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EQUITY'S LEADED FEET IN A CONTEST OF SCOUNDRELS: THE ASSERTION OF THE *IN PARI DELICTO* DEFENSE AGAINST A LAWBREAKING PLAINTIFF AND INNOCENT SUCCESSORS

*Brian A. Blum**

I. INTRODUCTION

"While a court of equity will on swift wings fly to relieve the innocent from wrong or injury, it travels with leaded feet and turns a deaf ear, when called on to furnish a cloak of righteousness to cover sin . . . ."[1]

"We do not . . . lend our aid to the furtherance of an unlawful project, nor do we decide, as between two scoundrels, who cheated whom the more."[2]

It is a broad and well-established principle of common law that a court will not entertain a claim by a wrongdoer arising out of the claimant's own illegal conduct.[3] This principle is applicable in any case

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1. Grant v. Grant, 286 S.W. 647, 650 (Tex. Civ. App. 1926).

2. Manning v. Noa, 76 N.W.2d 75, 77 (Mich. 1956).

3. Courts and commentators sometimes state this principle as applying to conduct that is illegal or against public policy. *See, e.g.*, Price v. Purdue Pharma Co., 920 So. 2d 479, 484 (Miss. 2006); Vincent R. Johnson, *The Unlawful Conduct Defense in Legal Malpractice*, 77 UKMC L. REV. 43, 58-59 (2008). The reference to public policy is misleading. Although public policy and the public interest are important considerations in the decision on whether to refuse enforcement of a claim based on illegal conduct, the underlying problem is that the conduct is illegal, not merely that the remedy should be denied purely on public policy grounds. The analysis of a transaction (or an aspect of a transaction) that is legal but violates public policy is different. For example, an overbroad liability limitation or noncompetition clause in a contract may offend public policy, but it does not arise from an illegal transaction—it is not illegal to include such a clause in the contract.

in which a person seeking a legal or equitable remedy violated the law in the transaction or situation from which the claim arises. The principle is expressed in two well-worn maxims: *ex dolo malo non oritur actio*—no action arises out of one's own fraud or wrongdoing—and *ex turpi causa non oritur actio*—no action arises out of an immoral act.[4] It is also reflected in the wrongful conduct rule of tort law and emerges in the equitable unclean hands doctrine.[5] (For the sake of brevity, this general principle is referred to in the rest of this article as the "*ex turpi causa* principle.") In its absolute, unqualified form, the *ex turpi causa* principle calls on a court to turn its back on a guilty claimant and refuse to countenance the claim at all.[6]

Where the illegal conduct has been committed by the plaintiff[7] alone and the defendant had no role in breaking the law the decision to refuse relief is relatively uncomplicated. A court will seldom have qualms about refusing to assist a wrongdoing plaintiff in enforcing any rights that she might otherwise have had against a defendant who was uninvolved in the misconduct.[8] However, in the usual case in which the *ex turpi causa* principle is invoked, the defendant was in some way complicit in the illegal activity.[9] In the worst case, this complicity may be deliberate and knowing involvement (where the defendant was an

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Therefore, the determination of whether to enforce the contract or offending clause does not involve the principles of *ex turpi causa* and *in pari delicto* that are the subject of this Article. *See infra* Part III.B.

4. *See* John W. Wade, *Benefits Obtained Under Illegal Transactions—Reasons for and Against Allowing Restitution*, 25 TEX. L. REV. 31, 44-46 (1947) (describing the maxims and their application).

5. *See* Johnson, *supra* note 3, at 49-51, 58-62 (discussing the statutory and common law bases for the wrongful conduct rule of tort law); William J. Lawrence, III, Note, *The Application of the Clean Hands Doctrine in Damage Actions*, 57 NOTRE DAME LAW. 673, 674 (1982) ("The clean hands doctrine demands that a plaintiff seeking equitable relief come into court having acted equitably in that matter for which he seeks remedy.").

6. Greenwald v. Van Handel, 88 A.3d 467, 472 (Conn. 2014) (stating *ex turpi causa* is a universal principle, dictated by public policy, that no one should be permitted to profit from his own wrong). Sometimes, particularly in older cases, courts express their disapprobation of the plaintiff with some flair. *See, e.g.*, *Grant*, 286 S.W. at 650; Collins v. Blantern (1765) 95 Eng. Rep. 847, 852; 2 Wils. K.B. 342, 350 ("[N]o polluted hand shall touch the pure fountains of justice. . . . [Y]ou shall not have a right of action when you come into a court of justice in this unclean manner to recover it back.").

7. The party asserting the claim based on the illegal transaction or interaction is invariably the plaintiff in litigation and is referred to as such in this Article. The person against whom the claim is asserted is, of course, the defendant in the suit.

8. *See, e.g.*, BDO Seidman, LLP v. Harris, 885 N.E.2d 470, 475-76 (Ill. App. 2008) (barring an accounting firm that incurred significant liability to victims of its client for enabling its client's misappropriation of trust funds and evasion of taxes from claiming reimbursement from its professional liability insurer on the grounds that it was a principal participant in the illegal activity).

9. *See infra* notes 66-72 and accompanying text.

instigator or collaborator), but it might also be passive acquiescence (where the defendant enabled the conduct), or negligent dereliction of the duty to discover and prevent the action instead. An unqualified application of the *ex turpi causa* principle would preclude any relief to the plaintiff, notwithstanding the defendant's participation in, or accountability for, the unlawful activity.[10] This creates a dilemma because refusal to aid the guilty plaintiff necessarily confers the benefit of escaping liability on the defendant who has some accountability for the illegal conduct. To deal with this dilemma, the law recognizes a qualification to the *ex turpi causa* principle, expressed in the maxim *in pari delicto potior est conditio defendentis*—where the parties are in equal guilt, the position of the defendant is the stronger.[11] Although commonly thought of as a barrier to relief, the *in pari delicto* rule is in fact a softening of the absolute bar on recovery expressed in the *ex turpi causa* maxim because it recognizes that the *ex turpi causa* principle may not bar relief where the plaintiff played a lesser role than the defendant in the illegal transaction or situation.[12]

Taken literally, the *in pari delicto* maxim seems to focus exclusively on the question of relative guilt. This belies the complexity of its application, inadequately describes the considerations that courts evaluate in deciding on whether to refuse relief, and engenders doctrinal confusion.[13] Although the relative guilt of the parties is a highly relevant consideration, it is just one of many factors that courts take into account, and it is often overcome by other considerations that carry more weight with courts under the circumstances of the case.[14] Therefore, even though courts regularly invoke the maxim in dealing with claims arising

10. Again, some of the older cases express this principle in delightfully purple prose. *See, e.g.*, Manning v. Noa, 76 N.W.2d 75, 77 (Mich. 1956); Stone v. Freeman, 82 N.E.2d 571, 572 (N.Y. 1948) ("[N]o court should be required to serve as paymaster of the wages of crime, or referee between thieves."); Nellis v. Clark, 20 Wend. 24, 32 (N.Y. Sup. Ct. 1838) ("[N]either . . . [the plaintiff nor the defendant] have any positive remedy on their own account. But as the law finds them, so it will leave them. They derive that kind of negative assistance which arises from their cases being mutually such that the law will not tarnish its hands by rescuing them from the mire.").

11. Official Comm. of Unsecured Creditors v. Cooper & Lybrand LLP, 322 F.3d 147, 158 (2d Cir. 2003).

12. *See infra* note 89 and accompanying text.

13. *See* Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Res. Found. v. PriceWaterhouseCoopers, 607 F.3d 346, 350 n.2 (3d Cir. 2010) (describing the *in pari delicto* rule as a "murky area of law . . . [and] an ill-defined group of doctrines that prevents courts from becoming involved in disputes in which adverse parties are equally at fault"); Johnson, *supra* note 3, at 71-73 (arguing that the *in pari delicto* maxim disorients analysis by its focus on relative fault, and that the real issue as not equality of fault, but whether the plaintiff's actions are so serious and closely related to his loss that it is fair to deny recovery).

14. *See infra* Part III.

out of illegal action by the plaintiff and defendant,[15] it is not really true to state that where the parties are *in pari delicto*, the defendant's position is inevitably stronger. It may or may not be, depending on a multifaceted evaluation of fact-specific situations in which the court exercises considerable discretion in balancing fault, the seriousness of the offense, the public interest, and the equities between the parties.[16]

The complexity of this analysis and the widely-variant factual situations to which it is applied allow courts considerable discretion to apply the rule in a way that best achieves the goals that it is meant to serve. However, in some situations, particularly where the plaintiff is not the actual wrongdoer but a party who has succeeded to the wrongdoer's cause of action for the benefit of innocent victims of the illegal conduct, many courts have adopted a doctrinaire approach to imputing the wrongdoing to the plaintiff, thereby losing sight of the true purpose and point of the rule.[17]

This Article begins with an exposition of the *in pari delicto* rule as it applies in situations in which the plaintiff is the lawbreaker.[18] Part II describes the nature, purpose, and scope of the *in pari delicto* rule.[19] Part III examines the complex and multifaceted balancing process that courts use in applying the rule.[20]

Part IV addresses the imputation of an agent's illegal action to the principal.[21] The following common situation provides a concrete illustration of the kind of case in which imputation occurs: The agent is an officer in control of a corporation. He engages in serious criminal activity during the course of conducting the corporation's business. For example, he operates a Ponzi scheme in which he fraudulently induces investments, but instead of investing the funds as promised, he misappropriates the funds for his own purposes and conceals the theft for some time by using a portion of later investments to repay earlier investors. He thereby creates the false impression that funds have been well invested and are earning the expected returns. Inevitably, the Ponzi scheme collapses and the fraud is discovered. The dishonest officer is ousted and prosecuted. It becomes apparent that some other person with a fiduciary duty to the corporation—say its lawyer or auditor—either

15. *See, e.g.*, Picard v. JPMorgan Chase & Co. (*In re* Bernard L. Madoff Inv. Sec. LLC), 721 F.3d 54, 63 (2d Cir. 2013).

16. *See infra* Part III.

17. *See infra* Part V.

18. *See infra* Parts II–III.

19. *See infra* Part II.

20. *See infra* Part III.

21. *See infra* Part IV.

knew or should have known that the officer was conducting a Ponzi scheme but abetted it or failed to take action to prevent or report it. The corporation sues the complicit or negligent lawyer or auditor to recover losses attributable to the lawyer or auditor's role in colluding in or enabling the illegal activity. The lawyer or auditor raises the *in pari delicto* defense on the theory that the corporation itself is a guilty plaintiff because the actions of the officer, in the course of his employment, are imputed to it. Courts commonly apply principles of imputation rigorously against the corporation, making it almost impossible for the corporation to distance itself from the actions of its officer.[22] In some cases, this is the proper result, but in others, where the fault of the complicit party is egregious and the principal's recovery would compensate innocent victims of the illegal action, refusal of relief is inconsistent with the purpose of the *in pari delicto* rule.

Part V deals with an even more troublesome application of imputation, in which the sins of the wrongdoing officer are imposed upon a plaintiff who is even further removed from the illegal action, and whose sole purpose is to recover from a complicit party for the benefit of victims of the illegality.[23] Using the same example, the officer's Ponzi scheme so badly damaged the financial viability of the corporation that it collapses after the scheme is uncovered, and the corporation is placed into receivership or bankruptcy. The task of the receiver or trustee is to recover monies for the estate to ultimately benefit creditors (including the defrauded investors) who are victims of the Ponzi scheme.[24] In fulfilling this task, the receiver or trustee sues the lawyer or auditor for losses resulting from its deliberate or negligent failure to prevent the officer's illegal conduct. This suit is met with the *in pari delicto* defense on the theory that the trustee or receiver is subject to any defenses that could have been raised against the corporation.[25] Based on an intricate set of variables, courts reject this argument in some situations but accept it in others.[26] Where courts allow the defense, they insulate the

22. *See, e.g.*, Belmont v. MB Inv. Partners, 708 F.3d 470, 496 (3d Cir. 2013) (finding imputation on investment advisor firm appropriate if senior executive made fraudulent statements within the scope of his authority); Seidman & Seidman v. Gee, 625 So. 2d. 1, 3 (Fla. Dist. Ct. App. 1992) ("Where it is shown . . . that a corporate officer's fraud intended to and did benefit the corporation . . . the fraud is imputed to the corporation . . . .").

23. *See infra* Part V.

24. *See infra* Part V.

25. *See infra* Part V.

26. *See infra* Part V.

wrongdoing defendant from accountability for its role in the illegal action and deprive victims of relief.[27]

Part VI argues that this is a perversion of the *in pari delicto* rule that courts could avoid by better use of the ample discretion allowed by the rule, a less rigid approach to imputation, and a clearer focus on the underlying purpose of the rule.[28]

II. THE NATURE, PURPOSE, AND SCOPE OF THE *IN PARI DELICTO* RULE

In a suit brought by a plaintiff arising from an illegal transaction or interaction, the *in pari delicto* rule manifests as an affirmative defense by a defendant who participated in or bears some responsibility for the plaintiff's illegal conduct. This Part explains the rationale, concept, and scope of the *in pari delicto* rule, its nature as an affirmative defense, and the wide range of transactions or interactions in which the defense might be raised.[29] It also discusses the relationship of the rule to the closely-related equitable doctrine of unclean hands and the wrongful conduct rule of tort law.[30]

A. The Rationale of the In Pari Delicto *Rule*

The *in pari delicto* maxim is of ancient origin. It can be traced to Roman law and first appeared in English law during the eighteenth century.[31] It has been part of American law for nearly as long.[32] It is widely recognized and applied in American jurisdictions by both state and federal courts.[33]

The policies behind the refusal to aid a plaintiff who has broken the law are routinely enunciated by courts and commentators. The most obvious public policy is to uphold the law that has been violated, rather

27. *See infra* Part V.A.

28. *See infra* Part VI.

29. *See infra* Part II.A–D.

30. *See infra* Part II.E.

31. For brief history of the maxim, its Roman Law origins, and its early use in English Law, see J.K. Grodecki, *In Pari Delicto Potior Est Conditio Defendentis*, 71 L.Q. REV., 254, 254-58 (1955). Grodecki identifies Lord Mansfield as first applying the doctrine in England in the case of *Smith v. Bromley* (1790) 99 Eng. Rep. 441; 2 Doug. 696. *Holman v. Johnson* is regarded as the seminal case in which Lord Mansfield expressed both the *ex turpi causa* principle and the *in pari delicto* rule. (1775) 98 Eng. Rep. 1120, 1121; 1 Cowp. 342, 343.

32. *See* Kirscher v. KPMG, LLP, 938 N.E.2d 941, 950 (N.Y. 2010) (citing New York cases from the early nineteenth century, the court observed that the *in pari delicto* doctrine "has been wrought in the inmost texture of our common law for at least two centuries").

33. *See, e.g.*, Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306-07 (1985); *Kirscher*, 938 N.E.2d at 950.

than to reward its violation.[34] The refusal of relief is also aimed at discouraging subsequent violations of the law by creating a disincentive to enter into this or any other illegal transaction in the future.[35] Courts also commonly express the concern about not becoming embroiled in a dispute between lawbreakers, which could result in the improper use of judicial power in abetting unlawful conduct.[36] Some courts also articulate a concern about public perception—that granting relief to a lawbreaker might cause the public to view the legal system as a mockery of justice and the mere tool of the iniquitous.[37] While some courts concede that punishment of the plaintiff is one of the motivations of the rule,[38] others take pains to stress that the refusal to aid the plaintiff is not punitive, but rather serves the broader policies of deterring such conduct and protecting the integrity of the judicial system and the overall public

34. Schlueter v. Latek, 683 F.3d. 350, 355 (7th Cir. 2012) (noting that if awarding relief to an equally guilty plaintiff would reward wrongdoing, courts will not adjudicate the dispute); Orzel *ex rel.* Orzel v. Scott Drug Co., 537 N.W.2d 208, 213 (Mich. 1995) (noting that by giving relief to the wrongdoer, a court would condone and encourage illegal conduct); RESTATEMENT (SECOND) OF CONTRACTS ch. 8, topic 1, intro. note (AM. LAW INST. 1981) (stating that the policy of freedom of contract requires the enforcement of consensual agreements, but where a contract violates the law, this policy might be outweighed by a stronger public interest in upholding the law that has been violated).

35. The question of creating a disincentive to future conduct is problematic, as discussed in Part III. Nevertheless, this is often expressed as a policy. *See, e.g.*, *Bateman Eichler*, 472 U.S. at 306 (1985) (stating that the *in pari delicto* defense is grounded on two premises: (1) courts should not mediate disputes between wrongdoers, and (2) the denial of judicial relief is an effective means of deterring illegality); RESTATEMENT (SECOND) OF CONTRACTS ch. 8, topic 1, intro. note (stating that refusal of enforcement is not so much based on "solicitude for the promisor," but arises from two fundamental considerations—first, to sanction and discourage the improper conduct, and second, to prevent the use of the judicial process in "carrying out an unsavory transaction").

36. This oft-expressed rationale is nicely articulated in *McCausland v. Ralston*, where the court stated: "[T]he law will not be the willing instrument of its own subversion, and to every appeal for assistance replies, *in pari delicto potior est conditis defendentis*." 12 Nev. 195, 204 (1877). However, this argument is something of an overstatement because courts often find themselves embroiled in unsavory situations (for example, in a criminal case in which a technical defense is raised) in which the law requires them to adjudicate in favor of a person who has engaged in illegal conduct. *See* Wade, *supra* note 4, at 41-44.

37. *Orzel*, 537 N.W.2d at 213 (determining that allowing a wrongdoer to profit from his illegal acts will cause the public to view the legal system as a mockery of justice). This seems to be largely a rhetorical point. As pointed out in *MCA Financial Corp. v. Grant Thornton*, the public could equally perceive it to be a mockery of justice not to allow relief against the defendant who is, after all, also a lawbreaker. 687 N.W.2d 850, 855 (Mich. Ct. App. 2004).

38. *See* Inhabitants of Worcester v. Eaton, 11 Mass. 368, 377 (1814) ("You have paid the price of your wickedness, and you must not have the aid of the law to rid you of an inconvenience which is a suitable punishment for your offence."); Meador v. Hotel Grover, 9 So. 2d 782, 786 (Miss. 1942) ("[Plaintiff's] right to invoke the power of the law to protect can be neutralized only by the power of the law to punish."); Wade, *supra* note 4, at 36, 36 n.21 (identifying cases in which courts articulate a punitive purpose in refusing relief).

good.[39] This does not suggest that refusal of relief has no punitive impact on the plaintiff, with a corresponding boon to the wrongdoing defendant. Rather, the point is that punishment is usually best left to penal provisions of the law and should not be the focus of the decision to refuse relief under the *in pari delicto* rule.

It is relatively easy for a court to feel confident in serving these policies where the plaintiff bears overwhelming responsibility for an egregious violation of the law and the decision to refuse any remedy clearly protects an important public interest. However, where the parties' guilt is more evenly balanced, the violation of the law is less outrageous, and the public interest in the refusal or denial of relief is more equivocal, the degree to which a particular resolution might advance respect for the law and public policy becomes less clear. As Part III shows, in such cases the right decision can be elusive, conjectural, and dependent on the perceptions of the judge.[40]

B. In Pari Delicto *as an Equitable Affirmative Defense*

While it is not entirely clear if the *in pari delicto* rule was originally adopted by courts of law or equity, courts uniformly describe it as an equitable doctrine.[41] The precise derivation of the doctrine is not legally significant because, unlike some other equitable doctrines,[42] courts do not confine it to suits in equity, and no court has refused to apply it on

39. *See Bateman Eichler*, 472 U.S. at 318 (stating that punishment of the plaintiffs is best left to the substantial criminal and civil penalties for violating the securities laws); Small v. Parker Healthcare Mgmt. Org., Inc., No. 05-11-01471-CV, 2013 WL 5827822, at *3 (Tex. App. Oct. 28, 2013) ("The purpose behind this rule is not to protect or punish either party, but to protect and benefit the public.") (citing Plumlee v. Paddock, 832 S.W.2d 757, 759 (Tex. App. 1947)).

40. *See infra* Part III.

41. The equitable nature of the *in pari delicto* rule is generally asserted baldly, without any explanation or citation of historical sources. *See, e.g.*, Pinter v. Dahl, 486 U.S. 622, 632 (1988); Nisselson v. Lernout, 469 F.3d 143, 151 (1st Cir. 2006); Glenbrook Capital Ltd. P'ship v. Dodds (*In re* Amerco Derivative Litig.), 252 P.3d 681, 694 (Nev. 2011); Symbol Techs., Inc. v. Deloitte & Touche, LLP, 888 N.Y.S.2d 538, (2009); Geis v. Colina Del Rio LP, 362 S.W.3d 100, 107 (Tex. App. 2011). However, some commentators identify the roots of *in pari delicto* as legal, not equitable. *See* T. Leigh Anenson, *Treating Equity Like Law: A Post-Merger Justification of Unclean Hands*, 45 AM. BUS. L.J. 455, 483-84 (2008); Grodecki, *supra* note 31, at 258 (stating that the rule was applied initially by courts of law, and was thereafter followed with some reluctance by courts of equity).

42. For example, as discussed below, some courts confine the unclean hands doctrine—which is closely linked to the *in pari delicto* rule—to suits in equity. *See infra* note 90 and accompanying text.

the grounds that the suit is legal in nature.[43] The characterization of the rule as one of equity allows courts the discretion to take equitable considerations into account in applying the rule and support the wide-ranging equitable balancing that is described in Part III.[44]

Courts also routinely treat *in pari delicto* as an affirmative defense to the plaintiff's claim, so that the defendant must plead and prove the facts necessary to invoke the defense.[45] In some cases, the defense raises disputed questions of fact that require resolution by trial.[46] However, if the crucial facts relating to the defense are apparent from or conceded in the pleadings so that there is no factual dispute to be decided at trial, it may be disposed of summarily on either a motion to dismiss or a motion for summary judgment.[47]

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43. *See* Nash v. Jones, 162 S.E.2d 392, 394 (Ga. 1968) ("Neither a court of law nor a court of equity will lend its aid to a party where it affirmatively appears that the plaintiff and defendant are *in pari delicto*.") (citing Clifton v. Dunn, 66 S.E.2d 735 (Ga. 1951)).

