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IN PARI DELICTO DECONSTRUCTED: DISMANTLING THE DOCTRINE THAT PROTECTS THE BUSINESS ENTITY'S LAWYER FROM MALPRACTICE LIABILITY

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> "Fraud on behalf of a corporation is not the same thing as fraud against it."[1]

> "If a lawyer for an organization knows that an [agent] . . . intends to act . . . [in] violation of law that reasonably might be imputed to the organization . . . then the lawyer shall proceed as is reasonably necessary in the best interest of the organization."[2]

INTRODUCTION

The *in pari delicto* doctrine provides that a plaintiff who participated equally with a defendant in wrongdoing cannot pursue a claim against the defendant.[3] *In pari delicto* is a shortened version of the phrase *in pari delicto potior est conditio defendantis*, which means "[i]n a case of equal or mutual fault . . . the position of the [defending] party . . . is the better

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1 Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 456 (7th Cir. 1982).

2 MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2015).

3 Feld & Sons, Inc. v. Pechner, Dorfman, Wolfee, Rounick, & Cabot, 458 A.2d 545, 548–49 (Pa. Super. Ct. 1983) (explaining that the *in pari delicto* doctrine is an application of the principle that "no court will lend its aid to a man who grounds his action upon an immoral or illegal act" and noting that the doctrine was first applied in a 1760 case by Lord Mansfield).

one."[4] Courts often describe dual policies underlying the *in pari delicto* defense: deterrence of illegal conduct and protection of the sanctity of the courts.[5]

Lawyers invoke *in pari delicto* when sued for malpractice for failing to protect a client from legal liability.[6] A common scenario involves a lawyer advising a client to lie under oath; the client follows the advice and suffers damage as a result.[7] When the client sues the lawyer for legal malpractice based on the lawyer's negligent advice, the lawyer can have the case dismissed based on *in pari delicto*.[8] Courts reason that the client understood that it was wrong to lie under oath and that both client and lawyer are equally at fault for the client's resulting damages, justifying dismissal on the basis of *in pari delicto*.[9]

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[4] Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985) (alteration in original) (quoting BLACK'S LAW DICTIONARY 711 (5th ed. 1979)).

[5] Bank of the United States v. Owens, 27 U.S. 527, 538 (1829) ("[N]o court of justice can in its nature be made the handmaid of iniquity."); Claybrook v. Broad & Cassel, P.A. (*In re* Scott Acquisition Corp.), 364 B.R. 562, 566 (Bankr. D. Del. 2007) (describing the equitable doctrine's purposes of preventing "culpable parties from benefitting from their wrongdoings" and ensuring that courts do not mediate disputes among wrongdoers).

[6] The claim may be framed as one for legal malpractice—that is, professional negligence, breach of fiduciary duty, or breach of contract. All three claims are often asserted by a plaintiff and treated by courts as essentially stating the same cause of action. *See, e.g.*, Wechsler v. Squadron, Ellenoff, Plesent & Sheinfeld, L.L.P., 212 B.R. 34, 39 (S.D.N.Y. 1997) ("The Trustee's three causes of action—legal malpractice, breach of contract and breach of fiduciary duty—essentially amount to a single claim for the provision of deficient legal services."); Kirschner v. K&L Gates LLP, 46 A.3d 737, 748, 755, 758 (Pa. Super. Ct. 2012) (trustee alleged legal malpractice/professional negligence, breach of contract, and breach of fiduciary duty based on law firm's failure to detect and report fraud of company CEO). The term "malpractice" as used in this Article is meant to encompass all such claims.

[7] *See, e.g.*, Grosso v. Biaggi, No. 12 Civ. 6118(JMF), 2013 WL 3743482, at *1–3 (S.D.N.Y. July 17, 2013) (in legal malpractice action, former client alleges that she committed perjury in dental malpractice case at direction of lawyer, resulting in a much smaller verdict than if she had not lied); Evans v. Cameron, 360 N.W.2d 25, 27 (Wis. 1985) (client alleges she lied in a bankruptcy proceeding at direction of her attorney, resulting in her investigation and possible prosecution for perjury).

[8] *Grosso*, 2013 WL 3743482, at *3 (ruling that where plaintiff bases her legal malpractice claim on her own perjury, plaintiff is *in pari delicto* with her attorney and the malpractice claim is barred as a matter of law); *Evans*, 360 N.W.2d at 29 (holding that the client's "deliberate act of lying under oath" places her *in pari delicto* with counsel, thus barring her claim against him).

