the Stock Purchase Agreement contains the express indemnity
19 provision whereby Smith agreed to indemnify the Plaintiff from any liability or damages
20 arising from any breach of the representations and warranties made by Smith in Sections 3
21 and 4 of the Agreement. The complaint alleges that Galen expressly guaranteed that it would
22 stand behind Smith's obligation to indemnify. The Plaintiff asserts that the express
23 indemnity provision in the Agreement does not bind HCA to an obligation to indemnify
24 because HCA was not a party to the contract. The Defendant does not deny that HCA was
25 not a party to the Agreement but argues that because HCA was involved in the negotiation
26 and drafting of the contract, the parties clearly intended to exclude HCA from any obligation
27 to indemnify by not imposing such an obligation through the express indemnity provision.
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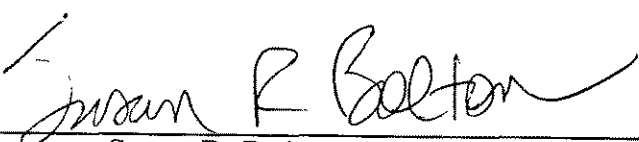
1 HCA, however, was not a party to the Stock Purchase Agreement, and there is no evidence
2 suggesting that the parties bargained for HCA's exclusion from indemnification. As Smith's
3 parent corporation, HCA may be liable under common law principles of implied indemnity
4 for its "passive' or 'secondary' negligence." *Id.* Thus, the court finds that the Plaintiff has
5 stated a proper claim against HCA for implied indemnity under its fourth claim for relief.

6 IT IS ORDERED granting the Defendants' Motion to Dismiss regarding the
7 Plaintiff's Section 1998 claim and dismissing this claim with prejudice (Doc. 10).

8 IT IS FURTHER ORDERED granting the Defendants' Motion to Dismiss regarding
9 the Plaintiff's common law fraud (fifth claim), Section 10(b) (eighth claim), and Section
10 1991 claims. These claims are dismissed without prejudice, with leave granted to the
11 Plaintiff to amend its complaint (Doc. 10).

12 IT IS FURTHER ORDERED denying the Defendants' Motion to Dismiss regarding
13 the Plaintiff's Implied Indemnity claim against Defendant HCA (Doc. 10).

14 DATED this 4th day of January, 2002.

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18 Susan R. Bolton
19 United States District Judge
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