44. *See infra* Part III.

45. Rogers v. Mc.Dorman, 521 F.3d 381, 386 (5th Cir. 2008) (stating that *in pari delicto* is an affirmative defense and must be raised as such with specificity so as to give the plaintiff fair notice that it is being advanced); *Nisselson*, 469 F.3d at 151 (stating *in pari delicto* is an affirmative defense); Tamposi v. Denby, 974 F. Supp. 2d 51, 56 (D. Mass. 2013) (determining *in pari delicto* is an affirmative defense, so that the facts establishing it must be definitively ascertainable from the complaint and must be sufficient to establish the defense with certitude); *In re* Appalachian Fuels, LLC, No. 09-10343, 2012 WL 4059973, at *1-2 (Bankr. E.D. Ky. Sept. 14, 2012) (labeling *in pari delicto* as an affirmative defense); Gamboa v. Alvarado, 941 N.E.2d 1012, 1016 (Ill. App. Ct. 2011) (stating that illegality is an affirmative defense in which, although the party admitted the sufficiency of the complaint, he raised a defense that negates the cause of action).

46. In the absence of a conclusive resolution on the pleadings, the matter must go to trial on the facts. *See* Scola v. Constantino Richards Rizzo, LLP, No. MICV2012-01269-D, 2013 WL 1342292, at *3 (Mass. Super. Mar. 28, 2013) (refusing to dismiss a malpractice suit against accountants on the basis of the *in pari delicto* defense where a trial was required to determine the relative fault of the parties); MCA Financial Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 852 (Mich. Ct. App. 2004) (finding summary judgment inappropriate because there was a material issue of fact); Skinner v. E.F. Hutton & Co., 333 S.E.2d 236 (N.C. 1985) (holding that although the plaintiff's participation in an illegal insider trading scheme was apparent from the complaint, this did not establish conclusively that this participation would preclude suit).

47. *See, e.g.*, *Nisselson*, 469 F.3d at 158 (holding that a motion to dismiss may be granted where the success of the affirmative defense is inevitable because the facts can be ascertained and are enough to establish the defense with certitude); Uecker v. Wells Fargo Capital Fin., LLC (*In re* Mortg. Fund '08 LLC), 527 B.R. 351, 369-70 (N.D. Cal. 2015) (determining that where the plaintiff's pleadings contain admissions that establish the *in pari delicto* defense, the matter can be disposed of summarily); *In re* Singh, No. 10-42050-D-7, 2015 WL 1887939, at *2-3 (Bankr. E.D. Cal. Apr. 22, 2015) (finding that where the defendant makes a prima facie showing that the *in pari delicto* defense applies, the matter can be disposed of summarily unless the plaintiff can show a genuine issue of material fact); Bush v. Textron Fin. Corp., 483 B.R. 630, 650 (N.D. Ohio 2012) (holding that where the plaintiff conceded that it had defrauded investors, the *in pari delicto* defense can be disposed of on the pleadings); OHC Liquidation Tr. v. Credit Suisse First Boston (*In re* Oakwood Homes Corp.), 389 B.R. 357, 372 (D. Del. 2008) (concluding that *in pari delicto* can be established on the pleadings in a motion to dismiss, and that relative guilt is not a jury question);

In fact, in many of the cases cited in this Article, courts allowed the defense on the basis of the pleadings.[48]

The nature of *in pari delicto* as an affirmative defense highlights the ironic aspect of the rule—although the court could raise the illegality of the transaction sua sponte,[49] it is hard to find a case in which this has occurred. Nor is the challenge to the plaintiff's suit brought by some public agency or public-spirited third party. Rather, the illegality is raised by the very person who participated in or enabled the plaintiff's illegal conduct. In some cases, the defendant may have genuinely repented of his role in the violation of the law or may have been coerced or misled into participation by the plaintiff. However, in many cases, the defendant's behavior was quite unsavory, and his motive in asserting the defense is nothing more than an effort to escape accountability for his own wrongful conduct on the grounds that the plaintiff's behavior was worse. This leaves the court with the distasteful choice between allowing

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Oden v. Pepsi Cola Bottling Co. of Decatur, 621 So. 2d 953, 954-55 (Ala. 1993) (determining that summary judgment is appropriate where it is undisputed that the plaintiff engaged in an illegal act and relies on that act for his claim); Joint Equity Comm. v. Genovese, No. G048238, 2014 WL 4162318, at *2 (Cal. Ct. App. Aug. 22, 2014) (establishing that the defense can prevail at the pleading stage if the plaintiff's own pleadings contain admissions that establish the defense); Price v. Purdue Pharma Co., 920 So. 2d 479, 485-86 (Miss. 2006) (holding summary judgment for the defendants to be appropriate where it was uncontroverted that the plaintiff had engaged in a scheme to get multiple prescriptions for a controlled drug); Teneyck, Inc. v. Rosenberg, 957 N.Y.S.2d 845, 848-49 (Sup. Ct. 2013) (determining that the case can be disposed of on a motion to dismiss where both parties admitted bribery and conceded equal guilt).

48. *See* cases cited *supra* note 47.

49. Affirmative defenses are usually waived if not asserted by the defendant. *See* Wood v. Milyard, 132 S. Ct. 1826, 1832 (2012) ("Ordinarily in civil litigation . . . an affirmative defense, once forfeited, is 'excluded from the case' . . . and, as a rule, cannot be asserted on appeal." (citations omitted)). However, the public policy against granting relief arising out of an illegal transaction muddies this principle in the case of the *in pari delicto* defense, so that some courts assert the power to raise it sua sponte. *See* Taylor v. AIA Servs. Corp., 261 P.3d 829, 841-42 (Idaho 2011) (explaining that the plaintiff cannot invoke waiver or estoppel to counter the *in pari delicto* defense, and the court can raise the illegality sua sponte); Small v. Parker Healthcare Mgmt. Org., Inc., No. 05-11-01471-CV, 2013 WL 5827822, at *5 (Tex. App. Oct. 29, 2013) (holding that although failure to plead illegality is a waiver of the defense, it can be asserted or raised by the court sua sponte, even in the absence of pleading, where illegality appears on the face of the contract or from evidence necessary to prove it). There is some confusion over whether the defense can be waived at all. This seems to depend on whether the transaction is voidable (in which case it can be waived) or void (in which case it cannot). Sometimes courts describe an illegal transaction as void. *See, e.g.*, *Taylor*, 261 P.3d at 841-42. In some cases, the statute that forbids the transaction itself declares that any transaction that violates the statute is void. *See, e.g.*, Ground Control, LLC v. Capsco Indus., Inc., 120 So. 3d 365, 368 (Miss. 2013) (citing a statute requiring contractors to have certificates of responsibility that declared contract in violation of the statute would be null and void) (citing MISS. CODE ANN. § 31-3-15 (2015)); Kelley v. Courtier, 30 P. 372, 374 (Okla. 1892) (stating that a waiver of the defense of illegality "would be tainted with the vice of the original contract and void for the same reason").

the guilty plaintiff to sue or the guilty defendant to escape liability.[50] The way in which courts grapple with this dilemma is one of the dominant themes of this Article.

C. *The Concept and Scope of Illegality in Relation to the* In Pari Delicto *Rule*

1. The Relationship Between Illegality and Denial of Relief

It is self-evident that a transaction is illegal if it is prohibited by law.[51] However, when dealing with the *in pari delicto* rule, we are not concerned with any other impact of illegality, such as the possibility of criminal or civil sanctions for violating the law. We focus purely on the question of the impact of the illegality on the plaintiff's remedial rights. Therefore, the question of illegality must go beyond the simple determination of whether the transaction violates the law to consider whether that violation should result in the consequence of denial of remedy. The easiest case for determining unenforceable illegality is where a statute expressly forbids the transaction at issue and also makes clear the impact of a violation on the remedial rights of a violator (for

50. This discomfort was expressed and rationalized by Lord Mansfield in *Holman v. Johnson*, in which he pointed out that the assertion that a contract is illegal "sounds . . . very ill in the mouth of the defendant." (1775) 98 Eng. Rep. 1120, 1121; 1 Cowp. 342, 343. However, it is not for the defendant's sake that the defense is allowed, but rather because courts "will not lend their aid to such a plaintiff. So if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it: for where both are equally in fault, *potior est conditio defendentis*." *Id.*

51. Courts and commentators sometimes use the phraseology "illegal or against public policy" when discussing illegal contracts. *See, e.g.*, *Taylor*, 261 P.3d at 841 (quoting Trees v. Kersey, 56 P.3d 765, 768 (Idaho 2002)) ("An illegal contract is one that rests on any consideration that is contrary to law or public policy."); RESTATEMENT (SECOND) OF CONTRACTS Ch. 8, topic 1, intro. note 8 (AM. LAW INST. 1979) (stating the term "illegality" is avoided in favor of the concept of unenforceability on grounds of public policy to make it clear that the focus is on enforceability, rather than on whether there is some other sanction for violating the law); RESTATEMENT OF CONTRACTS § 512 (AM. LAW INST. 1932) (defining a bargain as illegal if "either its formation or its performance is criminal, tortious, or otherwise opposed to public policy"); E. ALLAN FARNSWORTH, CONTRACTS § 5.1(A), at 315 (4th ed. 2004). Although the *Restatement (Second) of Contracts* advocates this semantic distinction for the sake of clarity, it seems to be more confusing than clarifying, because the policing of contracts on public policy grounds may not involve illegality at all. For example, if the plaintiff, a consumer, signifies assent to a standard agreement waiving the right to claim damages for the defendant's negligence, the contract is not illegal and is not subject to analysis under the *in pari delicto* rule. However, a court may conclude, based on all the circumstances of the case, that the disclaimer is too broad and should not be enforced on grounds of public policy. Therefore, when discussing the *in pari delicto* rule, it is best not to introduce the notion that something short of illegality will justify use of the rule. It is better to think of illegality as constituting a breach of the law, whether statutory or established by common law precedent.

example, by stating that a transaction in violation of the statute is void or unenforceable, or conversely, that despite the violation, one of the parties may sue for relief, in the form of enforcement, restitution, or statutory damages).[52] In the absence of that kind of clear statutory guidance, common law precedent may resolve the question of the impact of illegality on remedial rights. However, a court may still find a transaction to be illegal and subject to the *in pari delicto* rule, even in the absence of an express statutory or common law prohibition where it is so inimical to the public interest that it should be treated as illegal.[53]

Where the court lacks statutory or precedential guidance on the impact of illegality on the plaintiff's remedial rights, it must decide for itself if the infraction of the law is severe enough to merit a refusal of remedy.[54] Courts often distinguish between conduct that involves moral turpitude—serious wrongdoing that commonly amounts to criminal conduct[55]—and a less reprehensible violation of some regulation or administrative rule.[56] Sometimes the term *malum in se* (wrong in itself) is used to describe serious wrongdoing, as distinct from *malum prohibitum* (wrong merely because it violates some regulation).[57] The degree and seriousness of the illegality has some bearing on the decision of whether to apply the *in pari delicto* rule.[58] However, although courts distinguish a violation of regulatory law from one involving moral turpitude, this does not mean that a regulatory violation will always be treated leniently. The regulation may be aimed at public health or welfare, and its violation could be a serious

52. The impact of the presence or absence of statutory provisions relating to the availability of a remedy to a party that has violated the statute are discussed more fully in Part III. *See infra* Part III.B.

53. *See* JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 98, at 567 (5th ed. 2011).

54. The *Restatement (Second) of Contracts* identifies the seriousness of the misconduct as one of the factors to be taken into account in deciding not to enforce a contract. 2 RESTATEMENT (SECOND) OF CONTRACTS § 178(c)(3) (AM. LAW INST. 1981). Comment c to section 178 emphasizes that the decision not to enforce may be too severe a result where the violation of the law does not merit such a strong response. *Id.* § 178 cmt. c.

55. Of course, a criminal might not file a lawsuit because of the risk of exposing the crime. However, where the wrongdoer has been found out and punished criminally, he has nothing to lose in seeking recovery. Nevertheless, it is highly unlikely that a court would react sympathetically to his suit, given the seriousness of his wrongdoing.

56. According to Grodecki, *supra* note 31, at 255-56, there is some indication that the distinction between acts that were illegal and immoral (that would bar relief) and those that were merely illegal (that would not) was recognized even in Roman times. *Id.* The distinction was made early in English cases but was not followed uniformly. *Id.*

57. FARNSWORTH, *supra* note 51, § 5.5(C), at 335 (questioning the usefulness of this distinction, which does little to further the balancing of considerations called for in approaching questions of illegality).

58. *Id.* § 5.1(A), at 315.

matter, particularly where the infringement was deliberate.[59] In cases involving illegality in a contract, a court may be willing to sever an illegal term and enforce the remainder of the contract provided that the illegality does not permeate the entire contract, and the violation of the law is not serious misconduct.[60]

2. The Relationship Between the Transaction and the Illicit Conduct

The relationship between the transaction and the illegality is sometimes clear. In the most direct case, the law might be violated because the transaction itself is prohibited. For example, the unlawful action is fully implicated and inseparable from the transaction where a gambler sues for his winnings in an illegal gambling transaction, where one thief sues another to recover his share of the loot, or where the buyer of an illegal drug sues the seller for damages for non-delivery. However, illegality might also exist where an otherwise lawful transaction is permeated by some illegal action that is associated with it. The relationship between the illegal action and the transaction could be close—such as, bribing a person to secure an otherwise lawful contract; lawfully selling a chemical to a buyer, knowing that the buyer intends to use it to make an explosive device; or selling goods to the buyer in a legitimate sale knowing that the buyer intends to smuggle those goods.[61]

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59. *See id.* §§ 5.6–5.7, at 341-42.

60. Severance of an illegal contract term is possible where the removal of the term cures the illegal aspect of a contract that does not otherwise offend the law, the severance does not defeat or significantly alter the basis of the bargain, and the illegality is not so serious as to call for the denial of that remedy. *Id.* § 5.8, at 345. RESTATEMENT (SECOND) OF CONTRACTS, § 178(1) (AM. LAW INST. 1981), speaks of the unenforceability of a "promise or other term of an agreement," and comment f to section 178 contemplates the possibility that the illegality of one term in the contract may be sufficiently isolated from the rest of the contract to allow for enforcement of the part of the contract not affected by the illegality. *Id.* § 178 cmt f. The comment does observe, however, that in many contracts, severance will not be possible, and the illegality of one component will cause the contract as a whole to be unenforceable. *Id.* Severability of an offending term must be distinguished from divisibility, under which a court breaks a contract into component parts, avoiding some parts as illegal and allowing enforcement of others. *Id.* § 178 cmt. f; *id.* § 183 cmt. a.; *id.* § 184. Division is appropriate only where the contract can be divided into corresponding sets of self-contained and economically self-standing sets of performances. FARNSWORTH, *supra* note 51, § 5.8, at 344-45. As with severance, division is confined to situations in which the illegality is not serious and does not permeate the contract. *See id.* § 5.8, at 345.

61. This is what happened in the seminal eighteenth-century case of *Holman v. Johnson.* (1775) 98 Eng. Rep. 1120; 1 Cowp. 342. The seller claimed the price of tea, sold in France and ultimately smuggled into England. *Id.* at 1120. Although the seller may have known that the buyer intended to smuggle the tea, the court held that the seller's suit should not be barred because there was nothing illegal in the sale itself and the seller was not a participant in the smuggling. *Id.* at 1122.

Where the illegal action is ancillary to the transaction, its relationship to and effect on the transaction may not be straightforward and obvious, and it may not be clear that the illegal conduct is closely linked enough so as to permeate the transaction.[62] There must be a direct connection, not merely an incidental relationship, between the illegal action and the obligation sued upon. The relationship between the illegality and the transaction is mirrored in the proximate cause analysis under the wrongful conduct rule, discussed below.[63]

D. The Range of the In Pari Delicto *Rule: Illegal Contracts, Breaches of Statutory or Fiduciary Duty, and Torts*

In many cases, the *in pari delicto* defense is asserted against a claim arising from an illegal contract.[64] However, neither the *ex turpi causa* principle nor the *in pari delicto* rule are confined to contractual claims, but rather express a general principle applicable to all causes of action. In the cases cited in this Article, the *in pari delicto* defense has been raised not only in relation to contractual claims, but also as to claims arising out of the violation of a statutory duty, a breach of fiduciary duty, and a tort.[65]

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62. *See, e.g.*, Lamonica v. Safe Hurricane Shutters, Inc., 711 F.3d 1299, 1308-09 (11th Cir. 2013) (holding that the employee-plaintiffs were not active participants in the employer's labor law violation, even though they had used false social security numbers and had committed violations of tax law—there was no causal connection between these acts); Brubaker v. Hi-Banks Resort Corp., 415 N.W.2d 680, 681, 685-86 (Minn. Ct. App. 1987) (permitting the seller to sue for the agreed price of the property, even though he had conspired with the buyers to record a price lower than agreed to evade tax, because the tax evasion did not render the contract illegal); *id.* at 686 (Foley, J., dissenting) (disagreeing with majority and considering that the evasion of taxes was directly related to the contract); Meador v. Hotel Grover, 9 So. 2d 782, 784, 786 (Miss. 1942) (finding the illegal purpose too remote where the decedent was fatally injured in an elevator accident when riding the elevator to visit a prostitute); *id.* at 786-87 (Smith, J., dissenting) (finding a direct link between the use of the elevator and the intended illegal act); Grapico Bottling Co. v. Ennis, 106 So. 2d 97, 98-99 (Miss. 1925) (holding that the buyer had no cause of action for breach of warranty in relation to a contaminated soft drink bought on a Sunday in violation of a Sunday trading law, but the dissent argued the suit should be allowed because the contamination of the drink was unrelated to its improper Sunday sale); McConnell v. Commonwealth Pictures Corp., 166 N.E.2d 494, 496-97 (N.Y. 1960) (refusing to allow the plaintiff to recover on a legal contract because he committed bribery in the course of performing it); *id.* at 498-500 (Froessel, J., dissenting) (arguing that since the contract itself was not illegal, the plaintiff should not be precluded from enforcing it merely because he committed illegal acts in performing it).

63. *See infra* text accompanying notes 75-84.

64. *See, e.g.*, Taylor v. AIA Servs. Corp., 261 P.3d 829, 842-43 (Idaho 2011); *McConnell*, 166 N.E.2d at 495-96; *see also* Orzel *ex rel.* Orzel v. Scott Drug Co., 537 N.W.2d 208, 214 (Mich. 1995) (discussing the many instances in which the rule has been applied, including illegal contracts).

65. *See* sources cited *supra* note 62 and *infra* note 66.

In the context of tort law,[66] the *ex turpi causa* principle is manifested in the wrongful conduct rule[67] (also known as the "unlawful acts" or "unlawful conduct" rule, or the "outlaw" doctrine[68]), which bars relief for tortious injury suffered by a plaintiff who was injured by the deliberate or negligent actions of the defendant during the course of the plaintiff's illegal activity.[69] The doctrine derives from common law but has been given statutory form in some states.[70] The rationale for the wrongful conduct rule is that the purpose of the tort compensation system is to allow an innocent victim to recover for injury caused by the person responsible for that injury.[71] That policy is not advanced by allowing a lawbreaking plaintiff to impose liability on a negligent defendant where the injury arises directly from the unlawful activity in which the plaintiff was involved. For example, where corporate officers had operated a Ponzi scheme, the court held that the wrongful conduct rule barred the plaintiff corporation's malpractice suit against its

66. The wrongful conduct rule is almost always applied to tort claims. *See, e.g.*, Oden v. Pepsi Cola Bottling Co. of Decatur, 621 So. 2d 953, 954-55 (Ala. 1993); *Orzel*, 537 N.W.2d at 210. However, it is occasionally used in other situations involving wrongful conduct. For example, in *Kohut v. Metzler Loricchio Seera & Co., P.C. (In re Munivest Servs., LLC)*, the wrongful conduct rule was applied to a contract-based malpractice claim against an accountant who had enabled fraud by the officer of a corporation. 500 B.R. 487, 491, 493, 500 (E.D. Mich. 2013).

67. *See, e.g.*, *Kohut*, 500 B.R. at 494-95 (discussing the wrongful conduct rule and applying to tort action); Greenwald v. Van Handel, 88 A.3d 467, 472-78 (Conn. 2013) (establishing precedence for the using of the wrongful conduct rule to apply the *ex turpi causa* principle to negligence suits in tort as a matter of policy); *Orzel*, 537 N.W.2d at 212-14 (discussing the wrongful conduct rule and applying to tort action).

68. Dugger v. Arrendondo, 408 S.W.3d 825, 829 (Tex. 2013); Johnson, *supra* note 3, at 44-46.

69. Some courts require that the activity must constitute a serious criminal offense. *See Greenwald*, 88 A.3d at 473 ("Courts . . . have limited the rule's application to cases in which the plaintiff's injuries stem from conduct that is prohibited, as opposed to merely regulated, by law, and the violation is 'serious' or involves 'moral turpitude.'" (citations omitted)); *Orzel*, 537 N.W.2d at 208 ("[T]o implicate the wrongful-conduct rule, the conduct must be serious in nature and prohibited under a penal or criminal statute."). However, not all states require that plaintiff's claim arise out of a felony but extend the doctrine to any form of wrongful conduct. *See* Johnson, *supra* note 3, at 52 & n.52. For example, in *Lee v. Nationwide Mutual Insurance Co.*, the Virginia Supreme Court applied the doctrine to a minor who was injured while joyriding in a car, driven by his friend who had taken his parents' car without permission. 497 S.E.2d 328, 328-31 (Va. 1998). The Fifth Circuit observed that the case law provided so many permutations of the scope of the doctrine that it was difficult to state the contours of the rule with certainty. Rico v. Flores, 481 F.3d 234, 241-44 (5th Cir. 2008).