[9] Pantely v. Garris, Garris & Garris, P.C., 447 N.W.2d 864, 868 (Mich. Ct. App. 1989) ("We can readily envision legal matters so complex . . . that a client could follow an attorney's advice, do wrong and still maintain suit on the basis of not being

While this example involves a client who is an individual,[10] the *in pari delicto* defense also can be invoked when the client is a business that—through its agents—engaged in fraudulent or criminal conduct that ultimately damaged the company.[11] In this context, the legal malpractice case is filed against a business entity's attorney who failed to advise against the conduct, failed to inform other agents within the organization about the misconduct so that they could intervene, or participated in the misconduct.[12] Often, the business has filed for bankruptcy and the trustee is bringing the malpractice claim against the company's former lawyers.[13] In other cases, suit is filed by the company itself, an assignee of the company's rights, a court-appointed receiver, or its shareholders as a derivative suit.[14]

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equally at fault. But perjury is not complex; and telling the truth poses no dilemma.").

[10] *See* cases cited *supra* note 7.

[11] *See* Henry S. Bryans, *Claims Against Lawyers by Bankruptcy Trustees—A First Course on the* In Pari Delicto *Defense*, 66 BUS. LAW. 587, 587 (2011) ("A cursory examination of reported decisions in the last seven years reflects over forty claims brought by bankruptcy trustees against debtors' pre-petition lawyers.").

[12] *See, e.g.*, Kirschner v. KPMG LLP, 938 N.E.2d 941, 946 (N.Y. 2010) (including a lawyer allegedly participating in client's agents' fraudulent scheme). Similarly, an auditor malpractice case may be brought based on an auditor's failure to detect fraud and report it to appropriate company agents so that the company could have avoided injury. *See, e.g.*, Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 451 (7th Cir. 1982) (considering liability of independent auditors for failing to detect or report fraud by company management).

[13] *See, e.g.*, Claybrook v. Broad & Cassel, P.A. (*In re* Scott Acquisition Corp.), 364 B.R. 562 (Bankr. D. Del. 2007) (explaining that a chapter 7 trustee of the estates of Scott Acquisition Corporation and Scotty's Inc. filed claims against attorneys for legal malpractice and breach of fiduciary duty); *Kirschner*, 938 N.E.2d at 946 (bringing a suit by litigation trustee charged with pursuing causes of action possessed by company prior to its bankruptcy). The plaintiff stands in the shoes of the company and not its creditors, making the malpractice claim appropriate but also making the plaintiff subject to defenses that could have been asserted against the company. Grubin v. Rattet (*In re* Food Mgmt. Grp., LLC), 380 B.R. 677, 693 (Bankr. S.D.N.Y. 2008) (holding that a trustee "may only assert claims held by the bankrupt corporation.").

[14] Though some of the following cases were not legal malpractice claims, all are representative of the entities that could file a legal malpractice claim in this context. Cobalt Multifamily Inv'rs I, LLC v. Shapiro, 857 F. Supp. 2d 419, 423 (S.D.N.Y. 2012) (court-appointed receiver filed suit on behalf of the company against three sets of attorneys and their firms who represented company prior to receivership); Teachers' Ret. Sys. of La. v. PricewaterhouseCoopers LLP, 998 A.2d 280, 280–82 (Del. 2010) (bringing a derivative suit by the shareholders of AIG, Inc. against insiders and the company's accountants for professional negligence); Chaikovska v.

Courts have applied *in pari delicto* to dismiss these claims against the company's lawyers. The plaintiffs in these cases stand in the shoes of the wrongdoing company and cannot escape the company's misconduct.[15] There is indeed "company misconduct" because, applying basic agency principles, management's knowledge or misconduct must be imputed to the company.[16] While there is an exception to imputation when the agents acted adverse to the company's interests, that exception is a narrow one inapplicable when agents engaged in misconduct for the company's benefit.[17] Courts reason that applying *in pari delicto* in such cases deters illegal conduct[18] and allows courts to avoid being parties to the misconduct.[19]

This Article deconstructs these principles that seemingly favor the *in pari delicto* doctrine barring claims against an organization's lawyer. In examining *in pari delicto* in these cases, it becomes apparent that the doctrine is inconsistent with an attorney's fiduciary duty to organizational clients. By barring or substantially limiting claims against business lawyers in this context, *in pari delicto* has effectively immunized lawyers from liability when they fail to perform one of their most important functions: acting competently to protect their organizational clients from legal liability.[20] This Article explains how two bodies of law—*in pari delicto* and attorney fiduciary duty—should be reconciled to better protect the interests of organizational clients and to give attorneys incentives to competently represent their organizational clients.

Ernst & Young, LLP, 913 N.Y.S.2d 449, 451 (N.Y. App. Div. 2010) (filing accounting malpractice claim by the majority shareholder and corporation's assignee).

[15] *See infra* Section II.A.

[16] *See infra* Section II.A.

[17] *See infra* Section II.B.

[18] *See infra* Section II.E.

[19] *See infra* Section II.D.

