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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2010-023555 03/02/2011

HONORABLE GEORGE H. FOSTER, JR.

CLERK OF THE COURT
L. Timpauer
Deputy

TRUSTBANK JOHN M O'NEAL

v.

SURANCE L L C, et al. THOMAS P KACK

RULING

The Court took under advisement the matter of the Plaintiff's Motion to Dismiss the Counterclaims filed by the Defendants. The Court having considered the Motion, the Response, the Reply and the arguments of counsel finds as follows.

The Defendants' Counterclaim alleges under Count 1 Misrepresentation-Concealment, under Count 2, Negligent Misrepresentation, and under Count 3, Breach of the Covenant of Good Faith and Fair Dealing. The motion seeks to dismiss all three counts.

The Court should not grant a motion to dismiss unless it appears certain that the Plaintiff would be entitled to no relief under any state of facts which is susceptible of proof under the claim as stated. Rule 8(a), Rules of Civil Procedure 1956, section 21-404, A.C.A. 1939; 2 Moore's Federal Practice, par. 8.13; 6 Moore's Federal Practice, par. 54.60. The purpose of the foregoing rule is to avoid technicalities and give the opponent fair notice of the nature and basis of the claim and indicate generally the type of litigation involved. *Mackey v Spangler*, 81 Ariz. 113, 301 P.2d 1026 (1956).

The Plaintiff argues that the misrepresentation-concealment claim must be dismissed because it is in reality a non-disclosure claim. A review of the facts alleged in the Counterclaim support the argument of the Plaintiff. Nothing is alleged that complies with Rule 9's requirement that matters of fraud be plead with particularity to support a claim for misrepresentation based on

concealment. The fair, not extended, reading of the Complaint indicates that the Plaintiff did not disclose knowledge of an appraisal that valued the property at a value less than the purchase price. The Counterclaim does not allege any specific facts indicating any actions taken by the Plaintiff to "conceal" the appraisal as that term has been construed under Arizona law. "[T]he common law clearly distinguishes between concealment and nondisclosure. The former is characterized by deceptive acts or contrivances intended to hide information, mislead, avoid suspicion, or prevent further inquiry into a material matter. The latter is characterized by mere silence." Wells Fargo *Bank* v. Arizona Laborers, Teamsters and Cement Masons, 201 Ariz. 474, 498, 38 P.3d 12, 36 (2002). citing *United States v. Colton*, 231 F.3d 890, 899 (4th Cir.2000). The Counterclaim under Count 1 in this case is sufficient to allege non-disclosure but fails to be sufficient to allege concealment.

The Plaintiff argues that absent a special relationship between the parties, the bank is not under any duty to disclose. For this proposition the bank cites *Universal Investments CO. v Sahara Motor Inn, Inc*., 127 Ariz. 213, 6219 P.2d 485 (1980). But even that case notes there are exceptions to that general rule ("although generally no duty to disclose exists between [parties in an arm's length transaction] certain circumstances may give rise to such a duty"). *Id*. 127 Ariz. at 215.

The Courts have recognized special circumstances where a duty to disclose exists, such as where the bank has information not known to a customer that may tend to perpetrate a fraud. As stated by the Arizona Supreme Court in *Wells Fargo*:

> The primary case relied on by the lower courts, *Kesselman,* dealt solely with negligence-based claims that required a predicate legal duty and is thus not applicable to the intentional tort claims raised by the Funds. *Kesselman*, 188 Ariz. at 419, 937 P.2d at 341. Moreover, *Kesselman* is distinguishable on its facts.
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> ¶ 23 *Kesselman* involved no intentional tort claims. It held simply that a bank, under a negligence standard, is under no duty to private investors to take affirmative measures to avoid loss caused by check kiting by the bank's customer, absent a special relationship between the bank and the investors. *Id*. at 423-24, 937 P.2d at 345-46.
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> ¶ 24 The *Kesselman* plaintiffs cited several cases in support of their argument that the bank owed them a duty of disclosure. The Court found these cases unhelpful to the plaintiffs' argument, pointing out that the "key distinguishing factor in all of the cases [where a duty to disclose was found] ... is that the banks were *directly involved with the third parties in the transactions that were the subject of litigation.* This involvement satisfied the necessary relationship giving

rise to the duty of disclosure." *Id*. at 423, 937 P.2d at 345 (emphasis added). The facts of *Kesselman* disclosed no such relationship. In contrast, the Triparty Agreement, which the Bank insisted upon in the case at bar, provides clear, direct involvement between the Bank and the Funds.