70. Johnson, *supra* note 3, at 49-62.

71. *Greenwald*, 88 A.3d at 477; *see also Orzel*, 537 N.W.2d at 213 ("The rationale that Michigan courts have used to support the wrongful conduct rule are rooted in the public policy that courts should not lend their aid to a plaintiff who founded his cause of action on his own illegal conduct." (citations omitted)); Johnson, *supra* note 3, at 49-53.

accountant because granting relief to the plaintiff would condone its officer's wrongdoing and shift responsibility to its auditors.[72]

The rationale for the rule is not universally accepted. Some judges and commentators have argued that the rule undermines the tort principle of holding a tortfeasor accountable for his conduct and have questioned whether the wrongful conduct rule is compatible with contemporary principles of comparative fault.[73] However, the wrongful conduct rule does not conflict with these principles because it is not concerned with the role that the plaintiff's own negligence played in the injury, but rather with the fact that the plaintiff's injury arose in the course of illegal activity.[74]

The wrongful conduct rule only bars relief if there is a clear nexus between the plaintiff's illegal conduct and his injury.[75] The injury must be traceable to the violation of the law by a real and identifiable cause-and-effect relationship.[76] The unlawful act need not have been the *only* proximate cause, but must have been *a* proximate cause—one of the

72. MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 851-52 (Mich. Ct. App. 2004).

73. *See Greenwald*, 88 A.3d at 480-81, 483-85 (Eveleigh, J., dissenting) (arguing that tort law should focus on the defendants duty of care, not on the plaintiff's wrongful conduct, and the wrongful conduct rule undermines the principle of comparative negligence and resuscitates the older doctrine of contributory negligence, under which the plaintiff was barred from recovery if his negligence contributed to the injury); Stolicker v. Kohl's Dep't Stores, Inc., No. 302573, 2012 WL 676391, at *6-7 (Mich. Ct. App. 2012) (Gleicher, J., dissenting) (noting that the wrongful conduct doctrine was abrogated when the legislature abolished contributory negligence in favor of comparative negligence). Vincent R. Johnson sees the doctrine as a partial revival of the outlaw doctrine of older tort law, under which a person who engaged in unlawful activity could be injured with impunity. Johnson, *supra* note 3, at 44-46. He argues that although the outlaw doctrine is no longer a part of tort law, it has reemerged to some extent in the wrongful conduct doctrine's preclusion of compensation where the plaintiff's injury arises out of his serious unlawful conduct. *Id.*

74. *See Greenwald*, 88 A.3d at 476-77 (determining that because the wrongful conduct rule applies only where the plaintiff's injury was caused by his own illegal conduct, it is not negated by the comparative negligence principle, which allows the plaintiff to recover even if his own negligence contributed to his injuries); Rosenbach v. The Diversified Group, Inc. 926 N.Y.S.2d 49, 51-52 (App. Div. 2011) (holding that the wrongful conduct rule does not preclude a contribution claim among joint tortfeasors for injury to third parties, even if the tortfeasors engaged in illegal activity, because this is not a claim for injury to the plaintiff-tortfeasors themselves). *But cf.* Dugger v. Arredono, 408 S.W.3d 825, 830-33 (Tex. 2013) (holding that the statute that abolished contributory negligence extended to the unlawful acts doctrine and removed the complete bar to recovery under the common law doctrine).

75. *Greenwald*, 88 A.3d at 473 ("[C]ourts have universally recognized that there must be a sufficient causal nexus between the plaintiff's illegal conduct and his alleged injuries to bar recovery." (citations omitted)).

76. Oden v. Pepsi Cola Bottling Co., 621 So. 2d 953, 955 (Ala. 1993) (barring "any action seeking damages based on injuries that were a direct result of the injured party's knowing and intentional participation in a crime involving moral turpitude").

directly-contributing circumstances leading to the injury—and not merely collateral to or tangentially related to it.[77] Where proximate cause does not exist, the injury was not suffered in the course of the illegal conduct, which was merely ancillary to it, and the claim should not be affected by the plaintiff's wrongful conduct.[78] In some cases, the causal relationship is clear because the plaintiff's injury occurs during the illegal action and arises directly out of that action (for example, where the plaintiff was injured by excessive use of a drug for which he fraudulently obtained prescriptions[79] or the plaintiff was thrown from the bed of a truck while engaged in throwing rocks from it).[80] In other cases, however, it is more problematic to decide whether proximate cause exists (for example, where the plaintiff was injured in the course of being apprehended following a theft[81] or the plaintiff was killed by an

77. Rubio v. Motowski, No. 289526, 2010 WL 2540818, at *1-2 (Mich. Ct. App. 2010); Brassell v. Laban, No. 252749, 2006 WL 782163, at *2 (Mich. Ct. App. 2006); Quick v. Samp, 697 N.W.2d 741, 747-48 (S.D. 2005) (noting that the plaintiff's injury need not be the proximate cause, as long as it is a proximate cause).

78. *Greenwald*, 88 A.3d at 473-74, 477 (supporting the proposition that a person should not be barred from tort relief merely because he has broken the law—a lawbreaker is just as much entitled to protection from tortious acts as a law-abiding citizen unless his injury arises out of the very act of breaking the law and is directly related to it); Orzel *ex rel.* Orzel v. Scott Drug Co., 537 N.W.2d 208, 215-16 (Mich. 1995) (holding that the wrongful conduct rule does not apply where the illegal conduct is only incidentally or collaterally connected with the cause of action).

79. In *Price v. Perdue Pharma Co.*, the plaintiff, by misrepresenting his medical history and treatment to various doctors, managed to get multiple prescriptions for OxyContin, a strong painkiller and a controlled medication. 920 So. 2d 479, 482-83 (Mo. 2006). He was clearly guilty of violating the law by misleading the doctors and improperly having multiple prescriptions filled. *Id.* He later sued the doctors and the pharmacy for malpractice, claiming that he had been injured by his excessive use of the addictive drug. *Id.* at 481-82. Citing the *ex dolo malo* principle and the wrongful conduct rule, the court dismissed his suit. *Id.* at 484-86. The court held that his violation of the law was a proximate cause of his injury, and was not merely a remote or contributing cause. *Id.* at 485-86.

80. In *Rubio*, the decedent was killed by being thrown from the bed of a truck driven recklessly by the defendant after passing a house at which the decedent, standing on the bed of the truck, threw rocks. 2010 WL 2540818, at *2. The court barred the decedent's estate from recovering from the defendant because it found that the decedent's illegal activity was a proximate cause of his death. *Id.* at *2-3.

81. In *Stolicker v. Kohl's Department Stores, Inc.*, the majority of the court held that the plaintiff's illegal act was a proximate cause of her injury where she incurred the injury in a tussle with store security personnel in a store's parking lot after fleeing the store with shoplifted merchandise. No. 302573, 2012 WL 676391, at *1-3 (Mich. Ct. App. Mar. 1, 2012). It considered that the shoplifting was a proximate cause of the injury because it set in motion a chain of events leading to the injury. *Id.* at *3. However, the dissent disagreed that the plaintiff's shoplifting was a proximate cause of her subsequent injury. *Id.* (Gleicher, J., dissenting). It was not an integral part of the plaintiff's case, but was merely a remote link in the circumstances leading up to the injury suffered by her in the parking lot. *Id.* at *4 (Gleicher, J., dissenting). No such qualms were voiced in *Brassell*, where the court found that the plaintiff's theft was a proximate cause of his injury when he

improperly-secured vending machine that fell on him while he was attempting to steal drinks from it).[82] The most ambiguous cases are those in which the plaintiff is injured, not in the course of committing the wrongful act, but rather in preparing to commit it, or after it has been completed (for example, where the plaintiff was crushed in an elevator while riding to an assignation with a prostitute[83] or where the plaintiff was injured by stepping into a hole while leaving an illegal bingo game).[84]

In some cases, such as those involving the police officers or security personnel who injured the plaintiff after the plaintiff had committed the illegal act[85] or the manufacturer and owner of the vending machine that fell onto the plaintiff,[86] the defendants were not participants in the plaintiffs' illegal actions, but were sued for negligence that allegedly occurred before or after the illegal conduct.[87] In such a situation, the *in pari delicto* rule has no application. However, in other cases, such as the case in which the rock-throwing plaintiff was injured by the reckless driving of his cohort, the tortfeasor participated in the illegal action in which the plaintiff was injured. [88] Because the wrongful conduct rule is a manifestation of the *ex turpi causa* principle, the *in pari*

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was hit by a patrol car while fleeing from the police. No. 252749, 2006 WL 782163, at *1-2 (Mich. Ct. App. Mar. 28, 2006).

82. In *Oden*, the decedent was killed when a vending machine fell on him as he was trying to tilt it to steal drinks from it. 621 So. 2d 953, 954 (Ala. 1993). The majority of the court barred his estate's negligence claim against the manufacturer and owner of the machine because the decedent's injury was incurred in the course of his illegal act involving moral turpitude. *Id.* at 954-55. However, the dissent disagreed that the decedent's injury was incurred in the course of committing the crime of theft. *Id.* at 957 (Kennedy, J., dissenting). The dissent reasoned that the claim of the decedent's estate was based purely on the negligence of the manufacturer and owner of the machine in not securing it properly, and the estate therefore did not have to rely on the decedent's theft to establish its case. *Id.* at 956-58 (Kennedy, J., dissenting).

83. In *Meador v. Hotel Grover*, the decedent was crushed to death while riding in a hotel elevator on his way to meet with a prostitute in a hotel room. 9 So. 2d 782, 783-84 (Miss. 1942). The court held that his intended illegal purpose of patronizing a prostitute was not sufficiently linked to the elevator ride as to preclude relief for the injury. *Id.* at 785-86. However, it could have been argued that the only reason for his being in the elevator was his unlawful purpose.

84. In *Manning v. Noa*, the plaintiff fell and injured herself when she stepped into a hole on church property on her way home after participating in an illegal bingo game at the church. 76 N.W.2d 75, 76 (Mich. 1956). The court refused to bar her claim, holding that her unlawful activity was collateral to and not causally connected to her injury. *Id.* at 77-78. The court said that it was not enough that the illegal activity had some remote link in the chain of causation, even though she would not have been walking through the church property had she not been leaving the illegal game. *Id.* at 78.

85. *See Stolicker*, 2012 WL 676391, at *1; *Brassell*, 2006 WL 782163, at *1.

86. *Oden*, 621 So. 2d at 954.

87. *See id.*; *Stolicker*, 2012 WL 676391, at *1; *Brassel*, 2006 WL 782163, at *1.

88. Rubio v. Motowski, No. 289526, 2010 WL 2540818, at *2 (Mich. June 24, 2010).

delicto rule operates in this situation and should only bar suit for the injury if the factors in the overall balance (including the plaintiff's lesser degree of guilt) call for a denial of relief.[89]

E. The Relationship Between the In Pari Delicto *Rule and the Unclean Hands Doctrine*

The unclean hands doctrine, long recognized in courts of equity, proclaims that a party who seeks relief from a court of equity must come to court with clean hands—she must not have engaged in unjust or inequitable conduct in relation to the matter for which she seeks relief.[90] The doctrine is aimed not only at protecting the defendant who is the victim of the inequitable conduct, but also at protecting the court and advancing justice.[91] The doctrine is in one respect broader and in another respect narrower than the *ex turpi causa* principle. It is broader in that, unlike the *ex turpi causa* principle, it is not confined to situations in which the plaintiff has acted illegally in the transaction on which the claim is founded. The unclean hands doctrine extends beyond that to cover conduct, which, even if lawful, is inequitable in relation to the transaction or with regard to the litigation itself.[92] For the plaintiff to be

89. *See Rubio*, 2010 WL 2540818, at *2-3 (allowing the defendant to assert the *in pari delicto* defense against the estate's wrongful death claim because the decedent and defendant were equally guilty of the illegal act and the decedent was killed in the course of committing the illegal act); Orzel *ex rel.* Orzel v. Scott Drug Co., 537 N.W.2d 208, 212-15 (Mich. 1995) (refusing tort relief under the *in pari delicto* rule where the plaintiff, who sued negligent doctors and a pharmacy for injury sustained as a result of his excessive use of a controlled drug, had dishonestly procured multiple prescriptions for the drug); Dugger v. Arredondo, 408 S.W.3d 825, 829 (Tex. 2013) (recognizing that the unlawful acts doctrine is an extension to tort actions of the principle of *in pari delicto* and unclean hands); *see also* Johnson, *supra* note 3, at 70-71 (discussing the application of the *in pari delicto* defense in legal malpractice actions). *But see* Rosenbach v. The Diversified Grp., Inc., 926 N.Y.S.2d 49, 51-52 (N.Y. App. Div. 2011) (permitting contribution claims among tortfeasors who are *in pari delicto*).

90. *See* Epstein v. Epstein, 915 So. 2d 1272, 1275 (Fla. Dist. Ct. App. 2005); Schneider v. Schneider, 644 A.2d 510, 514 (Md. 1994) (applying the unclean hands doctrine only where there is a nexus between the plaintiff's improper conduct and her claim).

91. Mendoza v. Ruesga, 86 Cal. Rptr. 3d 610, 616-17 (Cal. Ct. App. 2009) (noting that the unclean hands doctrine is a principle of fairness that protects the plaintiff and also protects the court from having its power used to bring about an inequitable result); Monetary Funding Grp. v. Pluchino, 867 A.2d 841, 846 (Conn. App. Ct. 2005) (extending the unclean hands doctrine beyond protecting the defendant to the protection of the court and the advancement of justice—its application is in the broad discretion of the court).

92. *See* Yarn v. Hamburger Law Firm, LLC, No. RDB-12-3096, 2013 WL 5375462, at *10 (D. Md. 2013); *Epstein*, 915 So. 2d at 1275 (noting that because a court of equity is a court of conscience, it demands fair dealing by one who seeks equitable relief, so the rule applies to all unrighteous conduct and is not confined to fraud or illegality); Rose v. Nat'l Auction Grp., 646 N.W.2d 455, 461 (Mich. 2002) (noting that the unclean hands doctrine "'closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks

denied relief on the grounds of unclean hands, the wrong must be directly related to the litigation or the transaction on which the claim was based, and the defendant must have been harmed by the plaintiff's improper conduct.[93]

The unclean hands doctrine is narrower than the *ex turpi causa* principle in that, traditionally at least, it applies only where the relief sought by the plaintiff is equitable, not legal. Although the demarcation between law and equity is in an advanced stage of deterioration, some courts continue to confine the unclean hands doctrine to equitable relief.[94] Other courts are not so wedded to the crumbling division between law and equity and no longer confine the unclean hands doctrine to suits in equity.[95] This is more in accord with the approach to

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relief, *however improper may have been the behavior of the defendant*'" (quoting Stachnik v. Winkel, 230 N.W.2d 529, 532 (Mich. 1975)); Quick v. Samp, 697 N.W.2d 741, 747 (S.D. 2005) (noting that the unclean hands doctrine is broader than the *in pari delicto* rule and applies not only where the plaintiff has been guilty of illegal conduct, but in any situation in which the plaintiff's conduct in the transaction or litigation is inequitable); O.F. Jones, III v. Whatley, No. 13-09-00355-CV, 2011 WL 2405789, at *3 (Tex. App. 2011); T. Leigh Anenson, *Beyond Chafee: A Processed-Based Theory of Unclean Hands*, 45 AM. BUS. L.J. 509, 566-68 (2010) (stating that while the preservation of the integrity of the justice system is a predominant goal of the unclean hands doctrine, it differs from the *in pari delicto* rule in that it does not call for a balancing of fault or the parties' participation in a common unlawful scheme); Anenson, *supra* note 41, at 459-60; Lawrence, *supra* note 5, at 674-77.

93. *Jones*, 2011 WL 2405789, at *3.

94. PacifiCorp v. Nw. Pipeline GP, 879 F. Supp. 2d 1171, 1210 (D. Or. 2012) (noting that although the *in pari delicto* rule may be used in relation to claims at law, the unclean hands doctrine is confined to equitable suits); *Monetary Funding Grp.*, 867 A.2d at 846-47 (applying the unclean hands doctrine to bar an equitable foreclosure suit because the plaintiff acted improperly and unfairly in relation to the mortgage, but the court declined to say whether the plaintiff would have fared better had he sued in law for repayment of the mortgage debt); *Epstein*, 915 So. 2d at 175-76 (applying the unclean hands doctrine in refusing to grant an equitable lien to the plaintiff who had colluded in a deception, but it allowed him a money judgment on the basis that the unclean hands doctrine did not bar that legal remedy); *Yarn*, 2013 WL 5375462, at *10 (noting while the unclean hands doctrine applies in cases at equity, *in pari delicto* is a general rule applicable in law and equity).

95. *See Mendoza*, 86 Cal. Rptr. at 616-17 (stating that unclean hands is a defense in both legal and equitable suits because it is motivated by refusing relief on principles of fairness). The merger of courts of law and equity began in the United States by the adoption of the Field Code of 1848 in New York, which spread gradually to the federal system and most states. Anenson, *supra* note 41, at 456. However, the merger was jurisdictional, not substantive, so the absorption of equitable principles into legal cases has been more incremental and is still not complete. *Id.* at 465-69. Anenson lists the states in which courts have recognized the unclean hands doctrine in actions at law. *Id.* at 467-69. He suggests that in some cases, where courts have allowed the defense in a legal action without discussion, the court may simply not have been aware of the equitable origins of the doctrine. *Id.* at 480; *see also* Lawrence, *supra* note 92, at 679-82 (stating that the merger of legal and equitable jurisdiction justifies the application of the unclean hands doctrine in suits at law).

the *in pari delicto* rule, which, as noted earlier, courts apply equally to equitable and legal claims.[96]

Where the plaintiff's conduct is inequitable but lawful, the unclean hands doctrine occupies a different realm from the *in pari delicto* rule. However, the unclean hands doctrine is sometimes raised by a defendant where the plaintiff's hands have been soiled by illegal conduct in which the defendant played some role.[97] In that situation, there is some confusion over the relationship between the unclean hands doctrine and the *in pari delicto* rule. A number of courts have equated the two doctrines and have treated them as indistinguishable where the defendant has been complicit in the illegality, recognizing that they have in common the underlying goals of protecting the court's dignity and furthering public policy.[98] Even if the doctrines are not exactly equivalent, the need to take into account the defendant's wrongdoing is indisputable. The goals of equity would not be served if courts applied the unclean hands doctrine with a blinkered focus on the plaintiff's wrongful conduct in disregard of any impropriety on the defendant's part. Equity is not done by barring the claim of a plaintiff against a defendant who is as much or more to blame for the illegality, so the *in pari delicto* rule, with its full balance of the factors discussed in Part III, should operate to soften the absolute bar of the unclean hands doctrine.[99]

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96. *See supra* note 41 and accompanying text.

97. *See supra* note 90 and accompanying text.

98. *See* Pinter v. Dahl, 486 U.S. 622, 632 (1988) (describing the *in pari delicto* rule as "closely analogous" to the unclean hands doctrine); *see also* Bailey v. Titlemax of Ga., Inc., 776 F.3d 797, 801 (11th Cir. 2015) (noting that *in pari delicto* and unclean hands are similar and each requires a plaintiff to come to equity with clean hands); Schlueter v. Latek, 683 F.3d 350, 355 (7th Cir. 2012) (noting that where the plaintiff is asking for equitable relief, the *in pari delicto* defense is referred to as the clean hands defense, but the label doesn't matter); C&S Wholesale Grocers, Inc. v. Delano, No. 11-37711-B-7, 2014 Bankr. LEXIS 4258, at *13 (E.D. Cal. Sept. 29, 2014) (stating that contemporary courts have expanded the *in pari delicto* defense to situations closely analogous to unclean hands, so that *in pari delicto* is just part of the unclean hands doctrine); *PacifiCorp*, 879 F. Supp. at 1210 (noting that the *in pari delicto* defense is interchangeable with the unclean hands defense, but while unclean hands is an equitable defense, *in pari delicto* is available in suits at law); Joint Equity Comm. v. Genovese, No. G048238, 2014 WL 4162318, at *3-4 (Cal. Ct. App. Aug. 22, 2014) (stating that the *in pari delicto* rule is an "unclean hands defense" and further conflated the doctrines by stating that negligent or inequitable conduct was sufficient for the *in pari delicto* defense, which did not require a showing of illegality); Cole v. Mitchell, 73 So. 3d 452, 457 (La. Ct. App. 2011) (describing the *in pari delicto* rule as a "corollary of the 'unclean hands doctrine'" (citation omitted)); Anenson, *supra* note 41, at 482-83.

99. *See* Ground Control LLC v. Capsco Indus., Inc., 120 So. 3d 365, 369-71 (Miss. 2013) (holding that the plaintiff's claim was not barred under the unclean hands doctrine where both the plaintiff and the defendant had violated the law and the defendant's conduct was more egregious than the plaintiff's); Furman v. Furman, 34 N.Y.S.2d 699, 704-05 (Sup. Ct. 1941) (holding that the court will not use the unclean hands doctrine to bar relief where the plaintiff is less guilty than the defendant—this would be a greater offense to public morals); Quick v. Samp, 697 N.W.2d 741, 747

III. THE BALANCING PROCESS UNDER THE *IN PARI DELICTO* RULE

Having completed an overview of the rationale, concept, and scope of the *in pari delicto* rule, this Part examines the manner in which courts seek to balance the myriad, and sometimes conflicting, considerations that lead to the decision of whether or not the plaintiff's claim should be barred.[100] These considerations fall into four categories: the nature of the remedy sought, the relative guilt of the parties, public policy and public interest, and the equities between the parties.[101] As the discussion shows, public policy and the public interest come to the forefront as the crucial determinants.[102]

A. The Overall Approach to Balancing

As stated before, although the *in pari delicto* maxim focuses on equal guilt, the parties' relative responsibility for the illegal action is only one of the factors that courts take into account in deciding whether the plaintiff should be denied relief.[103] Some courts appear to follow the plain language of the maxim and place particular emphasis on relative guilt. They articulate a two-stage approach to applying the rule in which the relative guilt of the parties is foundational and other factors are not even reached unless the plaintiff's guilt equals or exceeds the

(S.D. 2005) (invoking both the unclean hands doctrine and the *in pari delicto* rule in barring the plaintiff from suing his attorney for malpractice arising out of the use of a forged document where the plaintiff knew of the forgery).

100. *See infra* Part III.

101. *See infra* Part III.B–E.

102. *See infra* Part III.D.