[20] George C. Harris, *Taking the Entity Theory Seriously: Lawyer Liability for Failure To Prevent Harm to Organizational Clients Through Disclosure of Constituent Wrongdoing*, 11 GEO. J. LEGAL ETHICS 597, 656–57 (1998) ("The protection of the [organizational] client from the consequences of fraud or illegal conduct within the scope of the lawyer's engagement is or ought to be central to the organizational lawyer's enterprise. When the lawyer is actually aware of such danger to the client's interests it does not seem unfair to hold her responsible for the consequences of failing to take reasonable steps to protect the client.").

Following this introduction, Part I discusses a representative case in this area.[21] The court's decision highlights the typical reasoning for barring a malpractice claim against a lawyer even when the lawyer facilitated agent misconduct that severely damaged an entity client. Then, Part II considers each of the principles underlying the *in pari delicto* defense in organizational client legal malpractice cases. Each principle is juxtaposed with attorney fiduciary duty law. Part III considers some variations on the *in pari delicto* doctrine and whether these variations are more compatible with an organization's attorney's fiduciary duty.

Having determined that attorney fiduciary duty is at odds with *in pari delicto* in the organizational client context, Part IV explores why the doctrines should be aligned and determines how best to accomplish that reconciliation. This Part considers when imputation may still be appropriate and discusses the safeguards that could prevent organizational clients from shifting all of the costs of agent misconduct to outside counsel. Finally, the Article concludes with thoughts about the benefits for businesses and the legal profession when lawyers face liability for failing to protect their organizational clients from liability.

I. A REPRESENTATIVE CASE: LAWYER MALPRACTICE IMMUNITY THROUGH *IN PARI DELICTO*

> "A criminal who is injured committing a crime cannot sue the police officer or security guard who failed to stop him; the arsonist who is singed cannot sue the fire department."[22]

Attorney Joseph Collins represented Refco and its related companies (referred to collectively as "Refco") in a number of business matters.[23] Beginning in 1998, Collins helped Refco

[21] The case is governed by New York law, which is significant because New York is noted for its protection of professionals through its strong *in pari delicto* doctrine. *See, e.g.*, Gregory W. Fox, *Limits of Expansive Protection of New York's In Pari Delicto Defense*, 33 AM. BANKR. INST. J. 20 (2014) ("Simply put, New York's version of the *in pari delicto* defense is among the most protective to professionals in the nation.").

[22] Kirschner v. KPMG LLP, 938 N.E.2d 941, 950 (N.Y. 2010).

[23] Collins, and other attorneys at his firm Mayer, Brown, Rowe, & Maw, LLP ("Mayer Brown"), represented Refco Group Ltd., LLC, its indirect subsidiary Refco Capital Markets. Ltd., and a company that was created through an initial public offering, Refco, Inc. Kirschner v. Grant Thornton LLP, No. 07 Civ. 11604(GEL), 2009 WL 1286326, at *1 (S.D.N.Y. Apr. 14, 2009). All of the Refco entities are referred to collectively in the courts' decisions as "Refco." *KPMG LLP*, 938 N.E.2d at 945 n.1.

executives structure seventeen "round-trip" loan transactions that had the sole purpose of temporarily removing hundreds of millions of dollars in uncollectable intercompany debt from Refco's books.[24] As a result, the company was able to attract investors for a 2004 leveraged buyout and for a 2005 initial public offering of its stock.[25] After the IPO, the hidden uncollectable debt was revealed, the stock price fell, and the company was forced to file for bankruptcy.[26] A "flood of civil litigation" followed.[27]

Collins and a number of Refco executives were convicted and sentenced for the roles they played in the massive fraud.[28] As the criminal cases proceeded, so did the bankruptcy case. The bankruptcy plan established the Refco Litigation Trust to pursue causes of actions possessed by Refco prior to bankruptcy.[29] Mark Kirschner, as trustee of the Refco Litigation Trust, filed a legal malpractice case against Collins' law firm, Mayer Brown, alleging claims of malpractice, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and aiding and abetting fraud.[30] Kirschner filed related claims of fraud, breach of fiduciary duty, and malpractice against Refco insiders, the investment banks that served as underwriters for the leveraged

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[24] *In re* Refco, Inc. Sec. Litig., 609 F. Supp. 2d 304, 306–07 (S.D.N.Y. 2009); *KPMG LLP*, 938 N.E.2d at 945–46 n.2.

[25] *KPMG LLP*, 938 N.E.2d at 945.

[26] *Id.* at 945–46.

[27] *Id.* at 945 n.2 (citing *In re* Refco, Inc. Sec. Litig., 503 F. Supp. 2d 611, 618 (S.D.N.Y. 2007); Thomas H. Lee Equity Fund V, L.P. v. Grant Thornton LLP, 586 F. Supp. 2d 119, 122 (S.D.N.Y. 2008); *In re* Refco Capital Mkts., Ltd. Brokerage Customer Sec. Litig., No. 06 Civ. 643(GEL), 2007 WL 2694469, at *1 (S.D.N.Y. Sept. 13, 2007)).