¶ 25 Moreover, while the court in *Kesselman* expressed no opinion on whether the bank owed a duty to any regulatory agency to report irregularities observed in its customer's account, the court did recognize, albeit in dictum, that fraudulent practices by a customer have "a very damaging effect on innocent persons, and a bank's failure to put an end to the practice contributes to such damage." *Id*. at 424, 937 P.2d at 346.

¶ 26 Even if the Funds' claims were dependent on a duty to disclose, *Kesselman* itself cited a Minnesota case that more accurately contemplates the facts presented here. *See Richfield Bank & Trust Co. v. Sjogren*, 309 Minn. 362, 244 N.W.2d 648 (1976). There, the Minnesota Supreme Court recited the rule that generally a party to a transaction has no duty to disclose material facts to the other party unless a "special circumstance" exists. *Id*. at 650. The court acknowledged that special circumstances are typically those where there is a fiduciary or confidential relationship**, or where one party has special knowledge of material facts to which the other party has no access, or where one party has spoken, but has not said enough to prevent his words from being misleading. *Id.***

¶ 27 The court explained that there were situations beyond those enumerated which would constitute special circumstances giving rise to an obligation to disclose. *Id*. The court held that one of those "special circumstances" arises when a bank has actual knowledge of the fraudulent activities of a customer and that if a bank has actual knowledge of the fraud, it has a concomitant "affirmative duty to disclos[e] those facts" before it engages in transactions with the customer which "further [ ] the fraud." *Id*. at 652; *see also Barnett Bank of West Florida v. Hooper*, 498 So.2d 923 (Fla.1986) (special circumstance requiring disclosure may be found where bank has actual knowledge of fraud being perpetrated).

Wells Fargo, *supra*, 201 Ariz. at 484 (emphasis added). In this case, it appears there are facts that could lead a reasonable jury to the conclusion that the Plaintiff had knowledge of a fraud upon the Defendants in the valuation of the property that would become subject to the loan.

In *Wells Fargo*, the Supreme Court went on to note that the distinction between non-disclosure and concealment is subtle and that the matter must be reviewed under the totality of

the circumstances including an analysis of various sections of the RESTATEMENT OF LAWS. It stated:

> Arizona recognizes the tort of fraudulent concealment:
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> One party to a transaction who by concealment or other action intentionally prevents the other from acquiring material information is subject to the same liability to the other, for pecuniary loss as though he had stated the nonexistence of the matter that the other was thus prevented from discovering.
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> RESTATEMENT (SECOND) OF TORTS § 550 (1976); *see also King v. O'Rielly Motor Co.*, 16 Ariz.App. 518, 521, 494 P.2d 718, 721 (1972). Where failure to disclose a material fact is calculated to induce a false belief, "the distinction between concealment and affirmative misrepresentation is tenuous." *Schock v. Jacka*, 105 Ariz. 131, 133, 460 P.2d 185, 187 (1969).
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> FN22. The confusion surrounding the requisites of fraudulent concealment results from the fact that there are three distinct classes of fraud: misrepresentation, concealment, and non-disclosure. Liability for fraudulent misrepresentation occurs under § 525 of the RESTATEMENT (SECOND) OF TORTS S S S and lies against "[o]ne who fraudulently makes a misrepresentation of fact ... for the purpose of inducing another to act or to refrain from action...." In contrast, liability for nondisclosure occurs under § 551 of the RESTATEMENT (SECOND) OF TORTS and lies against "[o]ne who fails to disclose to another a fact ... if, but only if, he is under a duty to the other ... to disclose the matter in question." Liability for fraudulent concealment occurs under § 550 of the RESTATEMENT (SECOND) OF TORTS and lies against a "party to a transaction who by *concealment or other action intentionally* prevents the other from acquiring material information." (Emphasis added.) As discussed, duty has no relevance in a tort requiring an intentional act. Concealment necessarily involves an element of non-disclosure, but it is the intentional act of preventing another from learning a material fact that is significant, and this act is always the equivalent of a misrepresentation. RESTATEMENT (SECOND) OF CONTRACTS § 160 ("Action intended or known to be likely to prevent another from learning a fact is equivalent to an assertion that the fact does not exist.").
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¶ 92 In Arizona, whether a duty to speak exists at all is determined by reference to all the circumstances of the case. *National Hous. Indus., Inc., v. E.L. Jones Dev. Co.*, 118 Ariz. 374, 379, 576 P.2d 1374, 1379 (App.1978) (citing 37 AM.JUR. 2d, *Fraud & Deceit* § 146 (1968)). On the issue of duty in a fraudulent concealment claim, we are persuaded by and affirm the reasoning articulated by the court of appeals decision in *King v. O'Rielly Motor Co.*