103. Both the *Restatement of Contracts*, published in 1932, and the *Restatement (Second) of Contracts*, published in 1981, articulate the various considerations that should be taken into account in deciding whether or not to enforce an illegal contract. RESTATEMENT OF CONTRACTS §§ 598-609 (AM. LAW INST. 1932); RESTATEMENT (SECOND) OF CONTRACTS §§ 178, 183, 197–99 (AM. LAW INST. 1981). The *Restatement of Contracts*, sections 598 to 609 do not mention expressly the *in pari delicto* rule, but they do recognize that comparative guilt is a consideration in deciding whether to grant relief and set out other considerations that a court should take into account in deciding whether to bar enforcement, or restitution, or both. The *Restatement (Second) of Contracts* makes it clear that the decision on whether to enforce an illegal contract is complex and dependent on the weighing of many factors listed in section 178. These include the justified expectations of the parties, the forfeiture that would result from a denial of enforcement, the seriousness of the infraction, and the public interest in favor of enforcement. *Id.* § 178(2). Comment b to section 178 suggests that in cases of doubt, the balance should tilt in favor of enforcement, and that enforcement should be refused "only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectation of the parties, its abhorrence of any unjust enrichment, and any public interest in the enforcement of the particular term." *Id.* § 178 cmt. b.

defendant's.[104] If this approach is followed strictly, a determination that the plaintiff did not bear equal or greater responsibility for the illegal conduct ends the inquiry and the *in pari delicto* defense fails. However, even courts that articulate a two-stage approach do not actually end their analysis after concluding that the plaintiff was less guilty than the defendant but proceed to weigh the other considerations.[105] Others do not even see the question of relative guilt as foundational, but rather treat it as one of the factors to be weighed in the overall balance, commingling the discussion of relative guilt with the other considerations, such as the nature of the relief sought, the impact and severity of the violation of the law, the equities between the parties, and the public policy and public interest implications of the decision. They address the policy implications of allowing or refusing relief, whether or not the plaintiff was guiltier, as guilty, or less guilty than the defendant.[106]

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104. Pinter v. Dahl, 486 U.S. 622, 635-36 (1988) (explaining that refusal of relief is only justified where the plaintiff was an active, voluntary participant in the illegal activity, and violated the law in cooperation with the defendant, so that the plaintiff bears substantially equal responsibility for the illegality); Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306-07, 310-11 (1985) (holding that the *in pari delicto* defense should be limited to situations in which the plaintiff truly bore at least substantially equal responsibility for his injury); Lamonica v. Safe Hurricane Shutters, Inc., 711 F.3d 1299, 1308-09 (11th Cir. 2013) (holding that because the plaintiff was not in equal guilt with the defendant, the court need not proceed to policy analysis); Rogers v. McDorman, 521 F.3d 381, 389-90 (5th Cir. 2008) (holding that the *in pari delicto* defense is appropriate to preclude suit by one equally guilty party against another); Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1153-54 (11th Cir. 2006); Bash v. Textron Fin. Corp., 483 B.R. 630, 650 (N.D. Ohio 2012) (opining that the defendant must establish that the plaintiff is at least equally guilty); Orzel *ex rel.* Orzel v. Scott Drug Co., 537 N.W.2d 208, 217 (Mich. 1995) (explaining that the plaintiff may recover if the defendant's culpability is greater than the plaintiff's); MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 854-55 (Mich. Ct. App. 2004) (holding that the *in pari delicto* defense was available where the plaintiff's guilt exceeded the defendants'); Teneyck, Inc. v. Rosenberg, 957 N.Y.S.2d 845, 848 (Sup. Ct. 2013) (holding that a defendant who is more at fault than the plaintiff cannot use the *in pari delicto* defense); Furman v. Furman, 34 N.Y.S.2d 699, 704-05 (Sup. Ct. 1941) (deciding that the court will grant relief to the less guilty of the parties); Feld & Sons, Inc. v. Pechner, Dorfman, Wolfee, Rounick & Cabot, 458 A.2d 545, 553-54 (Pa. Sup. Ct. 1983) (using a two-step approach in which relative guilt is determined first, followed by a determination of whether public policy is best served by denying or allowing relief); Small, III v. Parker Healthcare Mgmt. Org., No. 05-11-01471-CV, 2013 WL 5827822, at *4-5 (Tex. App. Oct. 29, 2013) (determining that the rule that the court will not entertain an illegal transaction may not apply where the plaintiff is less culpable).

105. This is most strikingly demonstrated by the approach of the U.S. Supreme Court. *See Bateman Eichler*, 472 U.S. at 315-17 (engaging in policy analysis despite holding that the *in pari delicto* rule should apply only where the plaintiff bears substantially equal responsibility for the violation of the law, and finding that the plaintiffs were less guilty than the defendants); Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 139-40 (1968) (conducting policy analysis after holding that the plaintiffs were less guilty than the defendants).

106. O'Hara v. Ahlgren Blumenfeld & Kempster, 537 N.E.2d 730, 737-38 (Ill. 1989) (holding

It is therefore important to understand that even though the maxim itself and some courts seem to emphasize the importance of relative guilt, courts are not likely to make a decision based on that factor alone, but will conduct a comprehensive evaluation of all relevant factors, which are usually interrelated and not easily separated or viewed in isolation. Indeed, the very question of relative guilt is sometimes dependent on or influenced by the policy underlying the violated law and the public interest.

B. The Role of the Claimed Remedy in the Balancing Process: The Distinction Between Enforcement and Restitution

Taken literally, the *ex turpi causa* and the *in pari delicto* maxims preclude all relief to a plaintiff whose claim arises out of illegal action for which he bears equal or greater responsibility.[107] At face value, the maxims make no distinction between the enforcement of rights arising out of the transaction and the restitution of any benefit that the plaintiff may have conferred on the defendant during the course of performing the transaction.[108] Nevertheless, there is a significant distinction between enforcement and restitution. The enforcement of rights deriving from the illegal transaction recognizes the legal efficacy of that transaction.[109] However, the plaintiff's restitutionary claim is based on disaffirmance of

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that even if the parties are not *in pari delicto*, the court may not enforce an agreement because the public interest is of "determining importance"); Shimack v. Garcia Mendoza, 912 P.2d 822, 825-26 (Nev. 1996) (holding that although the plaintiff, an investigator, was less guilty than the defendant, an attorney, in entering a fee-splitting arrangement, the court still analyzed the equities between the parties and the public interest before concluding that the plaintiff's suit could proceed); Goldberg v. Sanglier, 639 P.2d 1347, 1353 (Wash. 1982) (holding that where the conduct of a party who raises the *in pari delicto* defense "outrages public sensibilities" more than the conduct of the plaintiff, the court will not allow the defense, but the application of the doctrine is based, ultimately, on public policy considerations, and not on a "neat calculus for determining differential fault"); Marte v. Hernandez, No. 66664-9-I, 2011 WL 1833827, at *7-8 (Wash. Ct. App. 2011) (showing that although the court found the parties to be in equal guilt, it indicated that even if the plaintiff had not been found to be equally guilty, the court would conduct a policy analysis to decide if enforcement would be in the public interest). In some cases, the court has allowed the *in pari delicto* defense and refused relief to the less guilty plaintiff on public policy grounds. *See, e.g.*, *O'Hara*, 537 N.E.2d at 737-38 (refusing to enforce a fee-splitting arrangement on public policy grounds, even though it found that the defendant attorney was more guilty than the plaintiff).

107. *See supra* notes 66-69 and accompanying text.

108. The *Restatement (Second) of Contracts* enunciates the general rule that illegality precludes all relief, including restitution. Comment a to section 197 notes that this is in accord with the principle that the court will simply leave the parties to an illegal contract as it finds them. RESTATEMENT (SECOND) OF CONTRACTS § 197 cmt. a (AM. LAW INST. 1981).

109. Kevin H. Michels, *The Corporate Attorney as "Internal" Gatekeeper and the* In Pari Delicto *Defense: A Proposed New Standard*, 4 ST. MARY'S J. ON LEGAL MALPRACTICE & ETHICS 318, 335 (2014).

the transaction and restoration of the defendant's unjust enrichment, which implicates no judicial recognition of the validity of the transaction.[110] In fact, restitution, by placing the parties in the status quo *ante*, may be the closest a court can come to making a neutral decision that undoes, rather than recognizes, the transaction.[111] In addition, the unjust enrichment of the wrongdoing defendant is not an appealing result. Therefore, as a matter of principle, courts should not apply absolutely the apparent universal bar to remedy suggested by the *in pari delicto* rule, but should distinguish restitution from enforcement.

While some courts do articulate the distinction between restitution and enforcement, it is hard to discern any kind of universal or consistent approach, or to assert that courts have established a clear principle that restitutionary claims should be treated differently from claims that call for the enforcement of rights arising from the illegal transaction.[112] Courts are most likely to grant restitution to the wrongdoing plaintiff where there is a statute that specifically provides for that remedy.[113] In the absence of a clear statutory recognition of the plaintiff's right to restitution, the nature of the remedy sought becomes just one of the many considerations that courts weigh in the overall balance, and to some courts, the unjust enrichment of the defendant is not in itself enough to tip the scales where the plaintiff was equally or more guilty than the defendant.[114]

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110. *See* Stewart v. Wright, 147 F. 321, 334 (8th Cir. 1906). In claiming restitution of money advanced by the plaintiff to the defendant in furtherance of a fraudulent gambling scheme, the plaintiff "does not ask the court to recognize the propriety of his transaction or to award him any portion of the plunder. He proceeds not in affirmance or reliance, but wholly by way of repudiation, and seeks merely . . . what was illegally taken from him by fraud and false pretense." *Id.*

111. In *Feld & Sons, Inc. v. Pechner, Dorfman, Wolfee, Rounick, and Cabot*, the court refused to allow a client to claim damages for malpractice from an attorney, where the attorney had counselled the client to commit perjury and falsify evidence. 458 A.2d 545, 551-53 (Pa. Sup. Ct. 1983). However, it did allow the client to seek disgorgement of the fees paid to the attorney on the basis that restitution comes as close as possible to not aiding either party. *Id.* at 554.

112. *See* Collen P. Murphy, *Misclassifying Monetary Restitution*, 55 SMU L. REV. 1577, 1589-95 (2002) (describing the difference between restitution and enforcement).

113. *See, e.g.*, Pinter v. Dahl, 486 U.S. 622, 637-39 (1988) (determining that the Securities Act permits the purchaser of an unregistered security to sue the seller for restitution, and the court must follow the statutory policy of allowing restitution so as to further the statutory goal of encouraging private remedies to enhance enforcement of the statute).

114. Gamboa v. Alvarado, 941 N.E.2d 1012, 1017 (Ill. App. Ct. 2011) (determining that restitution is an appropriate remedy where the plaintiff was not *in pari delicto* with the defendant); Sw. Underground Supply & Envtl. Servs., Inc. v. Amerivac, Inc., 894 S.W.2d 15, 18 (Tex. App. 1994) (permitting quantum meruit recovery for the value of work performed where the plaintiff had entered the illegal contract under duress and was therefore less guilty than the defendant); Goldberg v. Sanglier, 639 P.2d 1347, 1354-55 (Wash. 1982) (allowing restitution and a disgorgement of profits to plaintiffs who were not *in pari delicto* with the defendants); Marte v. Hernandez, No.

Yet, there are some circumstances in which there is a softening of the approach to the restitutionary claim of an equally or more guilty plaintiff: true repentance, where the plaintiff withdraws from the transaction of his own accord, may make the court more amenable to the plaintiff's restitutionary claim.[115] Courts have also recognized that in some circumstances, the defendant's gain is so galling, and the plaintiff's forfeiture is so unfair that restitution best serves the equities and public policy.[116] Of course, a forfeiture of rights is inevitable where a remedy is refused, so courts that allow restitution on grounds of unfair forfeiture usually require some compelling demonstration of hardship.[117] Unfairness is an elusive concept, dependent on the circumstances of the case, the perceptions of the judge,[118] and the totality of the circumstances.[119]

The nature of the restitutionary claim also has a bearing on the court's willingness to grant restitution, even if it would not enforce the transaction. A straightforward claim for the restoration of property or money given to the defendant is very different from a claim in quantum meruit for the market value of the performance that the plaintiff has rendered. Because the agreed price of performance is often based on or

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66664-9-I, 2011 WL 1833827, at *8-9 (Wash. Ct. App. May 16, 2011) (holding that because the plaintiff was a willing participant in the fraud perpetrated against a third party, he was not entitled either to enforce the contract or to receive restitution of value paid to the defendant under it); RESTATEMENT (SECOND) OF CONTRACTS § 198(b), cmt. b (AM. LAW INST. 1981) (stating that restitution is an appropriate remedy where the plaintiff was not *in pari delicto* with the defendant).

115. RESTATEMENT (SECOND) OF CONTRACTS § 199(a) (stating that a party should be allowed restitution if she did not engage in serious misconduct and repented by withdrawing from the transaction before its illegal purpose was achieved); FARNSWORTH, *supra* note 51, § 5.9(D), at 350; Grodecki, *supra* note 31, at 261 (explaining that in the eighteenth century, English courts developed the qualification that the *in pari delicto* rule should not be applied where the contract was executory and the plaintiff repented, terminated the transaction, and sought restitution).

116. *See* RESTATEMENT (SECOND) OF CONTRACTS § 178(2)(b) (recognizing that one of the factors to be considered in deciding whether to refuse enforcement is "any forfeiture that would result if enforcement is denied"); *id.* § 197 (recognizing that a court may permit restitution where its denial would result in "disproportionate forfeiture"); *id.* § 197 cmt. b (explaining that the exception is intended to be narrow, and should only apply where the loss is disproportionate in relation to the violation of the law, and the plaintiff has committed a relatively harmless violation of technical rules); *see also* FARNSWORTH, *supra* note 51, § 5.9(D), at 348-49.

117. *See, e.g.*, Taylor v. AIA Servs. Corp., 261 P.3d 829, 844 (Idaho 2011) (holding that the plaintiff did not show that refusal of enforcement would be unduly harsh merely because the plaintiff would be deprived of the benefit of his bargain).

118. *See* Wade, *supra* note 4, at 53-55, 60 (determining that the court's response to a claim of restitution is probably emotional and depends on whether the court is more impressed by the defendant's unjust enrichment or the plaintiff's effort to curtail the loss from his illegal transaction).

119. *See, e.g.*, Juliet P. Kostritsky, *Illegal Contracts and Efficient Deterrence: A Study in Modern Contract Theory*, 74 IOWA L. REV. 115, 154 (1988) (noting that unfair forfeiture is more likely to be found where the plaintiff was less sophisticated and knowledgeable than the defendant).

equivalent to the market value of that performance, there may in fact be no economic difference in enforcement of the transaction and a claim in quantum meruit for the value of services. If that is so, a court may balk at allowing restitution where the quantum meruit claim is just a back door to enforcement of the contract.[120]

In short, there is no clear doctrinal rule that distinguishes restitution from enforcement and makes it easier for a plaintiff who seeks only restitution to resist the *in pari delicto* defense. The maxims fail to make any distinction between restitution and enforcement and encourage the premise that the nature of the remedy makes no difference. Although some courts have recognized that restitutionary claims should be evaluated more sympathetically, one cannot say that this is a clear and generally applied principle.[121] It should be, though. It is crucial to a principled and coherent application of the *in pari delicto* rule that courts recognize that the nature of the remedy sought is a significant consideration in the decision on whether to apply the *in pari delicto* rule.

C. Relative Guilt

Even where the parties knowingly and voluntarily collaborate in an illegal transaction, the determination of relative fault and the assignment of the degree of blame to each of the parties can be difficult because it is very much dependent on the facts of each case, the nature and purpose of the law that has been violated, and the personal attributes of the parties. However, the balance of guilt does not need to be precisely calibrated—it is enough to show that the parties' degree of fault is indistinguishable.[122]

Where there is no clear basis for tipping the balance of guilt one way or another, a court may simply disregard this factor and resort to policy to determine which party should be treated as more guilty.[123]

120. Ground Control, LLC v. Capsco Indus., Inc., 120 So. 3d 365, 371 (Miss. 2013) (allowing an unlicensed sub-subcontractor to recover in quantum meruit); *id.* at 375-76 (Randolph, J., dissenting) (considering that allowing the sub-subcontractor to recover in quantum meruit was tantamount to allowing it to enforce the contract); *id.* at 376-77 (Coleman, J., dissenting) (same); Sw. Underground Supply & Envtl. Servs., Inc. v. Amerivac, Inc., 894 S.W.2d 15, 17-19 (Tex. App. 1994) (allowing quantum meruit recovery for the value of work, but only because the plaintiff was less guilty than the defendant).

121. *See* Wade, *supra* note 4, at 41-44, 53-55.

122. Flaxer v. Gifford, 528 B.R. 598, 611-13 (S.D.N.Y. 2015) (holding that where the defendant deliberately engaged in fraud in the course of his employment, he could assert the *in pari delicto* defense against his equally guilty employer, which sanctioned the fraud); Quick v. Samp, 697 N.W.2d 741, 745-46 (S.D. 2005) (deciding that the court need not measure equality of fault exactly—all that need be shown is that the plaintiff is at least as guilty as the defendant).

123. For example, in *Skinner v. E.F. Hutton Co.*, the plaintiff had acted on insider information

Courts have identified a number of situations that strongly indicate where greater blame should be placed. First, where the law is intended to apply to only one of the parties, that party bears greater responsibility for its violation.[124] Second, the attributes, state of mind, motives, dominance, sophistication, responsibilities, duties, or expertise of one of the parties may make that party more blameworthy or may impose on him a stronger duty to obey the law. Therefore, for example, the fact that one of the parties was the ringleader or initiator of the illegal scheme may make him more guilty than his cohort.[125] Third, one of the parties may have been justifiably ignorant of the circumstances that made the transaction illegal and, may therefore, be less blameworthy than the party who knew these circumstances.[126] Fourth, a power imbalance between the parties may enable the dominant party to influence or coerce the weaker party to participate in the illegal action.[127] Fifth,

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in buying and retaining stock that failed to appreciate as expected. 333 S.E.2d 236, 237 (N.C. 1985). Both the plaintiff (the tippee) and the defendant (the tipper) had violated securities laws in trading on insider information. *Id.* at 238-39. On being sued by the tippee for compensatory and punitive damages, the tipper raised the *in pari delicto* defense. *Id.* at 237-38. The court refused to attempt to determine the relative guilt of the parties on the basis that the determination was too unreliable and unpredictable. *Id.* at 238-39. Instead, it decided, as a matter of policy, that the purposes of insider trading laws is best served by creating a per se rule that a tipper's guilt exceeds that of the tippee. *Id.* The court was dealing with a violation of state securities law, so it was not bound by *Bateman Eichler, Hill Richards, Inc. v. Berner*, and declined to follow it. *Id.* at 240 (citing Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985)). While the certainty of a per se rule is comforting, there may be some situations in which an analysis of the circumstances of the case would lead to the conclusion that the tippee did in fact bear greater responsibility for the violation of the law.

124. *See, e.g.*, Schlueter v. Latek, 683 F.3d 350, 355-56 (7th Cir. 2012) (holding a licensing statute was applicable only to a broker, and not to his customer, so the parties could not be in equal guilt).

125. However, if the cohort was an active participant in the ringleader's scheme, a court may find equal guilt. For example, in *Marte v. Hernandez*, two brothers entered into a partnership to acquire a McDonalds franchise. No. 66664-9-I, 2011 WL 1833827, at *1 (Wash. Ct. App. May 16, 2011). They knew that McDonalds would not grant the franchise to a partnership, and so, they concealed it, committing a fraud on McDonalds. *Id.* Although the brother who was the franchisee of record made the misrepresentation, the court held that the brother who was the undisclosed partner could not sue the franchisee's estate for his partnership interest. *Id.* at *7-8. As an active participant in the scheme, he was barred from recovery by the *in pari delicto* defense. *Id.*

126. Taylor v. AIA Servs. Corp., 261 P.3d 829, 842-43 (Idaho 2011) (holding that while ignorance of the law is no excuse, the parties are not in equal guilt if the one party is justifiably ignorant of the circumstances that made the transaction illegal). *But see* Small v. Parker Healthcare Mgmt. Org., No. 05-11-01471-CV, 2013 WL 5827822, at *5 (Tex. App. Oct. 29, 2013) (holding that because both parties operated under a mistaken belief as to the legality of the transaction, they were in equal guilt, even though the belief was based on legal advice); Geis v. Colina Del Rio, LP, 326 S.W.3d 100, 108-09 (Tex. App. 2011) (holding when only one of the parties had access to facts that made the transaction illegal, the other party is not *in pari delicto*).

127. Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 139-40 (1968) (finding muffler dealers who engaged in a conspiracy to restrain trade were not *in pari delicto* with the

where the parties are equally guilty in the transaction itself, the balance of guilt may be tipped by the conduct of one of the parties beyond the shared illegal purpose (for example, one of the parties may have induced the other to enter an illegal transaction by making a fraudulent misrepresentation to the other).[128] Sixth, where one of the parties is a professional such as a lawyer or an accountant, her professional duties may impose greater responsibility on her and may also allow her to influence the other party more easily. Professional duties of competence and honesty often place professionals such as lawyers and accountants in the position of being the more guilty party if they enter into transactions that violate both the law and their professional responsibilities[129] or if

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franchisor because they had little bargaining power against the franchisor); Tamposi v. Denby, 974 F. Supp. 2d 51, 57-58 (D. Mass. 2013) (determining that where both parties are *in pari delicto*, concurring in an illegal act, it does not always follow that their guilt is equal—there may be an inequality of condition or a confidential relationship between them); Schneider v. Schneider, 644 A.2d 510, 516-17 (Md. 1994) (stating that a wife dominated by her husband may not have been equally guilty of colluding in perjury to obtain a divorce); Proctor v. Whitlark & Whitlark, Inc., 750 S.E.2d 93, 96 (S.C. Ct. App. 2013) (holding that a power imbalance may arise from addictive or compulsive behavior, so a habitual gambler who engaged in illegal gambling was not *in pari delicto* with the operator of the illegal gambling machines because he was a habitual gambler); Sw. Underground Supply & Envtl. Servs., Inc.v. Amerivac, Inc., 894 S.W.2d 15, 18 (Tex. App. 1994) (holding that duress, combined with illegality, precluded enforcement of an illegal non-competition clause). In *Roma Construction Co. v. Russo*, a developer who bribed the mayor of a town was not deprived of a civil claim against the mayor under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 194 (2000), because the mayor extorted the bribes. 96 F.3d 566, 574-75 (1st Cir. 1996). While the case involved the interpretation of RICO, rather than the *in pari delicto* rule, the reasoning is analogous.