[28] Collins was sentenced to one year and one day for his conviction for "conspiracy, securities fraud, [submitting] false filings with the Securities and Exchange Commission, and wire fraud." United States v. Collins, 581 F. App'x 59, 59 (2d Cir. 2014). In the criminal case against Collins, the district court gave the jury an instruction on "conscious avoidance," allowing the jury to find the element of knowledge by determining that Collins's participation in the crime was "so overwhelmingly suspicious that the defendant's failure to question the suspicious circumstances establishes the defendant's purposeful contrivance to avoid guilty knowledge." *Id.* at 60 (emphasis omitted). The United States Court of Appeals for the Second Circuit affirmed the conviction, finding there was sufficient evidence to support the conscious avoidance charge. *Id.* at 61.

[29] *KPMG LLP*, 938 N.E.2d at 946.

[30] Complaint at 107–12, Kirschner v. Grant Thornton LLP, (No. 07-cv-05306) (Cook Cnty Ct. filed Sept. 19, 2007).

buyout and the initial public offering, third parties that participated in the loans, and accounting firms employed by Refco.[31] The cases, which were originally filed in Illinois and Massachusetts state court, were removed to federal court and transferred to the United States District Court for the Southern District of New York.[32]

The law firm, accounting firms, investment banks, and third party participants in the loans filed motions to dismiss, asserting that the litigation trustee lacked standing to bring the claims under the United States Court of Appeals for the Second Circuit's *Wagoner* doctrine.[33] The *Wagoner* doctrine provides that a bankruptcy trustee lacks standing to recover from third parties "alleged to have joined with the debtor corporation in defrauding creditors."[34] Because the *Wagoner* doctrine incorporates applicable state substantive law concerning *in pari delicto*,[35] the district court considered New York law in ruling that the case should be dismissed.[36]

On appeal, the Second Circuit noted that the parties were in sharp dispute concerning the district court's interpretation of New York law on the adverse-interest exception to the *in pari delicto* doctrine.[37] On that basis, the Second Circuit certified questions on that issue to the New York Court of Appeals.[38]

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[31] *KPMG LLP*, 938 N.E.2d at 946.

[32] *Id.*

[33] *Id.* at 946 (citing Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 118 (2d Cir. 1991)).

[34] *Id.*

[35] *Id.* at 946 n.3 (explaining that while the District Court characterized the Wagoner rule as "an application of the substantive law of New York," the *Wagoner* rule "is not part of New York law except as it reflects the in pari delicto principle"); *see also* Wechsler v. Squadron, Ellenoff, Plesent & Sheinfeld, L.L.P., 212 B.R. 34, 44 (S.D.N.Y. 1997) (explaining that the *Wagoner* rule refers to "dismissal of a bankrupt company's damage claims where the company's sole shareholder participated in the fraudulent scheme," and describing the rule as "application of the in pari delicto doctrine or certainly . . . closely akin to it"). The dissent in the *Kirschner* case asserts that the *Wagoner* decision and its progeny have "incorrectly characterize[d] New York's version of in pari delicto as a limitation on standing" and explains that under New York law, *in pari delicto* is an affirmative defense. *KPMG LLP*, 938 N.E.2d at 959–60 (Ciparik, J., dissenting).

[36] *KPMG LLP*, 938 N.E.2d at 947–48 (majority opinion).

[37] *Id.* at 948.

[38] *Id.* (internal quotation marks omitted) (discussing the Second Circuit asking the New York Court of Appeals to focus its attention on two of eight certified questions: "whether the adverse-interest exception is satisfied by showing that the

In its decision in the matter, the New York Court of Appeals began by explaining the basis for the *in pari delicto* doctrine is the principle that "courts will not intercede to resolve a dispute between two wrongdoers."[39] The court noted that the justice of the doctrine is apparent in cases where willful wrongdoer sues a party alleged to be negligent, but that the doctrine also applies when both parties engaged in willful misconduct.[40]

In cases involving an organizational client, imputation is essential to *in pari delicto's* application. The New York Court of Appeals explained that both the acts of an organization's agents and the knowledge they acquire "are presumptively imputed to their principals."[41] The court reasoned that principals select their agents, can only act through their agents, and should bear the risks of even the unauthorized acts of their agents.[42]

The court explained that the only time it is inappropriate to presume communication of knowledge from agent to principal is when the principal is the agent's intended victim.[43] This is the adverse-interest exception to imputation: when the agent has "*totally abandoned* the principal's interest," then his knowledge is not imputed to the principal.[44] If there is a benefit to both agent and principal, the adverse-interest exception does not apply.[45] It is only when the corporation enjoys no benefit whatsoever—such as theft by the agent from the corporation—that the exception applies, which means no imputation and the possibility of a malpractice suit.[46] The court rejected the suggestion that the company's ultimate bankruptcy is harm

insiders intended to benefit themselves by their misconduct; and whether the exception is available only where the insiders' misconduct has harmed the corporation"); *see also* Kirschner v. KPMG LLP, 590 F.3d 186, 194–95 (2d Cir. 2009) (describing the overarching question as whether the complaint's allegations "satisfy the 'adverse[-]interest' exception" to the rule of imputing insider misconduct to the corporation, and then describing seven subsidiary questions).