¶ 93 In *King*, a car buyer sued a car dealer for fraudulently representing that the car the buyer purchased was "as good as new" when in fact the car had been in an accident and, unbeknownst to the buyer, had been repaired by the dealer. The car dealer argued that because the buyer's claim existed under § 551 of the RESTATEMENT OF TORTS (Liability for Nondisclosure), the dealer could not be liable to the buyer because the dealer was under no duty to disclose. The court refused to limit its consideration of the plaintiff's claim to § 551, stating "[w]ith these facts in mind we feel that a consideration of §§ 529 and 550 of RESTATEMENT OF TORTS ... is necessary for the determination of the question at hand." *King* at 521, 494 P.2d at 721. The court further stated that, while " *[i]t is often difficult to distinguish misleading representations and fraudulent concealment from mere nondisclosure* and the classification of the act or acts in question must, of course, depend on the facts of each case," it was nevertheless true that "the facts of this case ... would be supportive of a finding of misleading representation as set forth in Restatement § 529 or fraudulent concealment as set forth in § 550." *King* at 521-22, 494 P.2d at 721-22 (emphasis added). An Oregon court advanced similar reasoning in *Paul v. Kelley*, 42 Or.App. 61, 599 P.2d 1236 (1979), concluding that a duty to disclose is not necessary to prevail on a fraudulent concealment claim.

¶ 94 In *Paul*, the seller of real estate knew, before the closing, that he was required to install a storm sewer if a drainage ditch on the property were eliminated. Instead of installing the storm sewer, the sellers simply filled the ditch and sold the property. Buyers of the land sued the sellers when they learned they had to put in an expensive sewer system. The sellers defended on the grounds that they had no affirmative duty to disclose the ditch to the buyers. The court found this argument meritless, stating:

Such a duty is not necessary.... [A]n active concealment such as the filling in of the ditch alleged in this case is to be distinguished from a simple nondisclosure.... Plaintiff's complaint sets forth facts alleging an active concealment of the drainage ditch and is *sufficient without the assertion of a duty to speak.*

Paul at 1238-39 (emphasis added); *see also* *Caldwell v. Pop's Homes, Inc.*, 54 Or.App. 104, 634 P.2d 471, 477 (1981) (where fraud is based on a plan of actual concealment, as opposed to simple nondisclosure, a duty to speak is not required).

[42] ¶ 95 "[T]he common law clearly distinguishes between concealment and nondisclosure. The former is characterized by deceptive acts or contrivances intended to hide information, mislead, avoid suspicion, or prevent further inquiry into a material matter. The latter is characterized by mere silence." ***498 **36** *United States v. Colton*, 231 F.3d 890, 899 (4th Cir.2000). "Thus, fraudulent concealment-without any misrepresentation or duty to disclose-can constitute common law fraud." *Id.* at 899.

The count for concealment should not be dismissed where sufficient facts are plead. In this case the facts are relatively bare and fail to meet the particularity requirement of Rule 9. Nevertheless the law demands that the Counterclaimant be given leave to amend to cure the deficiency, if possible. Before the trial court grants a motion to dismiss for failure to state a claim, the non-moving party should be given an opportunity to amend the complaint if such an amendment cures its defects. Dube v. Likins, 216 Ariz. 406, 167 P.3d 93 (App. Div. 2 2007), Since the Court cannot say that an amendment would be futile, the Counterclaimant should be given leave to amend.

IT IS ORDERED Count 1 is dismissed without prejudice and the Counterclaimant is granted leave to amend, said amended Counterclaim shall be filed, if at all, within **30 days** following the entry of this order.

As for the claim of negligent misrepresentation, as stated above, it appears from the Counterclaim that the Plaintiff has a special relationship with the Defendants as well as its own employee who had information that a jury could find would tend to make the entire transaction fraudulent. Here the lenders employee alleged brought the deal to the Defendants with knowledge that the property may have been overvalued. The information regarding the property's value was material particularly in light of the amount to of the difference and the obligations the Defendants would be undertaking. Under the law, knowledge of this information by the Plaintiff gives rise to a duty to disclose. If the Plaintiff failed in that duty, and this assumes the Plaintiff had actual knowledge, then a claim for negligence may be viable. To the extent the Counterclaimant fails to prove the Plaintiff had knowledge of the appraisal that substantially state a lower value than the purchase price and thereafter failed to disclose it, then the claim may not survive. However, at this time the claim under Count 2 asserts a possible cause of action and shall not be dismissed.