128. *See* Stewart v. Wright, 147 F. 321, 325-26 (8th Cir. 1906) (holding that although the plaintiff knowingly participated in a fraudulent gambling scheme, he was not *in pari delicto* with a bank that facilitated the scheme and collaborated in cheating the plaintiff); Berman v. Oakley, 137 N.E. 667, 670-71 (Mass. 1923) (holding that although a client was guilty of trying to suppress a criminal prosecution, his attorney could not raise the *in pari delicto* defense against the client because the attorney had defrauded and manipulated the client in relation to the case). *Bateman Eichler, Hill Richards, Inc. v. Berner*, involved insider trading under the securities laws. 472 U.S. 299 (1985). The insider information furnished to the investors was false, and the investors sued the tipsters for losses resulting from the bad investment. *Id.* at 301-02. The court refused to allow the *in pari delicto* defense. *Id.* at 310. Although both parties had violated the law, the plaintiffs (the investors) were not as guilty as the tipsters, who had deliberately provided misleading and deceptive information to induce the investment. *Id.* at 310-11.

129. In *Shimrack v. Garcia-Mendoza*, a lawyer entered into a fee-splitting arrangement with the plaintiff, a non-lawyer, in contravention of the rules of professional responsibility. 912 P.2d 822, 823-24 (Nev. 1996). Although the plaintiff likely knew this was a violation of the Rules, the court allowed him to recover the agreed compensation. *Id.* at 826-27. It was the lawyer, not the plaintiff who was subject to the Rules, and the lawyer was therefore at greater fault. *Id.* at 826. The court went on to find that public policy was best served by ensuring that the lawyer was not unjustly enriched by avoiding payment for the plaintiff's services. *Id.* In *Danzig v. Danzig*, a lawyer, in violation of the rules of professional responsibility, entered into an arrangement to pay a fee to a runner for directing clients to him. 904 P.2d 312, 313 (Wash. App. 1995). The majority of the court refused to dismiss the runner's claim on the basis of the *in pari delicto* rule and allowed him to

they advise, support, condone, or fail to detect the client's illegal actions.[130] However, this is not the inevitable result. Where the client's conduct is egregious and he deliberately engaged in defiance of the law, the client's guilt may surpass the lawyer or accountant's fault in counseling or overlooking the conduct.[131] The question of relative guilt also depends on the degree of culpability of the professional. Therefore, an auditor or attorney may succeed in raising the *in pari delicto* defense to a claim based on negligent failure to detect wrongdoing, but would be less successful in raising it where he aided and abetted the client's illegal conduct.[132]

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proceed to trial to show that he was less guilty than the lawyer and that public policy was best served by enforcement. *Id.* at 314-16. The dissent would have dismissed the claim on the basis that it was clear on the pleadings that the runner knew the contract was illegal, and public policy was best served by creating a disincentive for runners to enter into such contracts. *Id.* at 316-17 (Thompson, J., dissenting). Where the client acts illegally on the advice of a professional, without intent to violate the law, the professional should not be able to raise the client's illegality as a defense. For example, in *MF Global Holdings, Inc. v. PriceWaterhouseCoopers, LLP*, the court refused to allow auditors to assert the *in pari delicto* defense where a corporation followed improper accounting procedures recommended by the auditor, merely acting on the auditor's advice and without the deliberate intent to break the law. 57 F. Supp. 3d 206, 210-11 (S.D.N.Y. 2014).

130. Shaiman v. Carpet One of Hamptons, Inc., No. BRC 208-08, 2010 WL 2305549, at *5-6 (N.Y. D. Ct. June 9, 2010) (refusing to allow an accountant to raise the *in pari delicto* defense, although the client violated the law by underreporting sales taxes because the accountant deviated from accepted accounting practices by not verifying the client's figures).

131. Choquette v. Isacoff, 836 N.E.2d 329, 334 (Mass. App. 2005) (allowing attorney to raise the *in pari delicto* defense, although the client committed perjury on the advice of his attorney, because the client actually committed the crime); MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 854-55 (Mich. Ct. App. 2004) (holding that accountants for the plaintiff corporation did not bear equal guilt with the corporation where the accountants merely turned a blind eye to the fraud of corporate officers); Feld & Sons, Inc. v. Pechner, Dorfma, Wolfee, Rounick, and Cabot, 548 A.2d 545, 548-53 (Pa. Super. Ct. 1983) (holding that a client had no malpractice claim against his attorney where he committed perjury, falsified exhibits, and bribed a witness on the attorney's advice—the client knew he was violating the law and was *in pari delicto* with his attorney); Quick v. Samp, 697 N.W.2d 741, 747-48 (S.D. 2005) (barring suit by client for malpractice under the *in pari delicto* rule where an attorney and client collaborated in the forgery of a document relied upon in a lawsuit, because he did not act innocently on the attorney's advice, and knew that the falsification violated the law); Harborview Office Ctr., LLC v. Nash, 804 N.W.2d 829, 833-34 (Wis. Ct. App. 2011) (applying the *in pari delicto* rule to bar a developer from suing its attorney for malpractice where the developer illegally and egregiously spoliated evidence relating to defective work on a building, thereby resulting in dismissal of its suit against a contractor).

132. Stewart v. Wilmington Tr. SP Serv., Inc., 112 A.3d 271, 302, 317 (Del. Ch. 2015), *aff'd*, 126 A.3d 1115 (Del. 2015) (noting that while a claim based on breach of contract or professional negligence may be barred by the *in pari delicto* defense, a claim for aiding and abetting might not be because the defendant's degree of guilt is greater where he breaches his fiduciary duty).

D. *Public Policy and the Public Interest*

The analysis of public policy and the public interest looms as the most important factor in the equitable balancing under the *in pari delicto* rule. Even where a plaintiff is found to be guiltier of the illegal conduct than the defendant, the court may be persuaded to allow relief on grounds of public policy and the public interest.[133] In the absence of a clearly-articulated legislative policy determination, the decision of what result best serves public policy is notoriously difficult and unpredictable.[134]

Where the transaction violates a statute, the statute may obviate the need for the court to conduct a public policy analysis by settling the policy question legislatively. Where the statute speaks clearly on the effect of a contravention, the court's role is relatively simple—it applies the statute.[135] The statute may expressly declare that neither party may sue on a cause of action arising from the violation, or it may declare the transaction void, which has the same effect, or it may recognize a remedy in favor of one of the parties, but not the other.[136] Alternatively, it may disallow a claim for damages, but may give one or both parties a claim for restitution of any benefit conferred on the other under the illegal transaction.[137] Even if the statute does not specifically articulate the legal effect of the transaction, it may provide for a private

133. Geis v. Colina Del Rio LP, 362 S.W.3d 100, 108 (Tex. App. 2011) (finding that even if the parties are *in pari delicto*, the plaintiff may recover where public policy weighs in favor of allowing the claim).

134. Richardson v. Mellish (1824) 130 Eng. Rep. 294, 303; 5 Co. Rep. 91 (describing public policy as an unruly horse). This metaphor is still quoted frequently in cases and commentaries to describe the unpredictable and slippery nature of public policy analysis in dealing with illegal contracts. *See* Kojo Yelpaala, *Restraining the Unruly Horse: The Use of Public Policy in Arbitration, Interstate and International Conflict of Laws in California*, 2 TRANSNAT'L L. 379, 380-83 (1989).

135. Orzel *ex rel.* Orzel v. Scott Drug Co., 537 N.W.2d 208, 218 (Mich. 1995) (finding that where the statute expressly allows the plaintiff to recover, the court will simply permit the cause of action).

136. Pinter v. Dahl, 486 U.S. 622, 623 (1988) (describing securities law as providing a remedy to the purchaser of an unregistered security); Gamboa v. Albarado, 941 N.E.2d 1012, 1017-18 (Ill. App. Ct. 2011) (describing an immigration statute as designed to protect persons in the position of the plaintiffs and to provide them with a private right of enforcement to recover injunctive or compensatory relief).

137. Major League Baseball Props., Inc. v. Price, 105 F. Supp. 2d 46, 53 (E.D.N.Y. 2000) (allowing the recovery of gambling losses under a state law designed to protect gamblers); Proctor v. Whitlark & Whitlark, Inc., 750 S.E.2d 93, 96 (S.C. Ct. App. 2013) (holding that the purpose of a statute prohibiting gambling on video poker machines was to protect compulsive gamblers and their families, so that it was appropriate to grant a restitutionary remedy to the plaintiff gambler).

enforcement remedy, which may signify legislative intent not to bar relief, or at least not to bar all forms of relief.[138]

Sometimes, the statute's unstated but apparent goals may provide an indication of the proper disposition of the plaintiff's claim.[139] Some statutes that do not specifically address remedy have the clear purpose of protecting one class of parties against the other—usually a party who is vulnerable to being victimized by the other. Although the parties may

138. *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 315-16 (1985) (barring the *in pari delicto* defense by defendant stock brokers and allowing plaintiffs to sue for damages because private litigation was an important means of exposing and deterring the proscribed conduct); Perma Life Mufflers, Inc., v. Int'l Parts Corp., 392 U.S. 134, 138-39 (1968) (holding that muffler dealers who had engaged in a conspiracy with the franchisor to restrain trade were not barred from suing the franchisor under the antitrust laws because private enforcement suits under the antitrust laws are an important adjunct to government enforcement action); Gatt Commc'ns v. PMC Assocs., LLC, 711 F.3d 68, 80-81 (2d Cir. 2013) (explaining how the policy of allowing private enforcement actions under the antitrust laws must be weighed against the concern of rewarding a plaintiff that was completely and continually involved in a monopolization scheme); Carter v. Cohen, 116 Cal. Rptr. 3d 303, 310-11, 315 (Ct. App. 2010) (allowing a tenant's claim for disgorgement of rent paid in excess of the rent permitted by regulation because the ordinance allowed the tenant to recover excess rent payments plus treble damages and attorney's fees); The Diversified Group, Inc. v. Sahn, 696 N.Y.S.2d 133, 137 (App. Div. 1999) (holding that the *in pari delicto* rule did not bar the plaintiff's claim for a refund of money paid for illegally-scalped tickets because the anti-scalping statute provided for a private right of action to buyers, even if the buyer knew that the transaction was illegal); *cf.* Rogers v. McDorman, 521 F.3d 381, 387-89 (11th Cir. 2008) (explaining that the *in pari delicto* defense is consistent with RICO policy goals, which do not call for one guilty violator to recover from another); Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1152-56 (11th Cir. 2006) (holding that the *in pari delicto* rule precludes a corporation whose officers engaged in a Ponzi scheme from recovering statutory damages against custodians of IRA accounts that ignored or failed to detect the fraud because it would be anomalous to award those damages to a party who violated the statute). In *Republic of Iraq v. ABB AG*, the post-Hussein Republic brought a RICO claim to recover losses from those who had collaborated with the Hussein regime in illegally diverting funds from the "Oil for Food" program. 768 F.3d 145, 156-57 (2d Cir. 2014), *cert. denied* 135 S. Ct. 2836 (2015). The majority upheld the *in pari delicto* defense on the grounds that Hussein's illegal actions were imputed to the Republic, which must therefore be treated as an unlawful actor, and thus, it was precluded from claiming under RICO, which contemplated damages only to an innocent victim and not to a party that conspired in the racketeering activity, even if only by imputation. *Id.* at 167-68. The dissent argued that there would be no violation of RICO policy where the plaintiff was not the actual wrongdoer, but was in fact seeking relief on behalf of victims of the conspiracy. *Id.* at 181-82 (Droney, J., dissenting).

139. *See Pinter*, 486 U.S. at 634-35, 641, 647, 650 (showing that where the statute is unclear on the impact of illegality on the transaction, it has not abrogated the common law *in pari delicto* rule); MGM Constr. Serv. Corp. v. Travelers Cas. & Sur. Co. of America, 57 So. 3d 884, 885-86, 888, 891 (Fla. Dist. Ct. App. 2011) (showing when a municipal code provided penalties for performing unlicensed building work, but did not indicate the effect of noncompliance on a suit for the price of that work by an unlicensed contractor, the court must decide this question, taking into account the statutory purpose, the public interest, and the equities between the parties); Taylor v. AIA Serv. Corp., 261 P.3d 829, 844 (Idaho 2011) (finding that where the agreement—a stock repurchase financed other than out of the corporation's earned surplus—was exactly the kind of contract that was prohibited by the statute, non-enforcement best serves the policy of the statute).

have collaborated in entering the illegal transaction, the statutory purpose may best be served by allowing suit by the plaintiff if he falls within the class intended to be protected.[140] The question of whether the plaintiff falls within the protected class is a matter of interpretation.[141] The intent to protect one class of party against the other may be apparent from the obvious purpose of the statute, or if not, may be gleaned from other indicia, such as the imposition of a penalty for violation on only one class of party,[142] or the requirement that one party has to follow prescribed procedures that would have the effect of protecting members of the public who enter into transactions covered by the statute.[143]

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140. Bailey v. Titlemax of Georgia, Inc., 776 F.3d 797, 801-02, 804-05 (11th Cir. 2015) (holding that the Fair Labor Standards Act is intended to protect an employee's right to overtime pay, so the employer cannot assert the *in pari delicto* defense to a claim for unpaid overtime, even though the employee collaborated in underreporting his overtime hours); Karpenko v. Leendertz, 619 F.3d 259, 265-66 (3d Cir. 2010) (denying the defense of unclean hands to a claim for child custody under the Hague Convention where the purpose of the Convention was to protect the best interests of the child); *In re* Singh, No. 10-42050-D-7, 2015 WL 1887939, at *4-6 (Bank. E.D. Cal. Apr. 22, 2015) (showing that although a usury statute is intended to protect borrowers from paying excessive interest, its protection is confined to borrowers who did nothing more than pay usurious interest, and cannot be used to overcome the *in pari delicto* defense where the borrower deliberately offered to pay usurious interest to support a Ponzi scheme); *Carter*, 116 Cal. Rptr. 3d at 310-11 (holding that a tenant's claim for disgorgement of rent paid in excess of the rent permitted by regulation is consistent with statutory policy and should not be barred); Bodily v. Piedmont Vill. Green Home Owners Assoc. Inc., 163 Cal. Rptr. 658, 663 (Ct. App. 1980) (holding that the homeowner's association could sue under a contract that violated a law relating to the subdivision of land because the statute was meant to protect homeowners who purchase subdivided real property from a developer who has made the subdivision); Schneider v. Schneider, 644 A.2d 510, 517-18 (Md. 1994) (holding a statute providing for the enforcement of a spousal support obligation evinces a strong policy of protecting the creditor spouse, which outweighs that spouse's collusion with the debtor spouse in perjury relating to the divorce); *Orzel*, 537 N.W.2d at 218-19 (holding that the plaintiff did not fall within the class of persons intended to be protected by the statute and had, in fact, undermined the statutory purpose); MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 856-57 (Mich. Ct. App. 2004) (explaining where there is a basis in a statute for finding that it was intended to protect a class of persons of which the plaintiff is a member, a court may permit a remedy); Parsky Funeral Home, Inc. v. Shapiro, 372 N.Y.S.2d 288, 291-92, 294 (Civ. Ct. 1975) (holding that because a statute requiring the disclosure of funeral costs was aimed at protecting customers of funeral homes, a funeral home that failed to comply with the statute could not sue its customer); Geis v. Colina Del Rio LP, 362 S.W.3d 100, 109-10 (Tex. App. 2011) (holding that a statute requiring architects to be licensed was meant to protect users of architectural services, so the public interest is best served by allowing the client to sue the architect).

141. *See* Ryan v. Motor Credit Co., 28 A.2d 181, 182-83 (N.J. 1942) (holding that the purpose of a statute prohibiting usury was to protect only consumer borrowers from oppression, so a car dealer was not in the protected class and was *in pari delicto* because he knowingly and voluntarily agreed to the interest rate).

142. Suburban Home Mortg. v. Hopwood, 73 N.E.2d 519, 520 (Ohio Ct. App. 1947) (discussing where a statute imposes a penalty on only one of the parties, it is safe to assume that the other is not *in pari delicto*).

143. *Pinter*, 486 U.S. at 637-39 (explaining that the procedure of registration required by the statute was designed to protect purchasers by providing them with accurate information on which to

Where a statute neither addresses remedy nor has the apparent purpose of protecting one class of party, or where the illegality involves a violation of common law, the court has less guidance in determining which resolution best furthers public policy. Such cases present a greater risk that public policy analysis may be arbitrary and dependent on a particular judge's speculation regarding the impact of the decision on the public good. Whatever reasoning a court may use to justify its decision on public policy grounds, there is often an equally-persuasive, or at least plausible, argument for reaching the opposite conclusion. The elusive nature of a resolution that best serves the public interest is starkly illustrated by cases in which the majority and dissent reach opposite conclusions on this issue.[144] Although some judges have recognized the unpredictability of, and the flaws in, the public policy analysis,[145] they have to determine what is to be done with the plaintiff's claim, and therefore, take on the task of attempting to reach the best decision.[146]

A court might be influenced by the fact that the harm has already been done and cannot be undone by the refusal of remedy.[147] However,

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base an investment decision).

144. Republic of Iraq v. ABB AG, 768 F.3d 145, 167-69, 180, 183 (2d Cir. 2014), *cert. denied* 135 S. Ct. 2836 (2015) (demonstrating that the majority and dissent differed on whether RICO policy and the public interest was best served by allowing the *in pari delicto* defense); Stewart v. Wright, 147 F. 321, 329, 340-41 (8th Cir. 1906) (demonstrating disagreement between the majority, which decided that public policy was best served by permitting recovery by a plaintiff who collaborated in a fraudulent gambling scheme, and the dissent, which argued that this determination was too much a matter of an individual judge's view, and that public policy called for denial of relief); Ground Control, LLC v. Capsco Indus., 120 So. 3d 365, 373, 376, 381-82 (Miss. 2013) (demonstrating disagreement between the majority, which felt that allowing recovery by an unlicensed sub-subcontractor best served the public interest by preventing the unjust enrichment of the unlicensed subcontractor, and the dissent, which felt that refusal of recovery best served the policy of protecting the public from unlicensed contractors); Danzig v. Danzig, 904 P.2d 312, 314-16 (Wash. Ct. App. 1995) (demonstrating disagreement between the majority and dissent on whether the public interest was best protected by allowing or dismissing a runner's suit to enforce a claim for payment against the attorney who hired him).

145. *Stewart*, 147 F. at 341 (Sanborn, J., dissenting); *Ground Control*, 120 So. 3d at 376-81 (Randolph, J., dissenting).

146. Feld & Sons, Inc. v. Pechner, Dorfman, Wolfee, Rounick & Cabot, 458 A.2d 545, 551-52, 554-55 (Pa. Super. Ct. 1983) (showing that although the court felt that a determination of relative guilt and public policy was too dependent on the individual views of the judge and was arbitrary, its need to resolve the case compelled it to weigh the relative guilt of the parties and to conduct the policy analysis).

147. Carter v. Cohen, 116 Cal. Rptr. 3d 303, 310-11 (Ct. App. 2010) (explaining that where the public cannot be protected because the harm has been done, there is no serious moral turpitude, and the defendant is at greater fault and would be unjustly enriched, the *in pari delicto* rule should not be applied); Marte v. Hernandez, No. 66664-9-I 2011 WL 1833827, at *7 (Wash. Ct. App. May 16, 2011) (holding that if the harm has already been done, refusal of enforcement will not protect the public from the harm caused by the present transaction, especially if there is no serious moral turpitude and the defendant would be unjustly enriched).

courts often look beyond the current dispute to consider whether allowing or refusing relief will have an impact on discouraging these parties and others from engaging in similar illegal transactions in the future. The deterrent effect of the court's decision plays a significant role in the public policy analysis,[148] but divining the impact of the decision on future conduct is a guess. A prediction of the deterrent effect depends on a determination of possible incentives for entering into the transaction, but also on whether the disposition of this case would likely have the effect of reducing those incentives or changing behavior.[149] This could involve a complex prediction about whether the risk of non-enforcement would be enough to deter undesirable conduct, whether prospective lawbreakers may even come to know about it, and whether the precedential authority of the court is enough to bind future courts dealing with similar transactions.[150] The nature of the parties to transactions of this kind may suggest an answer to the question of where a disincentive is most-effectively aimed. The disincentive is most effective when aimed at a potential transgressor that is most likely to become aware of the disincentive and to take it into account in assessing the risk of violating the law.[151] Of course, because the court must

148. Juliet P. Kostritsky identifies the various factors that courts consider in evaluating relative guilt and concludes that these factors, combined with public policy considerations, enable courts to engage in efficient deterrence that effectively allocates the risk of non-enforcement to the party who is most likely to respond to the deterrence. Juliet P. Kostritsky, *Illegal Contracts and Efficient Deterrence: A Study in Modern Contract Theory*, 74 IOWA L. REV. 115, 126-27 (1988). For examples of cases in which deterrence is addressed, see *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985) (holding in a case involving insider trading, that the disincentive is best placed on the seller of the stock because sellers are more likely to be aware of the disincentive, and insider trading might thereby be nipped in the bud); *Carter*, 116 Cal. Rptr. 3d at 311 (allowing a lessee to sue the lessor for disgorgement of rent over the amount permitted by regulation best serves the policy of the ordinance by creating a disincentive to charging excessive rent); *O'Hara v. Ahlgren*, 537 N.E.2d 730, 737-38 (Ill. 1989) (holding that a lawyer is already deterred by the rules of professional responsibility from entering into a fee-splitting arrangement with a non-lawyer, so it is best to deter the non-lawyer from this kind of transaction by refusing the non-lawyer's claim for enforcement of the arrangement); and *Geis v. Colina Del Rio LP*, 362 S.W.3d 100, 110 (Tex. App. 2011) (holding that the public interest is best served by allowing the client to sue an unlicensed architect, because this creates a disincentive to architects to provide services without a license).

149. *See* Kotstritsky, *supra* note 148, at 145-46.