[39] *KPMG LLP*, 938 N.E.2d at 950.

[40] *Id.*; *see supra* note 22 and accompanying text.

[41] *KPMG LLP*, 938 N.E.2d at 950.

[42] *Id.* at 950–51.

[43] *Id.* at 951.

[44] *Id.* at 952.

[45] *Id.*

[46] *Id.* The court further clarifies that fraud committed against the corporation would invoke the exception while fraud on its behalf does not. *Id.*

enough, reasoning that when fraud ultimately causes bankruptcy, it does not follow that the company's agents totally abandoned the company.[47]

The New York Court of Appeals then considered and rejected arguments for expanding the adverse-interest exception in order to make outside professionals responsible for professional negligence to organizational clients.[48] First, the court considered whether the adverse-interest exception's availability should hinge on subjective intent, namely whether the insiders intended to benefit themselves at the company's expense, and that they either received such a benefit and/or that the company suffered long-term harm.[49] The court rejected this formulation, stating that the exception would encompass every corporate fraud because fraudsters are not motivated by charitable impulses and the company "is always likely to suffer long-term harm once the fraud becomes known."[50]

Second, the court considered New Jersey's approach of barring imputation of agent misconduct to the corporation in cases of professional negligence to the extent the recipient of recovery is an innocent shareholder[51] and Pennsylvania's approach of prohibiting imputation of agent misconduct in cases where the outside professional "had not proceeded in material good faith," such as by colluding with company agents to defraud the company.[52] The court understood the goal of such approaches as deterring third party professional misconduct and compensating innocent owners of these companies.[53]

The New York Court of Appeals was not persuaded, and explained that it does not understand why the "innocent stakeholders of corporate fraudsters [should] trump those of innocent stakeholders of the outside professionals who are the defendants in these cases."[54] The court saw the equities lying

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[47] *Id.* at 953.

[48] *Id.* at 954.

[49] *Id.* at 954–55 (citing *In re* CBI Holding Co., Inc., 529 F.3d 432, 438 (2d Cir. 2008)).

[50] *Id.* at 955.

[51] *Id.* (citing NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 890 (N.J. 2006)).

[52] *Id.* at 956 (citing Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Research Found. v. PricewaterhouseCoopers, LLP, 989 A.2d 313, 335–36 (Pa. 2010)).

[53] *Id.* at 957–58.

[54] *Id.* at 958.

with the outside professionals, and explained "the corporation's agents would almost invariably play the dominant role in the fraud and therefore would be more culpable than the outside professional's agents who allegedly aided and abetted the insiders or did not detect the fraud at all or soon enough."[55] The court asserted that there are already adequate disincentives to outside professionals participating in corporate client fraud without expanding the adverse-interest exception, noting settlements by underwriters and accounting firms in other cases.[56] The court ultimately concluded that the "speculative public policy benefits" of an expanded adverse-interest exception did not outweigh the policies underlying current *in pari delicto* law.[57]

II. DECONSTRUCTING THE *IN PARI DELICTO* DEFENSE IN A MALPRACTICE CASE AGAINST THE BUSINESS ENTITY'S LAWYER

This Part considers the various principles underlying application of the *in pari delicto* defense when a lawyer is sued for malpractice for failing to protect an entity client from legal liability at the hands of insiders. Each principle is juxtaposed with attorney fiduciary duties to organizational clients. In every case, there is conflict. The rules that courts rely upon in applying *in pari delicto* are counter to a lawyer's legal duties to organizational clients. Further, the policies that courts claim are furthered by applying *in pari delicto* are not advanced in this context of organizational clients or successors in interest suing counsel for professional negligence.

Some of the cases cited in this and the following Part are auditor malpractice cases. It is useful to consider auditor malpractice cases because auditors and lawyers are both: (1) outside agents of the organizational client, and (2) sued for failing to take action that would have protected the entity from liabity.[58] Even when a jurisdiction has not considered *in pari*

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[55] *Id.*
[56] *Id.* at 958–59.
[57] *Id.* at 959.
[58] *See supra* note 12 and accompanying text.

delicto in the context of business lawyer liability, it is highly likely that the auditor liability analysis would be applied in a lawyer liability case.[59]

A. *Courts Impute an Agent's Knowledge or Misconduct to the Entity Client*

Imputing the agent's knowledge or conduct[60] to the company is a necessary step in the *in pari delicto* analysis in these malpractice cases.[61] Without imputation, the company cannot be treated as equally responsible for the misconduct and barred from pursuing its claim.[62]

Imputation is a step that is easily satisfied, because courts generally presume imputation is appropriate in the *in pari delicto* context.[63] Some courts describe imputation in terms of imputing the agent's knowledge to the principal.[64] The Restatement (Third) of Agency section 5.03 provides that "notice of a fact that an agent knows" is imputed to the principal when

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[59] The reasons that emerge for questioning the appropriateness of *in pari delicto* defense in the lawyer malpractice context may also provide reason to question the defense in the auditor malpractice context. However, because this Article does not analyze the auditor's duties to the business client, it does not take a position on whether and how the *in pari delicto* defense should be reconceptualized in the auditor malpractice context.