IT IS FURTHER ORDERED denying the Motion to Dismiss as to Count 2.

The motion also seeks to dismiss the claim for breach of the covenant of good faith and fair dealing on the basis that the Counterclaim establishes a breach, if at all, during the negotiations of but prior to the formation of the contract. Again, in *Wells Fargo* our Supreme Court explained:

> Arizona law implies a covenant of good faith and fair dealing in every contract. *Enyart v. Transamerica Ins. Co.*, 195 Ariz. 71, 985 P.2d 556, ¶ 14 (1998) (citing *Rawlings v. Apodaca*, 151 Ariz. 149, 726 P.2d 565 (1986); *see also Wagenseller v. Scottsdale Mem'l Hosp.*, 147 Ariz. 370, 383, 710 P.2d 1025, 1038 (1985)). Such implied terms are as much a part of a contract as are the express terms. *Golder v. Crain*, 7 Ariz.App. 207, 437 P.2d 959 (1968). The implied covenant of good faith and fair dealing prohibits a party from doing anything to prevent other parties to the contract from receiving the benefits and entitlements of the agreement. The duty arises by operation of law but exists by virtue of a contractual relationship. *Rawlings* at 153-54, 726 P.2d at 569-70.
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> ***29 *491* [17] ¶ 60 Breach of the implied covenant may provide the basis for imposing damages. *Burkons* at 355, 813 P.2d at 720. A party may bring an action in tort claiming damages for breach of the implied covenant of good faith, but only where there is a "special relationship between the parties arising from elements of public interest, adhesion, and fiduciary responsibility." *Id.* at 355, 813 P.2d at 720; *see also Wagenseller* at 383, 710 P.2d at 1038; *McAlister v. Citibank (Arizona), a Subsidiary of Citicorp*, 171 Ariz. 207, 829 P.2d 1253 (App.1992) (a special relationship must exist in order to support a *tortious* breach of the implied covenant of good faith and fair dealing). The Funds have conceded that they do not have the required "special relationship" to support a claim for tortious breach.
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> [18] ¶ 61 There is a difference, however, in the proof required, depending on whether the claim sounds in tort or in contract. Here, the remedy for breach of the implied covenant is an action for breach claiming *contract* damages. *Burkons* at 355, 813 P.2d at 720. When the remedy for breach of the covenant sounds in contract, it is not necessary for the complaining party to establish a special relationship. *Firstar Metro. Bank & Trust v. Federal Deposit Ins. Corp.*, 964 F.Supp. 1353, 1358 (D.Ariz.1997).

Wells Fargo , supra, 201 Ariz. at 490, 491. The Plaintiff argues that since any breach occurred during negotiations before the contract was executed there can be no breach. However the Plaintiff cites no authority for that proposition. The matter is one of policy. The Plaintiff has not cited and this Court has not found any Arizona case on point. It is noted, however, that in other matters involving good faith negotiations the Arizona Courts have found a party may be guilty of bad faith in insurance bad faith cases. Indeed in the federal context labor negotiations are subject to penalties for failing to negotiate in good faith. In the absence of legal authority that negotiations prior to finalizing an agreement are not actionable for bad faith this Court declines to grant the Motion to Dismiss.

The Plaintiff also complains that the claims made by the Counterclaimant are barred by the statute of limitations. However, the discovery rule applies in this case. Under Arizona law, statutes of limitations for both negligent and intentional misrepresentation begin to run when the Plaintiff knew or by reasonable diligence should have known of the misrepresentation. Bank of the West v. Estate of Leo, D.Ariz.2005, 231 F.R.D. 386. e statute of limitations for a negligent misrepresentation claim is two years. *See* *Hullett v. Cousin*, 204 Ariz. 292, 297, ¶ 23, 63 P.3d 1029, 1034 (2003). In any event the issue is not ripe for determination of a Motion to Dismiss.

IT IS FURTHER ORDERED The Motion to Dismiss the Count 3 of the Counterclaim is denied.

This case is eFiling eligible: http://www.clerkofcourt.maricopa.gov/efiling/default.asp. Attorneys are encouraged to review Supreme Court Administrative Orders 2010-117 and 2011-10 to determine their mandatory participation in eFiling through AZTurboCourt.