150. *Id.* (discussing the various alternative outcomes depending on the policy adopted).

151. John W. Wade suggests that when a court weighs disincentives, it assumes, possibly quite fictionally, that its determination actually filters down to would-be violators and will have an impact on their behavior. Wade, *supra* note 4, at 50. In her article, *Illegal Contracts and Efficient Deterrence: A Study of Modern Contract Theory*, Juliet Kostrinsky offers the example of an employer's failure to pay wages to an illegal alien. Kostritsky, *supra* note 148, at 150-51. Both parties knowingly violated the law in entering into the employment contract. *Id.* If the court bars relief to the worker, the employer gets a windfall by avoiding payment for the work, so the

speculate on the deterrent effect of its determination, it is hard to know whether the court has reached the right conclusion, and often possible to argue that the opposite conclusion would be more effective.[152]

E. The Equities Between the Parties: The Defendant's Unjust Enrichment and the Plaintiff's Unfair Forfeiture

Where both parties are responsible for violating the law, it is often noted that the refusal to grant relief to the plaintiff is not for the sake of the defendant, who merits little sympathy as a collaborator or participant in the illegal transaction, but to protect the public interest and the integrity of the court.[153] Similarly, a court's decision to allow a remedy to a guilty plaintiff is not intended as an approbation of the plaintiff's conduct, but results from a determination that this best serves the public interest.[154] That is, the public interest is dominant and drives the decision, even if it means that a defendant profits from the denial of the plaintiff's claim, or a plaintiff is allowed to assert rights arising from an illegal transaction.

Yet, this does not mean that the impact of the decision on the parties themselves is of no account in all circumstances, and the equities between the parties is a legitimate consideration to weigh in deciding whether or to what extent to refuse relief to the plaintiff. This equitable balancing between the parties will likely not overcome the court's view of the resolution demanded by public policy.[155] However, the prospect

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likelihood of non-enforcement gives employers an incentive to enter the illegal contract. *Id.* Because the employer is likely in a stronger bargaining position and is more likely to be aware of the disposition of such cases, a disincentive aimed at the employer is likely to be more effective. *Id.* Therefore, the worker's claim should not be barred by the *in pari delicto* rule. In *Greenwald v. Van Handel*, the dissent questioned the deterrent effect of refusing relief under the wrongful conduct rule, noting that the application of the rule is too unpredictable to be an effective discouragement of unlawful conduct. 88 A.3d 467, 484-85 (Conn. 2014) (Eveleigh, J., dissenting).

152. Wade, *supra* note 4, at 50. In the example involving the employment contract in the preceding note, it might just as well be argued that a disincentive aimed at the worker, who has more to lose, would be the most effective. *See supra* note 151. The same is true of each of the cases cited in that footnote—an argument could be made that placing the disincentive on the other party could be just as effective or a more effective deterrent. *Supra* note 151.

153. *See supra* Part II.A.

154. *Greenwald*, 88 A.3d at 472 (stating that *ex turpi causa* is a universal principle, dictated by public policy, that no one should be permitted to profit from his own wrong).

155. Honein v. Honein (*In re* Honein), No. NV-10-1494, 2012 WL 2428916, at *6-7 (B.A.P. 9th Cir. June 27, 2012) (indicating that although the equities between the parties favored enforcement, the plaintiff's equal guilt precluded relief); Schneider v. Schneider, 644 A.2d 510, 515-16 (Md. 1994) (stating that although it may seem unjust to allow one malfeasor to set up his own wrongdoing as a defense against the other, the individual equities must be subordinated to the public interest).

of a profoundly unfair result may have some influence in cases where the other factors, such as equality of guilt and public interest, do not strongly point in a direction that is opposite to that called by the equities between the parties.[156]

In evaluating the equities between the parties, particularly as they apply to the question of whether the plaintiff should be denied relief, courts may invoke the unfair forfeiture rule, which was discussed above in relation to the remedy of restitution.[157] The fact that the plaintiff, even if *in pari delicto* with the defendant, would suffer an unduly harsh and disproportionate forfeiture, resulting in an unpalatable windfall to the defendant, may persuade a court that the equities between the parties call for the remedy of restitution.[158]

IV. THE IMPUTATION OF AN AGENT'S ILLEGAL ACTION TO THE PRINCIPAL

This Part explains the concept of imputation under the law of agency and makes the point that where an agent (in most cases, a corporate officer) engages in illegal action in the scope of his employment, it is very difficult for the principal (the corporation) to resist having the agent's illegal conduct imputed to it.[159] Even where the corrupt officer has been removed from the corporate management and the corporation seeks, for the benefit of innocent victims, to recover losses from a party who collaborated in or enabled the officer's illegal action, that defendant usually succeeds in raising the *in pari delicto* defense against the corporation.[160] As a result, corporations are seldom able to recover losses from a defendant who bore some responsibility for the officer's illegal conduct, even where that recovery would benefit victims of the illegal action.[161]

156. Shimrack v. Garcia-Mendoza, 912 P.2d 822, 822-23 (Nev. 1996) (holding that where the defendant, an attorney, was more guilty than the plaintiff, the equities favored allowing the plaintiff to recover for work done for the defendant under an impermissible fee-sharing arrangement).

157. *See supra* Part III.B.

158. As discussed above, restitution is based on disaffirmance of the transaction, not enforcement, and the equities between the parties might be adequately addressed by restoring them to the status quo *ante*. *See supra* Part II.A.

159. *See infra* Part IV.A–B.

160. *See infra* Part IV.A.

161. Daniel D. Edelman, *In Pari Delicto Continues to Curtail Financial Suits Against Professional Service Firms in N.Y.*, CROWELL MORING (Oct. 27, 2010), https://www.crowell.com/NewsEvents/AlertsNewsletters/all/In-Pari-Delicto-Continues-to-Curtail-Financial-Fraud-Suits-Against-Professional-Service-Firms-in-New-York.

A. The Basic Principles of Imputation

When an agent commits a wrongful act within the scope of his employment, that wrongful act, and any knowledge that the agent had in committing it, is imputed to the principal.[162] This is in accordance with well-established principles of the common law of agency under which a principal that appoints an agent to do its business must be accountable for what the agent does on its behalf.[163] Imputation is conceptually related to the doctrine of *respondeat superior*, under which a principal is liable for the torts committed by the agent in the scope of his employment.[164] As long as the agent is acting within the scope of his authority, imputation occurs even if the agent acts deceptively, without the principal's knowledge, and out of self-interest.[165] This means that if the principal sues a third party who was complicit in, or in some way responsible for, its agent's malfeasance, that third party can raise the *in pari delicto* defense against the principal by imputation, even though the agent acted in violation of his fiduciary duty, and the principal was unaware of the agent's illegal action.

While imputation applies generally to all agents and principals, cases involving the assertion of the *in pari delicto* defense against a principal arising from imputation of its agent's illegal actions almost invariably concern corporations.[166] An incorporated entity can act only through its agents (its officers), and a corporation is therefore particularly susceptible to the assertion that it is accountable for the illegal conduct of an officer acting within the his scope of authority.

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162. RESTATEMENT (THIRD) OF AGENCY § 5.03 (AM. LAW INST. 2006).

163. Republic of Iraq v. ABB AG, 768 F.3d 145, 165-66 (2d Cir. 2014), *cert. denied* 135 S. Ct. 2836 (2015) (stating that government is not a legally separate entity from the state that it represents, so it is incorrect to characterize the government as an agent of the state, and the acts of the government are imputed to the state, which is treated as accountable for corrupt conduct in relation to the "Oil For Food" program); 1031 Tax Grp., LLC v. Citibank, N.A. (*In re* 1031 Tax Grp., LLC), 420 B.R. 178, 199 (S.D.N.Y. 2009); Kirschner v. KPMG, LLP, 938 N.E.2d 941, 950-51 (N.Y. 2010) ("It is a fundamental principle that has informed the law of agency for centuries . . . [that] the acts of agents . . . are presumptively imputed to their principals."); RESTATEMENT (THIRD) OF AGENCY § 5.03.

164. Mark J. Lowenstein, *Imputation, the Adverse Interest Exception, and the Curious Case of the* Restatement (Third) of Agency, 84 U. COL. L. REV. 305, 309-11 (2013).

165. Belmont v. M.B. Inv. Partners, Inc., 708 F.3d 470, 494-95 (3d Cir. 2013) (finding that the imputation doctrine recognizes a principal's responsibility for the acts of its agent within the scope of authority, based not on the agent's presumed authority to do the act, but on the public policy that a principal who has selected and delegated responsibility to the agent should be accountable).

166. Christine M. Shepard, Note, *Corporate Wrongdoing and the* In Pari Delicto *Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275, 296-316 (2012) (surveying the application of *in pari delicto* in New Jersey, New York, Pennsylvania, and Delaware and virtually all cases arising in the corporate context).

Because corporate entities are typically the type of principal involved in these cases, the rest of this discussion focuses on them.

Imputation to a corporation has its strongest justification where an officer of the corporation, acting on behalf of the corporation, commits a wrongful act that harms an innocent third party. For example, where the officer makes a fraudulent misrepresentation to an innocent third party who enters into a transaction with the corporation through the officer, the officer's fraud is readily imputable to the corporation in a suit against it by the victim.[167] The *in pari delicto* defense plays no part in this suit where the plaintiff was uninvolved in the illegality. Similarly, if the corporation sues the faithless officer for loss resulting from a breach of his fiduciary duty, it would be ludicrous to allow the officer to impute his own illegal conduct to the corporation so as to render it *in pari delicto* with him.[168] Between these two obvious situations lie those in which the defendant is neither the lawbreaking officer nor an innocent victim, but participated in, abetted, or enabled the officer's illegal action.[169] While the *in pari delicto* defense is potentially available to such a defendant by imputation of the officer's illegal conduct to the corporation, the appropriateness of allowing the defense is questionable because the fundamental purpose of imputation—the protection of an innocent third party—is not served.[170]

Even more troublesome are cases where the party who colluded with or enabled the officer's wrongdoing is itself an agent of the corporation, such as the corporation's accountant or lawyer who colluded in or failed to prevent the illegal action of the officer. For example, imagine that an officer of a corporation fraudulently promotes an investment fund that is in fact a Ponzi scheme.[171] The corporation's auditor colludes in the deception or fails to exercise the proper degree of professional diligence to detect it.[172] Clearly, the innocent investors have, and should have, a cause of action against the corporation for

167. *See, e.g.*, *Belmont*, 798 F.2d at 477 (describing a corporate officer perpetrating a Ponzi scheme on innocent third parties and remanding for trial).

168. A wrongdoing insider cannot rely on the imputation of his own conduct to the corporation for the purpose of raising the *in pari delicto* defense if sued by the corporation for loss arising from that conduct. Grayson Consulting, Inc. v. Wachovia Sec., LLP (*In re* Derivium Capital LLC), 716 F.3d 355, 368 (4th Cir. 2013); Zazzali v. Hirschler, Fleischer, P.C., 482 B.R. 495, 513-14 (D. Del. 2012); Pitt Penn Holding Co. v. Mazzuto (*In re* Pitt Penn Holding Co.), 484 B.R. 25, 38-39, 41 (D. Del. 2012); Jurista v. Amerinox Processing, Inc., 492 B.R. 707, 739 (D.N.J. 2013); O'Connell v. Pers. Fin. Servs., Inc. (*In re* Arbco Capital Mgmt., LLP), 498 B.R. 32, 45 (S.D.N.Y. 2013).

169. Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449, 451 (7th Cir. 1982).

170. Scholes v. Lehman, 56 F.3d 750, 754 (7th Cir. 1995).

171. *Id.*

172. *Id.*

losses resulting from the fraud of its officer.[173] If the corporation sues its auditor, either for deliberate collusion or malpractice, the defendant will seek to impute the officer's wrong to the corporation and to raise the *in pari delicto* defense to that suit. There would be greater justification to allow that defense if the wrongdoing officer was still in control of the corporation or would otherwise benefit from the suit. Where the wrongdoing officer has been ousted and the corporation's recovery would not benefit the officer[174] but would benefit only innocent shareholders, investors, or creditors, allowing the *in pari delicto* defense perverts the goals of both imputation and the *in pari delicto* rule.[175] Yet, courts readily allow imputation and the *in pari delicto* defense under these circumstances.[176] The rationale for doing so is that imputation creates an incentive for the corporation to ensure that it appoints trustworthy agents, and that it monitors and controls them effectively.[177]

173. That is, the investors are not investing in the corporation itself, so as to become stockholders, but are placing funds with the corporation for investment on their behalf by the corporation. When the officers do not make the investments as represented, but instead operate a Ponzi scheme, the investors become tort creditors. *Id.* at 755.

174. The question of whether a wrongdoing officer would be benefitted by the corporation's recovery is factual and requires an evaluation of the circumstances of each case. A benefit could be direct (for example, if the officer holds shares in the corporation) or indirect (for example, if recovery by the corporation would reduce any personal liability of the officer). *Cenco, Inc.*, 686 F.2d at 455-57.

175. Kevin H. Michels points out that vicarious liability and imputation assume that the agent has committed a wrong against a third party, but a principal's suit against its lawyer for breach of the lawyer's duty to the principal does not involve an innocent third party, but rather another agent with her own duties to the principal. Kevin H. Michels, *The Corporate Attorney as "Internal" Gatekeeper and the* In Pari Delicto *Defense: A Proposed New Standard*, 4 ST. MARY'S J. LEGAL MALPRACTICE & ETHICS 318, 353-56 (2014). He observes that imputation is even less defensible where the lawyer was specifically engaged to monitor or uncover officer malfeasance and failed to discharge that duty properly. *Id.* Section 5.04 of the *Restatement (Third) of Agency* confines imputation to situations in which it is "necessary to protect the rights of a third party who dealt with the principal in good faith," which excludes a third party who dealt with the agent "knowing or having reason to know that the agent acts adversely to the principal." RESTATEMENT (THIRD) OF AGENCY § 5.04 (AM. LAW INST. 2005). While the section speaks of good faith, its reference to a "reason to know" standard suggests that imputation should not be applied if the third party is a professional who negligently failed in his duty to the principal to detect the agent's illegal actions. *Id.* The dissent in *Republic of Iraq v. ABB AG*, argues that the rationale supporting imputation breaks down where there has been collusive conduct between the agent and the defendant because the purpose of the rule is to protect innocent third parties, not those who conspired with the agent. 768 F.3d 145, 179-82 (2d Cir. 2014), *cert. denied* 135 S. Ct. 2836 (2015) (Droney, J., dissenting).

176. Stewart v. Wilmington Tr. SP Serv., Inc., 112 A.3d 271, 307-08 (Del. Ch. 2015) (observing that to refuse imputation where the corporation sues for the benefit of stockholders in a derivative suit would eviscerate the *in pari delicto* rule).

177. Belmont v. M.B. Inv. Partners, Inc., 708 F.3d 470, 495 (3d Cir. 2013) (finding that the doctrine of imputation creates an incentive for the principal to choose the agent carefully and to take care in delegating to him); *Cenco, Inc.*, 686 F.2d at 455-56; MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 855 (Mich. Ct. App. 2004); Glenbrook Capital Ltd. P'ship v. Dodds (*In re*

However, the irony of this argument, when used to justify imputation to allow the *in pari delicto* rule to be raised by a corporation's auditor or lawyer, is that one of the important means of control open to a board of directors is the employment of independent and competent professionals. Where these professionals fail to perform properly, it would seem that there is an equally strong public interest in holding them accountable and giving them a disincentive to neglect their duties.[178]

It must be stressed that imputation of the officer's wrongdoing does not, in itself, ensure that the defendant will escape accountability for a role in the illegal action. First, the imputation of the officer's wrongdoing is to the corporation, and not to stakeholders in the corporation, so allowing the *in pari delicto* defense against the corporation does not affect any direct cause of action that innocent stakeholders might have against the collaborator or enabler.[179] However, the existence of a stakeholder's independent cause of action against the collaborator or enabler is dependent on the nature of the claim and the relationship between the stakeholder and the collaborator or enabler. In some cases, there may not be any independent cause of action,[180]

Amerco Derivative Litig.), 252 P.3d 681, 694-96 (Nev. 2011); NCP Litig. Tr. v. KPMG, LLP, 901 A.2d 871, 879-80 (N.J. 2006) (holding that the rationale for imputation is to give the principal an incentive to choose the agent carefully and to establish effective monitoring procedures); Kirschner v. KPMG, LLP, 938 N.E.2d 941, 951-52 (N.Y. 2010) (holding that in a choice between the innocent stakeholders in the corporation, and the innocent stakeholders in the accounting firm sued for malpractice by the corporation, the corporate stakeholders, whose agent committed the fraud, should bear the loss); Lowenstein, *supra* note 164, at 316-17.

178. Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Res. Found. v. PriceWaterhouseCoopers, LLP, 607 F.3d 346, 354-55 (3d Cir. 2010); Michels, *supra* note 175, at 356-58, argues that while imputation may give the corporation the incentive to monitor its agents, the employment of professionals is an important means of monitoring, so it seems ironic that the monitor can evade responsibility for its failure to do its job by imputing the officer's wrongdoing to the corporation and raising the *in pari delicto* defense.

179. Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1151 (11th Cir. 2006) (holding that the individual creditors of the principal could pursue claims against the abettor of the agent's fraud without being subject to the *in pari delicto* defense).

180. Kohut v. Metzler Loricchio Seera & Co., P.C. (*In re* Munivest Servs., LLC), 500 B.R. 487, 501-04 (E.D. Mich. 2013) (holding that investors in a corporation who were victims of a Ponzi scheme had no independent malpractice cause of action against the corporation's accountant because they were neither clients of the accountant nor third party beneficiaries of the accountant's contract with the corporation); MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d at 855-56 (Mich. Ct. App. 2004) (declining to decide if innocent investors had their own cause of action against the corporation's accountant but noting that if they did, the wrongful act of the corporate officer would not be imputed to them, even though it is imputed to the corporation); Kirschner v. K&L Gates, LLP, 46 A.3d 737, 761 (Pa. Super. Ct. 2012) (noting that a person, other than the principal, injured by the agent's illegal action may or may not have a direct cause of action against the person who abetted or overlooked the illegal conduct).

and the only recourse that the stakeholder may have would be through the corporation.

Second, imputation to the corporation does not assure that the defendant will ultimately succeed in the *in pari delicto* defense. The determination that the *in pari delicto* defense can be raised against the corporation is just the first step in the process of deciding if the *in pari delicto* defense is viable.[181] The next step is to conduct the balancing test set out in Part III to determine if the defense should prevail.[182]

In short, while imputation does not mean that the defendant will prevail in the end, it is the first step towards an unprincipled application of the *in pari delicto* rule if it is too-readily allowed at the instance of a defendant who colluded in or enabled the officer's illegal action. Courts should not apply principles of imputation mechanically, but should focus on the duty owed by the defendant to the corporation, the ultimate beneficiaries of the suit, and the existence of any independent cause of action against the defendant by those beneficiaries.

B. The Difficulty of Avoiding Imputation Under the Adverse Interest Exception and the Sole Actor Rule

1. The Restricted Availability of the Adverse Interest Exception to Imputation

The adverse interest exception is a well-recognized exception to imputation: the officer's illegal act will not be imputed to the corporation if the officer engaged in the illegal act solely for his own personal benefit and no benefit or advantage accrued to the corporation.[183] Because adverse interest is an exception to imputation, the question of whether it applies does not arise unless the court first finds that the officer's action is imputable to the corporation.[184] The

181. *See supra* note 104 and accompanying text.

182. *See supra* Part III. Courts sometimes express relative guilt as a basis for imputation or as a reason for not applying the adverse interest exception, which tends to confuse matters. *See NCP Litig. Tr.*, 901 A.2d at 881 (explaining that the adverse interest exception should apply whether the defendant was merely negligent or an active participant); Official Comm. of Unsecured Creditors of Allegheny Health Educ. and Res. Found. v. PriceWaterhouseCoopers, LLP, 989 A.2d 313, 335-36 (Pa. 2010) (finding imputation should be allowed where auditors were merely negligent in not detecting fraud, but it should not apply where they actively colluded in it). Relative guilt is not relevant to imputation or to the availability of the adverse interest exception, but to the question of whether the *in pari delicto* defense should prevail.

183. Williamson v. Stallone, 905 N.Y.S.2d 740, 752 (Sup. Ct. 2010).

184. *Id.* at 752-53 (finding imputation was not appropriate, so the court did not have to reach the question of adverse interest).

exception is, in essence, an application of the general rule that the conduct of an agent is imputed to the principal only where the agent's act is within the scope of his employment. Where the act is so far removed from the interests of the corporation, it may be deemed to be outside the officer's scope of employment.[185] However, this rationale must be approached with caution because many courts apply the adverse interest exception with excruciating narrowness.

It is common for courts to confine the exception to situations in which the action benefitted only the officer and provided no conceivable benefit to the corporation. The test used by these courts to decide if the corporation received a benefit is very broad and inclusive: the corporation benefits from the action if it in any way advanced the corporation's interests, even if that benefit was fleeting and short-term and was ultimately lost when the final impact of the malfeasance struck.[186] So, for example, an officer's fraud or deception that allows the corporation to survive a bit longer, or to gain a brief economic advantage that was ultimately lost, is enough to constitute a benefit.[187] This means that to establish the exception, the corporation must demonstrate that the

185. Anderson v. Cordell (*In re* Infinity Bus. Grp., Inc.), 497 B.R. 794, 805-07 (D.S.C. 2013); 1031 Tax Grp., LLC v. Citibank, N.A. (*In re* 1031 Tax Grp., LLC), 420 B.R. 178, 200 (S.D.N.Y. 2009) (explaining that the manager must have abdicated completely from the interests of the corporation so that he is acting outside of the scope of his authority); Symbol Tech., Inc. v. Deloitte & Touche, LLP, 888 N.Y.S.2d 538, 542-43 (App. Div. 2009) (explaining that the adverse interest exception is narrowly defined, so that the officer must have been acting entirely in his own interest and outside the scope of his authority).