[60] This Article and many cases generally refer to both knowledge and conduct being imputed to the organizational client. *But see* Deborah A. DeMott, *Further Perspectives on Corporate Wrongdoing,* In Pari Delicto*, and Auditor Malpractice*, 69 WASH. & LEE L. REV. 339, 341–342 (2012) (describing the distinction between attributing conduct and imputing knowledge to a principal).

[61] *See, e.g.*, Casey v. U.S. Bank Nat'l Ass'n, 127 Cal. Rptr. 3d 401, 404 (Cal. Ct. App. 2005)Joint Equity Comm. v. Genovese, No. .

[62] *Id.* at 404–05.

[63] *See, e.g.*, Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP, 133 Cal. Rptr. 3d 31, 46 (Cal. Ct. App. 2005) (stating that the question of imputation "is not complicated" because there is settled law in California that an officer's knowledge within the scope of his duties is imputed to the corporation).

[64] *See, e.g*., N.K.S. Distrib., Inc. v. Wheeler, Wolfenden & Dwares, P.A., No. N11C-11-146-JRJ, 2014 WL 4793438, at *3 (Del. Super. Ct. Sept. 26, 2014) (explaining that for purposes of applying *in pari delicto*, Delaware agency law requires court to impute agent knowledge to the principal unless agent's interests were adverse); NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 879 (N.J. 2006) (asserting that pursuant to the common law of agency, the principal is "deemed to know facts that are known to its agent"); Chaikovska v. Ernst & Young, LLP, 913 N.Y.S.2d 449, 452 (N.Y. App. Div. 2010) (asserting that, in discussing the application of the *in pari delicto* doctrine, "knowledge" of an agent acting within the scope of agency is imputed to the principal and the principal is bound by that knowledge even if it was never communicated).

the fact is material to the agent's duties.[65] Other courts describe imputation in terms of conduct.[66] This is akin to the Restatement (Third) of Agency's discussion of vicarious liability.[67]

Regardless of whether a court in these cases is imputing knowledge or conduct, imputation is based entirely upon basic principles of agency law.[68] The same principles are relied upon in cases in which a company and a third party are involved in tort, contract, or other litigation.[69] The agent's actions and knowledge are attributed to the principal and can result in the principal's liability to a third party.[70]

But reliance on agency principles as a basis for barring the malpractice claim is not legally sound.[71] The law allows a company to sue its employees without imputation barring the company's claims.[72] Yet, these same jurisdictions bar comparable

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[65] RESTATEMENT (THIRD) OF AGENCY § 5.03 (AM. LAW INST. 2006). The provision notes that imputation does not apply if the agent acts adversely to the principal. *Id.* at § 5.04.

[66] *See, e.g.*, Tolz v. Proskauer Rose LLP (*In re* Fuzion Techs. Grp., Inc.), 332 B.R. 225, 230 (Bankr. S.D. Fla. 2005) ("Normally, under agency principles, if the plaintiff acted wrongfully through an agent in the scope of that agency relationship, then the wrongdoing of the agent is attributed to the plaintiff."); Am. Int'l. Grp. v. Greenberg (*AIG I*), 965 A.2d 763, 823 (Del. Ch. 2009) (explaining that under New York law the agent's knowledge and "the wrongdoing" is imputed to the corporation).

[67] RESTATEMENT (THIRD) OF AGENCY § 7.03(2) (AM. LAW INST. 2006) (describing principal's vicarious liability to third party harmed by agent's conduct).

[68] *Id.* at ch. 2, intro. note ("This Chapter states . . . the three distinct bases on which the common law of agency attributes the legal consequences of one person's action to another person. . . . The three distinct bases for attribution are actual authority, apparent authority, and respondeat superior. . . . The legal consequences that these doctrines attribute to a principal are not consequences of agency doctrine itself but of other bodies of law.").

[69] *Id.* § 6.01 (principal has contractual liability when agent with actual or apparent authority makes a contract on behalf of a disclosed principal); *id.* § 7.03 (describing circumstances in which principal has tort liability for agent's conduct under principles of actual authority, apparent authority, and respondeat superior).

[70] *Id.* §§ 6.01, 7.03.

[71] *See* Baena v. KPMG LLP, 453 F.3d 1, 8 (1st Cir. 2006) ("Whether or not application of the *in pari delicto* doctrine should depend on imputation rules borrowed from agency law is debatable."); *AIG I*, 965 A.2d at 828 n.246 (questioning New York's reliance on agency principles in the *in pari delicto* context and explaining, "[i]t is a policy judgment, not some rote conflation of contextually different questions of agency, that must determine whether . . . an auditor should face liability of professional negligence to its client corporation").

[72] *See, e.g.*, Claybrook v. Broad & Cassel, P.A. (*In re* Scott Acquisition Corp.), 364 B.R. 562, 565 (Bankr. D. Del. 2007) (referencing the fact that, in dismissing claims against attorneys who participated with insiders in conduct that damaged the company, insiders were sued in a separate action and that the court refused to

claims against attorneys through imputation.[73] In other words, imputation is used inconsistently depending on the identity of the agent. But there is no substantive difference between insiders and attorneys: both are agents, owing fiduciary duties to a principal, who engaged in misconduct alleged to have proximately caused damages to that principal.[74] A cause of action should be allowed to proceed against both without a bar via imputation.

Moreover, applying agency principles to bar a malpractice claim is inconsistent with an attorney's fiduciary duties of care and loyalty to the entity client.[75] A lawyer advising and assisting

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dismiss claims against them); Goldin v. Primavera Familienstiftung, Tag Assocs., Ltd. (*In re* Granite Partners, L.P.), 194 B.R. 318, 332 (Bankr. S.D.N.Y. 1996) ("*In pari delicto* bars claims against third parties, but does not apply to corporate insiders or partners. Otherwise, a trustee could never sue the debtor's insiders on account of their own wrongdoing."); Am. Int'l Grp., Inc., v. Greenberg (*AIG II*), 976 A.2d 872, 876 (Del. Ch. 2009) (explaining that AIG's suits were allowed to proceed against the company's own officers and employees without consideration of *in pari delicto* because "the doctrine does not have force in a suit by a corporation against its own officers or employees"); Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., No. 1571-N, 2006 WL 4782378, at *33 n.132 (Del. Ch. Aug. 10, 2006) (refusing to apply in pari delicto based on imputation from insiders); *see also* RESTATEMENT (THIRD) OF AGENCY § 5.04 cmt. b. (AM. LAW INST. 2006).

[73] *See, e.g.*, Kirschner v. KPMG LLP, 938 N.E.2d 941, 945 (N.Y. 2010).

[74] The Delaware Court of Chancery has explained that it is sound for the *in pari delicto* doctrine to be put aside so that a company—via a derivative suit—can pursue a claim against insiders who breached fiduciary duties to the company. *AIG II*, 976 A.2d at 890 ("If there was illegal conduct, derivative plaintiffs may recover for the harm that the corporation suffered when those fiduciaries knowingly caused the corporation to violate positive law."). The court went on to explain that the same analysis supports allowing derivative suits against outside corporate agents like auditors and counsel. *Id.* at 890 n.49 ("If these professionals fail in their duties as gatekeepers, there is a strong argument to be made that they ought to be accountable for their malpractice and not immunized by the very actions that were not discovered due to their failure to meet expected professional standards.").

[75] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16(2), (3) (AM. LAW INST. 2000) (stating that a lawyer's duty of care requires the lawyer to "act with reasonable competence and diligence" while duty of loyalty requires the lawyer to comply with obligations concerning confidentiality, avoid conflicts of interest, deal honestly with the client, and not take advantages from the relationship adverse to the client); *id.* § 16 cmt. b (stating that the rationale for § 16 is that the lawyer is a fiduciary); *see also* Kirschner v. K&L Gates, LLP, 46 A.3d 737, 757 (Pa. Super. Ct. 2012) (describing attorney's duty to client as including "both a duty of competent representation and the highest duty of honesty, fidelity, and confidentiality."). A lawyer should face civil liability for violating these duties of care and loyalty if the violation is the legal cause of injury to the client. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS §§ 48, 49.

an organizational client[76] should face liability if he failed to protect the client from liability arising from agent misconduct when a reasonably prudent lawyer would have done so.[77] While an attorney usually must accept instructions of the company's authorized agents, that obligation changes when agents are planning to engage in criminal or fraudulent conduct.[78] Instead, a competent, loyal lawyer should inform other authorities within the company who can take action to protect the company.[79] In

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[76] The lawyer in this context is not a litigator acting as an advocate for the client in an adversary proceeding. *See* JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 192–93 (2006) (contrasting the role and work of a corporate lawyer with that of a litigator). This lawyer is hired to advise and assist in a course of future conduct, not to zealously advocate in litigation for the client's position concerning past events. *Id.*