186. Nisselson v. Lernout, 469 F.3d 143, 156-57 (1st Cir. 2006); Zazzali v. Eide Bailly, LLP., No. 1:12–CV–349–S, 2013 WL 6045978, at *20 (D. Idaho Nov. 14, 2013); Pitt Penn Holding Co. v. Mazzuto (*In re* Pitt Penn Holding Co.), 484 B.R. 25, 39-40 (D. Del. 2012); *In re 1031 Tax Grp., LLC*, 420 B.R. at 200; MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 857 (Mich. Ct. App. 2004); Bondi v. Citigroup, Inc., 32 A.3d 1158, 1174-75 (N.J. Super. Ct. App. Div. 2011); *Symbol Techs.*, 888 N.Y.S.2d at 542-43.

187. *Nisselson*, 469 F.3d at 156-57 (finding that fleeting value was enough to preclude application of the exception where officers of the corporation misstated its revenue to the target of a merger so that the merged entity collapsed shortly after the merger); O'Connell v. Pers. Fin. Servs., Inc. (*In re* Arbco Capital Mgmt., LLP), 498 B.R. 32, 46 (S.D.N.Y. 2013) (finding that the exception is narrow, and even a short-term benefit, such as the longer survival of the corporation, is enough, even if the actions harmed the corporation in the long-term); *Zazzali*, 2013 WL 6045978, at *20 (finding that the adverse interest exception is narrow and does not apply if the corporation received any benefit from the officer's illegal action, even if the action eventually led to the collapse of the corporation); *Bondi*, 32 A.3d at 1174-75 (finding management's fraudulent efforts to keep the corporation afloat benefitted the corporation, even if only transitorily, so that the adverse interest exception did not apply—but sometimes the transitory benefit could be so minimal that the exception might apply); *MCA Finan. Corp.*, 687 N.W.2d at 857 (finding that the exception applies only where a corporate officer acts solely for his own benefit and against the interests of the corporation, and it does not matter that the actions resulted in deepening the insolvency of the corporation and led to its ultimate collapse).

officer so completely abandoned the corporation's interests that no benefit whatsoever was derived from the conduct. On this narrow test, sometimes referred to as the "total abandonment" rule,[188] the exception does not apply much beyond situations in which the illegal action is aimed directly against the corporation, such as an officer's embezzlement of corporate funds or looting of corporate assets.[189] Although the determinative question is whether there is some discernable benefit to the corporation, the relevance of the officer's state of mind is unclear.[190] While some courts stress that it is the effect of benefit that is crucial, rather than the intention of the officer,[191] others treat the officer's motivation as highly relevant.[192]

Courts that construe the exception narrowly hold that broad availability of the *in pari delicto* defense is needed to avoid shifting the

188. *In re Infinity Bus. Grp., Inc.*, 497 B.R. at 809 (asserting the total abandonment standard is the majority rule); *In re 1031 Tax Grp., LLC*, 420 B.R. at 200; Stewart v. Wilmington Tr. SP Serv., Inc., 112 A.3d 271, 303, 309 (Del. Ch. 2015) (holding that the adverse interest exception covers only total abandonment, such as outright stealing from the corporation, and does not apply if the corporation received any benefit, even if outweighed by long-term damage); *Symbol Techs.*, 888 N.Y.S.2d. at 543.

189. Republic of Iraq v. ABB AG, 768 F.3d 145, 166-67 (2d Cir. 2014), *cert. denied* 135 S. Ct. 2836 (2015) (finding the adverse interest exception inapplicable because the Hussein regime did not totally abandon Iraq's interests); Peterson v. McGladrey & Pullen, LLP, 676 F.3d 594, 599 (7th Cir. 2012) (finding that fraud is imputed where officers are not stealing from the corporation, but are using it as an engine of theft from outsiders); Cenco, Inc. v. Seidman & Seidman, 686 F.2d 449, 454-55 (7th Cir. 1982); Glenbrook Capital Ltd. P'ship v. Dodds (*In re* Amerco Derivative Litig.), 252 P.3d 681, 694-96 (Nev. 2011) (finding corporate officers must have acted completely adverse to the corporation, so that there has been outright theft or embezzlement that does not benefit the principal in any way); Kirschner v. K&L Gates, LLP, 46 A.3d 737, 763-65 (Pa. Super. Ct. 2012) (applying the adverse interest exception and not imputing the officer's action to the corporation where the corporate officer looted the corporation).

190. *See Bondi*, 32 A.3d at 1174.

191. *In re Arbco Capital Mgmt., LLP*, 498 B.R at 46 (noting that it is not enough to show that the agent acted to benefit himself, not the principal); *In re Amerco Derivative Litig.*, 252 P.3d at 694-96 (noting that a mere conflict of interest or the agent's intent to benefit his own interests is not enough).

192. Section 5.04 of the *Restatement (Third) of Agency* recognizes agent intent as relevant, and provides that imputation should not occur if the agent acts adversely to the principal, "intending to act solely for the agent's own purposes or those of another person." RESTATEMENT (THIRD) OF AGENCY § 5.04 (AM. LAW INST. 2006); *see* Bankr. Servs., Inc. v. Ernst & Young LLP (*In re* CBI Holding Co.), 529 F.3d 432, 451-52 (2d Cir. 2008) (explaining that the total abandonment standard looks principally to the intent of the manager, and that intent to benefit, as opposed to actual benefit, is key); Rogers v. McDorman, 521 F.3d 381, 394-95 (5th Cir. 2008) (stating the exception did not apply where the corporate officer engaged in a check kiting scheme for the purpose of benefitting the corporation, and not for personal gain); *In re 1031 Tax Grp., LLC*, 420 B.R. at 200 (the officer's intent is an important factor and may override some incidental benefit to the corporation); *MCA Fin. Corp.*, 687 N.W.2d at 857-58 (finding that if a corporate officer acted in the misguided belief that his actions might help the corporation, the adverse interest exception does not apply).

risk of officer malfeasance to the persons who dealt with the officer.[193] This rationale makes sense with regard to a claim by an innocent party who played no role in the wrongdoing. However, where the person dealing with the officer enabled or colluded in the misconduct, a less-restrictive exception is more appropriate.[194] Some courts recognize this and are willing to disregard a transitory, incidental, or meaningless benefit to the corporation where the defendant collaborated in or enabled the wrongdoing.[195] This more realistic test of benefit allows for the use of the adverse interest exception to avoid imputation where considerations of policy and fairness and the goals of the *in pari delicto* rule point to the refusal of the defense.

2. The Sole Actor Doctrine as a Further Limit on the Availability of the Adverse Interest Exception

The adverse interest exception is further weakened by another limitation, known as the "sole actor" doctrine, which is sometimes described as an exception to the adverse interest exception; even if the test for the adverse interest exception is satisfied, the exception cannot be used if the officer who engaged in the illegal action has such complete control over the corporation that the officer and the corporation can be viewed as the same entity.[196] This limitation has some affinity to

193. Belmont v. M.B. Inv. Partners, Inc., 708 F.3d 470, 495-96 (3d Cir. 2013).

194. *Id.* (observing that courts that require only a small benefit to the corporation favor a readily available *in pari delicto* defense so as not to allocate the risk of officer wrongdoing to those who transact with the corporation, but courts that require a more material benefit are concerned about collusion between the officer and the defendant).

195. *In re CBI Holding Co.*, 529 F.3d at 453 (explaining that the illusory benefit of prolonging the corporation's existence should not be treated as a benefit); *In re Arbco Capital Mgmt., LLP*, 498 B.R at 46-47; Anderson v. Cordell (*In re* Infinity Bus. Grp., Inc.), 497 B.R. 794, 809-10 (D.S.C. 2013); NCP Litig. Tr. v. KPMG, LLP, 901 A.2d 871, 885-86 (N.J. 2006) (softening of the imputation rule allows just recovery); *Bondi*, 32 A.3d at 1175 (explaining that sometimes the transitory benefit could be so minimal and illusory that the exception might apply); Kirschner v. KPMG, LLP, 938 N.E.2d 941, 962 (N.Y. 2010) (Ciparick, J. dissenting) (noting that an illusory short term benefit should not be enough to preclude the exception); Official Comm. of Unsecured Creditors of Allegheny Health Educ. and Res. Found. v. PriceWaterhouseCoopers, LLP, 989 A.2d 313, 335-36 (Pa. 2010) (rejecting a "peppercorn" test of benefit).

196. Grayson Consulting, Inc. v. Wachovia Sec., LLP (*In re* Derivium Capital LLC), 716 F.3d 355, 368 (4th Cir. 2013) (noting that the sole actor rule defeats the adverse interest exception); Janvey v. Democratic Senatorial Campaign Comm., 712 F.3d 185, 191 (5th Cir. 2013); O'Connell v. Pers. Fin. Servs., Inc. (*In re* Arbco Capital Mgmt., LLP), 498 B.R. 32, 47-48 (S.D.N.Y. 2013) (explaining that the sole actor rule is an exception to the adverse interest exception); *In re 1031 Tax Grp., LLC*, 420 B.R. at 202 (finding that there is no reason for the adverse interest exception when principal and agent are essentially the same); Bash v. Textrol Fin. Corp., 483 B.R. 630, 650-51 (N.D. Ohio 2012) (explaining that the sole actor rule limits the adverse interest exception); Stewart v. Wilmington Tr. SP Serv., Inc., 112 A.3d 271, 310-11 (Del. Ch. 2015).

the concept of piercing the corporate veil where a corporation is the mere alter ego of its owner.[197] It is also a well-established principle of agency law.[198] The effect of this doctrine is that even if the officer acted in a way that is completely adverse to the corporation (under the narrow application of the adverse interest exception described above), the corporation cannot avoid imputation if the officer's control and dominance of the corporation qualifies him as a sole actor.[199]

The sole actor rule is not limited to situations in which the wrongdoing officer is the sole officer and shareholder in the corporation. It could also apply where there are other officers or shareholders, but the wrongdoing officer completely dominates and controls the corporation so that there is no constituency in the corporation that can exercise restraint on his conduct.[200] Therefore, the key to deciding if the sole actor rule should apply is whether there are any innocent decision-makers (that is, persons not implicated in the illegal conduct) in the corporation with the power to stop the officer's wrongdoing.[201] While the existence of an innocent decision-maker may be relatively easy to establish, it is much more difficult and speculative to decide if the innocent party was in fact able to prevent the illegal act. If no such innocent decision-makers exist, the illegal conduct is imputed to the corporation, even where the officer acted solely for his own benefit in

197. While the sole actor doctrine is commonly characterized as an exception to the adverse interest exception, it can be seen simply as a conclusion that imputation is not needed because the corporation, as the alter ego of the officer, was itself directly involved in the illegal action. Teneyck, Inc., v. Rosenberg, 957 N.Y.S.2d 845, 848-49 (App. Div. 2011) (explaining that the corporation, acting through its sole owner, must be viewed as a participant in the owner's illegal action).

198. *In re Derivium Capital LLC*, 716 F.3d at 368.

199. Hagan v. Baird (*In re* B&P Baird Holdings, Inc.), 591 F. App'x 434, 441 (6th Cir. 2015); USACM Liquidating Tr. v. Deloitte & Touche, 523 F. App'x 488, 489 (9th Cir. 2013); *In re Derivium Capital LLC*, 716 F.3d at 368; Uecker v. Wells Fargo Capital Fin., LLC (*In re* Mortg. Fund '08 LLC), 527 B.R. 351, 369 (N.D. Cal. 2015); *Bash*, 483 B.R. at 651. Although the rule is referred to as the "sole actor" doctrine, it could also apply where there is more than one actor involved in the illegal conduct (say, all of the corporation's management), but those actors, in combination, exercised complete control over the corporation. *USACM Liquidating Tr.*, 523 F. App'x at 489-90 (noting that the sole actor rule applied where the majority shareholders of the corporation held all the top management positions, and completely controlled the corporation).

200. *USACM Liquidating Tr.*, 523 F. App'x at 490.

201. *In re B&P Baird Holdings, Inc.*, 591 F. App'x at 441-42; *USACM Liquidating Tr.*, 523 F. App'x 488; *In re Arbco Capital Mgmt., LLP*, 498 B.R at 47-48; Anderson v. Cordell (*In re* Infinity Bus. Grp., Inc.), 497 B.R. 794, 814 (D.S.C. 2013); *In re 1031 Tax Grp., LLC*, 420 B.R. at 202-03 (finding that if there is an innocent insider who had the power to stop the fraud, the offending officer is not a sole actor and the corporation is not his alter ego); Glenbrook Capital Ltd. P'ship v. Dodds (*In re* Amerco Derivative Litig.), 252 P.3d 681, 696 (Nev. 2011). Not all courts recognize that the presence of innocent decision-makers will prevent the application of the sole actor rule. In *Bash*, the court, while noting that the plaintiff had not shown the existence of innocent decision-makers, questioned whether this fact was even relevant. 483 B.R. at 652.

looting or stealing from the corporation, with no benefit to the corporation itself.[202] As a general matter, this makes sense because the corporation is the alter ego of the officer. However, where there are in fact innocent officers or shareholders, or where recovery would benefit creditors,[203] the sole actor rule makes it difficult, if not impossible, for the corporation to resist imputation. This means that the *in pari delicto* defense can be raised by a defendant who enabled or colluded in the officer's wrongdoing. It is hard to reconcile this result with the underlying goals of the *in pari delicto* rule.[204]

V. IMPUTATION OF ILLEGAL CONDUCT TO RECEIVERS AND BANKRUPTCY TRUSTEES

This Part deals with the situation in which a corporation has been placed into receivership or bankruptcy following (and usually as a result of) extensive illegal conduct by its officer. One of the primary functions of a receiver or trustee is to pursue claims for the benefit of victims of the illegal conduct.[205] Where such a claim is a suit against a defendant who collaborated in or enabled the officer's illegal action, that defendant is likely to raise the *in pari delicto* defense on the theory that the illegal action should be imputed to the receiver or trustee.[206] The question of whether imputation is appropriate in this situation depends on two factors: first, whether or not the claim derives from the corporation. If it does not, no imputation occurs. If it does, the second factor becomes relevant: whether the corporation is in receivership or bankruptcy. Courts generally do not impute the illegal conduct to a receiver, but do impute it to a trustee.[207] While the different treatment of receivers and

202. *In re Derivium Capital LLC*, 716 F.3d at 36-69.

203. As noted earlier, innocent investors may not be stockholders in the corporation, but may be persons who gave funds to the corporation to invest on their behalf, so that upon misappropriation and loss of the funds, they become tort creditors of the corporation. *See supra* note 180.

204. Scholes v. Lehman, 56 F.3d 750, 754-55 (7th Cir. 1995) (noting that where the sole shareholder, who used "zombie" corporations as his "robotic tools," has been ousted, recovery by the corporation is for the benefit of creditors, including defrauded investors, and should be allowed).

205. Janvey v. Democratic Senatorial Campaign Comm., 712 F.3d 185, 189 (5th Cir. 2013) (allowing the receiver to sue for and recover fraudulent transfers made by the former corporate officer who had operated a Ponzi scheme); Official Comm. of Unsecured Creditors v. Edwards, 437 F.3d 1145, 1149-50 (11th Cir. 2006); Williamson v. Stallone, 905 N.Y.S.2d 740, 752-53 (Sup. Ct. 2010).

206. *Official Comm. of Unsecured Creditors*, 437 F.3d at 1152; John T. Gregg, *The Doctrine of* In Pari Delicto*: Recent Developments*, 5 ANN. SURV. OF BANK. L. 1, 1-3 (2006).

207. Gregg, *supra* note 206, at 3-5.

trustees can be explained on purely doctrinal grounds,[208] imputation to a trustee cannot be reconciled with the underlying purpose and policy of the *in pari delicto* rule.[209]

A. The Context in Which the In Pari Delicto *Defense is Asserted Against a Receiver or Trustee*

The receiver or trustee may have a cause of action against a wrongdoing defendant, independent from any claim that the corporation itself may have had. For example, if the defendant received an improper payment or transfer of property from the corrupt officer, the receiver or trustee's suit to recover that fraudulent transfer of corporate assets is not based on a right of the corporation, but derives from succession to a right of creditors or from a statutory grant of the right.[210] In this situation, the *in pari delicto* defense cannot be asserted by the defendant because the trustee or receiver does not step into the shoes of the corporation and is not subject to any defense that could have been raised against the corporation by imputation. However, other causes of action against a party that participated in, aided, or wrongfully overlooked the officer's wrongdoing, such as a claim for professional malpractice against the corporation's lawyers or accountants, breach of fiduciary duty, or breach of contract, derive from the corporation. Where the receiver or trustee asserts such a claim, he is in the position of a successor to the corporation.[211]

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208. *Official Comm. Of Unsecured Creditors*, 437 F.3d at 1151-52 (noting that a receiver is distinguishable from a bankruptcy trustee because the trustee's rights are governed by the Bankruptcy Code); Uecker v. Wells Fargo Capital Fin., LLC (*In re* Mortg. Fund '08 LLC), 527 B.R. 351, 368 (N.D. Cal. 2015) (explaining that a receiver is distinguished from a bankruptcy trustee in that the receiver is not subject to the strictures of § 541 of the Bankruptcy Code); Gregg, *supra* note 206, at 2-5.

209. *See* Lowenstein, *supra* note 164, at 317-18, 322-23; *supra* notes 34-35 and accompanying text.

210. A bankruptcy trustee has a statutory right to recover fraudulent transfers. *Infra* Part V.B. A receiver or similar official appointed under state law is treated as a successor of innocent investors. *See, e.g.*, Williamson v. Stallone, 905 N.Y.S.2d 740, 751 (Sup. Ct. 2010). The general partner of a limited partnership deliberately and significantly overstated the value of a hedge fund operated by the partnership, as a result of which some investors were paid out much more than they were entitled to receive. *Id.* at 749-50. After the collapse of the fund, the liquidating trustee appointed by the court sought to recover the overpayments to the investors as fraudulent transfers. *Id.* at 750. As discussed below, the trustee was held not to be subject to the *in pari delicto* defense. *Id.* at 752-53; *infra* Part V.B. In *Janvey*, the receiver sued for and was able to recover fraudulent transfers—campaign contributions—made by the former corporate officer who had operated a Ponzi scheme. *Janvey*, 712 F.3d at 189.

211. *Williamson*, 90 N.Y.S.2d at 751 (explaining that an "innocent successor [trustee]" is one who is appointed by the court to recover funds from wrongdoers for the benefit of the limited

The *in pari delicto* rule arises in this context where the defendant argues that the corporation itself is subject to the defense through the imputation of its officer's illegal action, and that this imputation extends to the receiver or trustee who, as successor to the corporation's claim, is subject to any defenses to the claim that could have been asserted against the corporation.[212] To decide if imputation extends to the receiver or trustee, courts apply agency law to determine if there should be imputation to the corporation, and then apply the law governing receiverships or bankruptcy to decide the question of further imputation.[213] Most courts do not impute the officer's illegal conduct to the receiver.[214] However, courts reach the opposite conclusion with regard to bankruptcy trustees and hold that imputation does bar claims by a trustee where the trustee claims as successor to the debtor.[215] While imputation can be supported on doctrinal grounds, it is hard to justify in light of the underlying purpose and equitable character of the *in pari delicto* rule. Imputation to an official who represents the interests of victims who were not implicated in the wrongdoing is inconsistent with the stated goal of the rule—the refusal to aid a wrongdoing plaintiff who is equally or more guilty than the defendant. It thereby deprives victims of the wrongdoing of recovery and allows the defendant to escape accountability for its role in the illegal transaction.[216] In addition, it is most unlikely that the policy goal of deterrence could be achieved by refusing relief to the victims.[217]

B. Receivers

Receivership is an equitable remedy under state law or may be provided by a statute regulating a particular industry.[218] A receiver is a court-appointed official whose task is to take control of a failed

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partners who lost money).

212. *Id.* at 752.

213. *Id.* at 750-51.

214. *Id.* at 751.

215. Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 354-58 (3d Cir. 2001); Steven Rhodes & Kathy Bazoian Phelps, *Equity Receivers and the* In Pari Delicto *Defense*, 69 BUS. LAW. 699, 702-03 (2014).

216. Rhodes & Phelps, *supra* note 215, at 709-11 (finding that where a receiver represents innocent victims, the court is not mediating a dispute between wrongdoers, and the grant of relief would not benefit the wrongdoer, so refusing relief merely harms those who had no role in or control over the wrongdoing officer).

217. *Id.* at 703, 709-10 (refusing relief to victims, who had no control over the actions of the wrongdoing officer, does not deter illegality by an officer, but instead encourages the defendant's participation in it and perpetuates the victimization of the victims).

218. *Id.* at 702, 708-09; 65 AM. JUR. 2d *Receivers* § 15 (2015).

corporation and, amongst other things, recover claims for the benefit of innocent stakeholders in the corporation.[219] The equitable nature of a receivership requires a court to take particular care to ensure that a defendant who colluded with or failed in its duty to avert illegal action by a corporate officer should not be able to achieve the inequitable result of barring the receiver's recovery by asserting the *in pari delicto* defense.[220] While some courts disregard this principle and treat a receiver as a mere successor to the corporation, subject to any *in pari delicto* defense that could be raised by imputation against the corporation,[221] this is not a common approach. The better and more prevalent view is that a receiver appointed in equity to deal with the affairs of the corporation in receivership is not a representative of the corporation, but instead is a representative of its innocent investors and creditors.[222] Therefore, even if the acts of the corporate officer are imputed to the corporation under the law of agency, the imputation does not extend to the receiver, and the receiver's claim is not subject to the *in pari delicto* defense.[223] This principle has also been applied to other officials appointed by a court to manage the affairs of a failed entity.[224]

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219. Rhodes & Phelps, *supra* note 215, at 708-09.

220. *Id.* at 702, 709, 711.

221. Wuliger v. Mfrs. Life Ins. Co., 567 F.3d 787, 798-99 (6th Cir. 2009); Stewart v. Wilmington Tr. SP Serv., Inc., 112 A.3d 271, 313-14 (Del. Ch. 2015) (noting that because a corporation itself, even in a derivative suit, is not treated as an innocent party, it would be inconsistent to treat a receiver as such); MCA Fin. Corp. v. Grant Thornton, LLP, 687 N.W.2d 850, 858-59, 861 (Mich. Ct. App. 2004). In *Cobalt Multifamily Investors, LLC v. Arden*, the court held that the receiver for a corporation lacked standing to sue one who collaborated in the illegal actions of a corporate officer. However, it seems that the court reached this conclusion by misapplying precedent relating to a bankruptcy trustee under the so-called Wagoner Rule discussed in note 243. 46 F. Supp. 3d 357, 361-62, 364 (S.D.N.Y. 2014).

222. Wooley v. Lucksinger, 61 So. 3d 507, 606 (La. 2011).

223. Janvey v. Democratic Senatorial Campaign Comm., 712 F.3d 185, 190 (5th Cir. 2013) (explaining that once a receiver is appointed, the fraudulent conveyance of funds by a corporate officer is not imputed to the receiver); Jones v. Wells Fargo Bank, N.A., 666 F.3d 955, 966 (5th Cir. 2012) (applying the *in pari delicto* rule to a receiver would undermine the purpose of the receivership—to benefit the victims of fraud); Scholes v. Lehman, 56 F.3d 750, 754-55 (7th Cir. 1995) (noting that once the wrongdoer has been removed, and the corporation is in the hands of a receiver, the wrongful acts of the former officer are not imputed to the receiver); Reneker v. Offill, No. 3.08-CV1394-D, 2012 WL 2158733, at *26 (N.D. Tex. June 14, 2012) (applying the *in pari delicto* rule would undermine the receivership's goal of recovering funds for the benefit of innocent parties); *Wooley*, 61 So. 3d at 507 (explaining that the receiver of an insolvent corporation acts as the representative of innocent shareholders and can maintain an action against a wrongdoer even if the corporation itself could not).

224. Williamson v. Stallone, 905 N.Y.S.2d 740, 752-53 (Sup. Ct. 2010) (finding that a liquidating trustee, appointed by the court under state law to liquidate the assets of a general partnership, is an impartial party who must be given the status of an innocent successor, precluding imputation and the assertion of the *in pari delicto* defense).

C. *Trustees in Bankruptcy*

In the bankruptcy context, the corporation may be in liquidation under either Chapter 7 or Chapter 11 of the Bankruptcy Code,[225] or may be seeking to rehabilitate its business through bankruptcy reorganization under Chapter 11.[226] In a Chapter 11 case, the debtor-corporation itself usually assumes the role of trustee as a debtor in possession,[227] but even if there is no independent trustee, the management of the debtor in possession will not likely include any former officer whose illegal conduct brought it to ruin.[228] If the guilty officer tries to hold onto control of the bankrupt corporation as it seeks to reorganize under Chapter 11, creditors can apply to remove and replace him by a trustee.[229] In the remainder of this discussion, "trustee" must be understood to mean either an independent trustee or a debtor in possession in the role of a trustee. One of the trustee's principal tasks is to collect property or money due to the corporation, which will ultimately enhance recovery by its creditors (including those who gave money to the corporation for investment).[230]

The crucial distinction between equitable receiverships and bankruptcy is that the rights of the trustee are governed by the Bankruptcy Code.[231] As noted earlier, the determination of whether the trustee is subject to the *in pari delicto* defense depends on whether the trustee's right of action derives from the rights of the debtor or is a statutory right conferred on the trustee by the Bankruptcy Code.[232] Where the claim asserted by the trustee on behalf of the bankruptcy estate is a claim that the debtor held at the date of the bankruptcy petition, the trustee steps into the debtor's shoes, so that she acquires no greater rights than the debtor had and is subject to any defense that could have been raised against the debtor.[233] By contrast, where the trustee's

225. *See* 11 U.S.C. § 109 (2012).

226. 11 U.S.C. §§ 1101–1174 (2012).

227. 11 U.S.C. § 1107 (2012).

228. Lawrence V. Gelber & Aaron Wernick, *Ousting the Debtor in Possession: The Good, the Bad and the Ugly of Replacing a Debtor's Management with a Chapter 11 Trustee*, COM. BANKR. LITIG. (Oct. 3, 2013), https://www.dailydac.com/commercialbankruptcy/litigation/articles/ousting-the-debtor-in-possession-the-good-the-bad-and-the-ugly-of-replacing-a-debtors-management-with-a-chapter-11-trustee.

229. 11 U.S.C. § 1104 (2012).

230. 11 U.S.C. § 704(a)(1) (2012).

231. *Id.*; 65 AM. JUR. 2d *Receivers* § 15 (2015).

232. 11 U.S.C. § 704; 65 AM. JUR. 2d *Receivers* § 15.

233. *See* Official Comm. of Unsecured Creditors v. Edwards, 437 F.3d 1145, 1149-52 (11th Cir. 2006) (explaining that a receiver is distinguishable from a bankruptcy trustee because the trustee's rights are governed by the Bankruptcy Code); *see also* Uecker v. Wells Fargo Capital Fin.,

claim arises from a statutory grant of the cause of action by the Bankruptcy Code, the problem of imputation to the trustee does not arise because the trustee does not act as a successor to the debtor and is, therefore, not subject to any restrictions on the debtor's rights.[234]

Therefore, for example, if the trustee sues a party for the return of a fraudulent transfer made by the officer, the trustee's suit is based on either § 544(b)[235] or § 548[236] of the Bankruptcy Code, which do not derive from any right that the debtor had, but confer the cause of action on the trustee directly.[237] However, a suit to recover a fraudulent transfer is only available to recover property fraudulently conveyed by the officer of the debtor.[238] The trustee has no cause of action, independent of succession to the debtor's rights, to hold accountable in damages a person (such as an errant accountant or lawyer) who participated in or failed to prevent the illegal action.[239] To pursue an action of this kind, the trustee must base her claim on a breach of duty to the debtor, to which the estate succeeded upon the filing of the bankruptcy petition.[240]

LLC (*In re* Mortg. Fund '08 LLC), 527 B.R. 351, 368 (N.D. Cal. 2015); (distinguishing a receiver from a bankruptcy trustee in that the receiver is not subject to the strictures of § 541 of the Bankruptcy Code); Williamson v. Stallone, 905 N.Y.S.2d 740, 750-53 (Sup. Ct. 2010) (noting that a liquidating trustee appointed by the court under state law is distinguishable from a bankruptcy trustee in that the liquidating trustee is treated as an innocent successor, while a bankruptcy trustee who asserts a claim derived from the debtor is merely a successor to the debtor, subject to any defenses that could be raised against the debtor).

234. *Williamson*, 905 N.Y.S.2d at 751.

235. The Bankruptcy Code grants to the trustee the right to avoid any pre-bankruptcy transfer by the debtor that could have been avoided by an unsecured creditor outside of bankruptcy under state law. 11 U.S.C. § 544(b) (2012).

236. Section 548 grants to the trustee the power to avoid a pre-bankruptcy fraudulent transfer by the debtor if the transfer satisfies the requirements set out in the section. 11 U.S.C. § 548.

237. McNamara v. PFS (*In re* Pers. & Bus. Ins. Agency), 334 F.3d 239, 241 (3d Cir. 2003) (finding that because § 548 does not have the limitations of § 541, there is no reason not to seek the more equitable result by refusing to impute the agent's wrongdoing to the trustee); Sec. Inv'r Prot. Corp. v. Bernard Madoff Inv. Sec. LLC (*In re* Madoff), 531 B.R. 439, 449-50 (S.D.N.Y. 2015) (finding that the *in pari delicto* rule does not bar a trustee's claim to avoid transfers); C&S Wholesale Grocers, Inc. v. DeLano Retail Partners, LLC, No. 11-37711-B-7, 2014 LEXIS 4258 (Bankr. E.D. Cal. Sept. 29, 2014) (noting that while the trustee stands in the debtor's shoes under § 541, the trustee's suit under § 548 is bestowed on the trustee by statute and is not subject to the *in pari delicto* defense); Jurista v. Amerinox Processing, Inc., 492 B.R. 707, 739 (D.N.J. 2013) (noting that unlike § 541, the trustee does not stand in the shoes of the debtor in seeking to avoid a fraudulent transfer under § 548).

238. *In re Madoff*, 531 B.R. at 449-50.

239. Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 118 (2d Cir. 1991).

240. In a rare case, the trustee's suit against a collaborator in an officer's fraud might derive, not from the debtor's rights, but from another source. *See, e.g.*, Kirschner v. Wachovia Capital Mkts. (*In re* Le-Nature's, Inc.), No. 8-1518, 2012 WL 363981, at *5-6 (W.D. Pa. Feb. 2, 2012). In *In re Le-Nature's Inc.*, the debtor corporation was placed in the control of a court-appointed custodian shortly before its bankruptcy. The corrupt management team had been removed, so that

The trustee's succession to that right is governed by § 541(a) of the Bankruptcy Code.[241]

Section 541(a) creates an estate upon the commencement of a bankruptcy case, to which passes "all legal or equitable interests of the debtor in property as of the commencement of the case."[242] In essence, whatever property interests the debtor corporation held at the commencement of the case become property of the estate, including any cause of action against a person who collaborated in or enabled the illegal act of its officer or who aided and abetted the officer's breach of fiduciary duty to the corporation.[243] The property rights the debtor has at the commencement of the case are determined by the law of the jurisdiction that governs that property[244] and are subject to any

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when the bankruptcy was filed, the trustee stepped into the shoes of the custodian, not the debtor, and the officers' wrongdoing was therefore not imputed to the trustee. *Id.*

241. 11 U.S.C. § 541(a) (2012).

242. *Id.*

243. All courts that have considered this question, except for the Second Circuit Court of Appeals, have held that the right to claim against a wrongdoer who collaborated in the officer's illegal act is a right of the debtor, which becomes property of the estate. *In re 1031 Tax Grp., LLC*, 420 B.R. at 197 (noting that the "First, Third, Fifth, Eight, and Eleventh Circuits do not follow the Second Circuit's approach"). However, the Second Circuit has taken the position that this claim belongs to the creditors, and not the estate, so that the trustee has no standing to sue. *Shearson Lehman Hutton, Inc.*, 944 F.2d at 120. This approach is known as the "Wagoner Rule" because it was articulated in Shearson Lehman Hutton, Inc. v. Wagoner. *Id.* Only the Second Circuit and courts within that circuit have considered themselves bound by this approach. *See, e.g.*, Picard v. JPMorgan Chase & Co. (*In re* Bernard L. Madoff Inv. Sec. LLC), 721 F.3d 54, 63 (2d Cir. 2013); *In re 1031 Tax Grp., LLC*, 420 B.R. at 196-98. Other courts reject the Wagoner Rule and have held that the bar to the trustee's claim is not a matter of standing at all. The trustee does have standing to sue, but is subject to the *in pari delicto* defense. Nisselson v. Lernout, 469 F.3d 143, 150-51 (1st Cir. 2006); Zazzali v. Hirschler Fleischer, 482 B.R. 495, 510 (D. Del. 2012); *see also* Gregg, *supra* note 206, at 8-11; Jeffrey Davis, *Ending the Nonsense: The* In Pari Delicto *Doctrine Has Nothing to Do With What Is Property*, 21 EMORY BANKR. DEVS. J. 519, 522-33 (2005). Some courts have stated that the Wagoner Rule is essentially the same as the *in pari delicto* rule, and is to the same effect. Cobalt Multifamily Inv'rs I, LLC v. Arden, 46 F. Supp. 3d 357, 362 (S.D.N.Y. 2014) (noting that the Wagoner Rule is "essentially an application of the *in pari delicto* rule"); *In re 1031 Tax Grp., LLC*, 420 B.R. at 197-98 (noting the result is the same, whether the Wagoner Rule or the *in pari delicto* rule is applied—the trustee is denied recovery against the party that collaborated in or enabled the criminal actions of the officer). However, the rules are not necessarily equivalent because the lack of standing is an absolute bar, while the *in pari delicto* defense could fail if the court decides that the balance of the factors set out in Part III calls for denial of the defense. *Id.* at 198; *see supra* Part III.

244. It is crucial to determine if, under the law of the jurisdiction, the cause of action asserted by the trustee is in fact a right of the debtor. In *McLemore v. Regions Bank*, the court found that the trustee's suit against a bank that aided and abetted a corporate officer's theft from employee benefit plans did not derive from the debtor's rights and was not property of the estate. Because the debtor was a fiduciary with regard to the plans, the cause of action to which the trustee succeeded was the debtor's cause of action to recover on behalf of the beneficiaries. 682 F.3d 414, 420-22 (6th Cir. 2012).

restrictions, qualifications, or third-party rights recognized by that law, including the *in pari delicto* defense.[245] Courts have quite consistently taken this position and have held that the trustee is subject to the *in pari delicto* defense where the trustee's claim is grounded in a cause of action possessed by the debtor and succeeded to by the estate under § 541.[246] This same principle has been applied to a suit by a creditors' committee,[247] by a liquidation trustee (who is appointed to liquidate the estate),[248] and by an assignee of the claim from the estate.[249] The only restriction on this rule is that it does not apply if the defendant was an insider of the debtor.[250]

VI. CONCLUSION: AVOIDING THE PERVERSITY OF ALLOWING THE *IN PARI DELICTO* DEFENSE TO DEFEAT THE INTERESTS OF INNOCENT VICTIMS

The stark difference between the treatment of a receiver and of the trustee as a successor to the debtor under § 541 may be justified as a

245. Calvert v. Bongards Creameries (*In re* Schauer), 835 F.2d 1222, 1225 (8th Cir. 1987).

246. Grayson Consulting, Inc. v. Wachovia Sec., LLP (*In re* Derivium Capital LLC), 716 F.3d 355, 367 (4th Cir. 2013); Peterson v. McGladrey & Pullen, LLP, 676 F.3d 594, 598-99 (7th Cir. 2012) (noting that the trustee's suit against an auditor for failing to prevent a Ponzi scheme derives from the debtor's rights under § 541, so the trustee is subject to the *in pari delicto* defense); Nisselson v. Lernout, 469 F.3d 143, 153 (1st Cir. 2006) (noting that the trustee acquires only those rights that the debtor had at the time of the bankruptcy petition, and there is no innocent successor exception); Uecker v. Wells Fargo Capital Fin., LLC (*In re* Mortg. Fund '08 LLC), 527 B.R. 351, 367-68 (N.D. Cal. 2015); Zazzali v. Eide Bailly, LLP, No. 1:12-CV-349-S, 2013 WL 6045978, at *21-22 (D. Idaho Nov. 14, 2013) (explaining a trustee is distinguished from a receiver because the trustee's right is that of successor to the debtor under § 541); Kohut v. Metzler Loricchio Seera & Co., P.C. (*In re* Munivest Servs., LLC), 500 B.R. 487, 494-99 (E.D. Mich. 2013) (noting that the great weight of authority is that § 541 places the trustee in no better position than the debtor occupied, and subject to all defenses available against the debtor).

247. Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 354-58 (3d Cir. 2001) (finding that a creditors' committee is subject to the same defenses that could have been asserted against the debtor because the committee stands in the shoes of the debtor to which the officer's illegal action was imputed).

248. *Zazzali*, 2013 WL 6045978, at *21 (explaining that a litigation trustee, like a bankruptcy trustee, steps into the shoes of the debtor under § 541 and is subject to any defense that could have been raised against the debtor, including the *in pari delicto* defense).

249. *In re Derivium Capital LLC*, 716 F.3d at 367.

250. Hosking v. TPG Capital Mgmt., L.P. (*In re* Hellas Telecomm. (Lux.) II SCA), 524 B.R. 488, 532-33 (S.D.N.Y. 2015) (finding that the *in pari delicto* rule does not apply if the defendant's control and domination of the debtor rendered them insiders, whether they are shareholders, corporate officials, or third-party professionals); OHC Liquidation Tr. v. Credit Suisse First Boston (*In re* Oakwood Homes Corp.), 389 B.R. 357, 365-66 (D. Del. 2008) (noting that the *in pari delicto* defense is not available to an insider of the debtor corporation, including not only its officers or owners, but also any person that is so closely associated with the debtor that it was able to dominate or control it).

matter of statutory interpretation, but does not make sense as a matter of policy or rationality. In both situations, the purpose of the suit is to increase the value of the estate to the ultimate benefit of creditors—innocent parties who were not implicated in the illegal actions.[251] Some courts recognize this but consider themselves bound by the plain meaning of § 541.[252] Arguments that the legislative history of § 541 shows that Congress did not intend defenses that are purely personal against the debtor, such as the *in pari delicto* defense, to be effective against the estate[253] have not persuaded courts.[254]

A more persuasive basis for challenging the courts' approach to § 541 is that it is completely at odds with the policies and goals of both

251. Some courts have expressed concern that the recovery by the trustee might not benefit only innocent parties. *Nisselson*, 469 F.3d at 157-58. In some cases, it is possible that a benefit may also be conferred on the officers who were implicated in the illegal act. For example, recovery by the estate could reduce the officer's own liability to creditors. If the officer has equity in the corporation, it is conceivable that recovery could result in some value going to stockholders, but in most cases this does not happen because equity interests are wiped out in the bankruptcy. In *Nisselson*, the court expressed concern that it can be difficult to separate the interests of innocent and culpable parties, and so the court considered it best not to allow the estate to recover and to leave innocent parties to sue on their own behalf. *Id.* However, even if it is difficult to determine if the guilty officer would benefit, this is a factual question capable of determination. The solution of allowing innocent parties to assert a direct cause of action is only an alternative where the innocent parties have a direct cause of action. However, they do not necessarily have such an independent cause of action, as would be true, in say, a malpractice case against an accountant or lawyer who failed to prevent an officer's illegal conduct.

252. *In re Derivium Capital LLC*, 716 F.3d at 367 (finding that although the reasoning in cases involving receivers is appealing, it does not comport with the plain meaning of § 541); *Zazzali*, 2013 WL 6045978, at *21 n.18 (finding that if it is unfair to apply the *in pari delicto* defense to a trustee who represents innocent creditors, this must be corrected by Congress, not the courts); Kohut v. Metzler Loricchio Seera & Co., P.C. (*In re* Munivest Servs., LLC), 500 B.R. 487 495-99 (E.D. Mich. 2013) (explaining that although there are attractive policy rationales in favor of allowing the trustee to recover, they cannot overcome the rule of § 541 that makes the trustee subject to the *in pari delicto* rule).

253. William McGrane, *The Erroneous Application of the Defense of* In Pari Delicto *to Bankruptcy Trustees*, 29 CAL. BANKR. J. 275, 280-81 (2007); Tanuir Alam, *Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How* In Pari Delicto *Has Been Perverted to Prevent Recovery for Innocent Creditors*, 77 AM. BANKR. L.J. 305 (2003); Davis, *supra* note 243, at 521-22, 538-40 (arguing that courts have misread the legislative history of § 541 by ignoring the qualification relating to defenses personal against the debtor).

254. No court has accepted this argument. In *Official Committee of Unsecured Creditors of PSA, Inc.*, the court said that it need not resort to the legislative history of § 541 because the section is unambiguous, and its plain meaning is that the trustee stands in the debtor's shoes. 437 F.3d 1145, 1150 (11th Cir. 2006). The court went on to say that even if the legislative history were to be considered, it does not support the view that § 541 was not intended to allow against the trustee defenses that were personal against the debtor and that, in any event, the *in pari delicto* defense does not qualify as a defense personal against the debtor. *Id.* In *Uecker v. Wells Fargo Capital Financial, LLC (In re Mortg. Fund '08 LLC)*, the court found that the legislative history of § 541 supports the conclusion that the section was not intended to expand the estate's rights beyond those held by the debtor at the commencement of the case. 527 B.R. 351, 367-68 (N.D. Cal. 2015).

the *in pari delicto* rule and bankruptcy law. It is a fundamental goal of bankruptcy law to enhance the value of the estate to the benefit of creditors.[255] The aims of the *in pari delicto* rule are to deter wrongdoing and to prevent a wrongdoer from using the courts to gain relief for loss or damages suffered as a result of the illegal transaction.[256] By applying the *in pari delicto* rule to a trustee, the court does nothing to deter wrongdoing but allows the person that aided or overlooked the officer's illegal conduct to escape accountability, creates no disincentive to other officers to behave more honestly in future cases, does not serve justice, and does not favor the public good.[257] Concern about benefitting the wrongdoing officer is misplaced in most cases, and even where this is a realistic concern, it can be dealt with in the individual case and does not justify a blanket bar on relief.

Because courts have not been willing to interpret § 541 to exclude defenses personal to the debtor, it may seem that there is not much to be done, apart from making the argument to those courts that have not yet passed on the question or following the unlikely path of trying to get Congress to amend the section. However, there is a simpler way to avoid the unfairness of allowing the *in pari delicto* defense against the trustee: courts could avoid barring trustee relief by exercising the considerable discretion that they have in deciding the question of imputation to the debtor itself and in the application of the *in pari delicto* rule. A court that recognizes that neither the goals of the *in pari delicto* rule nor bankruptcy policy are served by precluding the trustee's suit might avoid that result by a narrower rule of imputation that looks at real and substantial benefit to the corporation.

Even if the court decides to impute the officer's action to the corporation, there must still be a determination of whether the corporation bears equal or greater guilt than the defendant, and the court has broad authority for achieving a principled and policy-based resolution of that issue through the discretionary balancing described in Part III.[258] At every stage of the *in pari delicto* analysis, the court has a significant amount of discretion—it may make judgments on the questions of whether the breach of the law is sufficient to merit refusal

255. Davis, *supra* note 243, at 521.

256. *See supra* Part II.

257. McLemore v. Regions Bank, 682 F.3d 414, 422 (6th Cir. 2012) (holding that the *in pari delicto* doctrine is an equitable doctrine and should be limited to the equitable purposes that it is meant to serve—preventing courts from wasting judicial resources in mediating disputes between wrongdoers and deterring illegality).

258. *See supra* Part III.

of relief, whether the plaintiff bears at least equal responsibility for the illegality, whether a claim for restitution should be looked upon more favorably than a claim for enforcement, and whether public policy and the equities of the situation demand the refusal of relief. This discretion is greatest where there is little or no statutory mandate for granting or refusing relief, but it still exists to some degree even where the violation of the law offends a statute that does not express the impact of the violation on the private rights of the parties to the transaction. By following a coherent, goal-oriented approach to application of the rule, courts are able to exercise discretion in a manner that is most likely to curtail randomness and to provide a more certain, predictable, and fair basis for handling claims arising out of illegal transactions.

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