[77] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS §§ 96(2), cmt. d, cmt. f, note to cmt. f (citing cases that stand for the proposition that an attorney has a duty to protect the organizational client against wrongful acts by constituents). *See, e.g.*, FDIC v. O'Melveny & Myers, 969 F.2d 744, 748 (9th Cir. 1992) (citing California law for the proposition that it is an attorney's duty to "protect his client in every possible way" and that an attorney fulfills this duty by acting with the "skill, prudence and diligence as lawyers of ordinary skill and capacity commonly possess."), *rev'd*, 512 U.S. 79 (1994) (reversed on the grounds that the court applied federal and not state law), *remanded to* 61 F.3d 17, 19 (9th Cir. 1995) (adopting earlier opinion with the exception of part concerning defenses in which earlier decision relied upon federal law); *see also* Harris, *supra* note 20, at 638 (explaining that if a lawyer's loyalty is owed to an organizational client, then the lawyer has a duty to that client to prevent and/or limit the consequences of constituent fraud or crime that will harm the organization "through liability to third parties or otherwise").

[78] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) (explaining that if lawyer knows that constituent of an organization intends to act in a way that violates an obligation to the organization or that will be imputed to the organization and likely to result in substantial injury to it, then "the lawyer must proceed in what the lawyer reasonably believes to be the best interests of the organization"); *id.* § 96 cmt. d (2000) (explaining that an agent's instruction to the organization's lawyer to perform, counsel, or assist in an unlawful act does not bind the lawyer and "does not remove the lawyer's duty to protect the best interests of the organizational client"); *see also* Harris, *supra* note 20, at 638 ("If one takes the entity theory seriously, the lawyer for an organizational client must act . . . in a manner loyal to the interest of the entity and without regard to the direction of agents of the organization who are engaged in or complicit in wrongdoing. . . . The organizational constituent engaged in crime or fraud . . . is in effect disabled . . . from speaking on behalf of the client.").

[79] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(3) (attorney may seek review by higher authorities in the organization, "including referring the matter to the highest authority that can act in behalf of the organization."); *see, e.g.*, *In re* Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig., 794 F. Supp. 1424, 1453 (D. Ariz. 1992) ("[W]here a law firm believes the management of a corporate client is committing serious regulatory violations, the firm has an obligation to actively discuss the violative conduct [and] urge cessation of the activity."); Wechsler v.

other words, as a fiduciary, the lawyer has a duty to inform company decision makers of the material information that company agents are planning or are engaged in harmful wrongdoing.[80] Further, it is in the organizational client's interest for the lawyer to withdraw from the representation rather than facilitate an agent's crime or fraud.[81]

These fiduciary obligations of the organization's attorney are embodied in professional conduct rules.[82] These rules direct attorneys that they should not comply with instructions from company agents who want to engage in conduct that will create liability for the company.[83] Further, the rules guide attorneys in steps they should take to protect the client from an agent's

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Squadron, Ellenoff, Plesent & Sheinfeld, L.L.P., 212 B.R. 34, 38–39 (S.D.N.Y. 1997) (explaining that the plaintiff alleged a breach of the duty to exercise "reasonable care, skill, prudence and judgment" when lawyers "fail[ed] to advise members of [the client] of . . . factual information and legal considerations reasonably necessary to alert [the client] to the nature of its actions"). In addition, an attorney may also have an obligation of disclosure outside of the organization if doing so will protect the interests of the organization and is not prohibited by professional conduct rules. Paula Schaefer, *Overcoming Noneconomic Barriers to Loyal Disclosure*, 44 AM. BUS. L.J. 417, 434 (2007) [hereinafter Schaefer, *Loyal Disclosure*] (asserting that in a jurisdiction that has adopted a loyal disclosure rule, it would be a violation of a lawyer's duties of loyalty and care to not disclose when doing so would protect the organizational client).

[80] William H. Simon, *Duties to Organizational Clients*, 29 GEO. J. LEGAL ETHICS 489, 501 (2016) (describing a lawyer's duty to report up-the-ladder as broader than stated in Rule 1.13 because "under traditional fiduciary principles" a lawyer should provide the client with the material information needed to make decisions).

[81] *See, e.g.*, *Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 794 F. Supp. at 1453 (explaining that if a lawyer cannot convince management to cease misconduct, the lawyer must "withdraw from representation where the firm's legal services may contribute to the continuation of such conduct.").

[82] *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 1 cmt. b (AM. LAW INST. 2000) (explaining that professional conduct rules draw from preexisting legal requirements, including agency law); Paula Schaefer, *A Primer on Professionalism for Doctrinal Professors*, 81 TENN. L. REV. 277, 287–88 (2014) (explaining that some professional conduct rules, including Model Rule of Professional Conduct 1.13, are based on lawyers' fiduciary duties to clients). A violation of rules such as these—that describe the lawyer's duty to a client—could be evidence in a claim for malpractice that the lawyer breached the duty owed to the client. *See* MODEL RULES OF PROF'L CONDUCT pmbl., ¶¶ 10–11 (AM. BAR ASS'N 2014).

[83] *See* MODEL RULES OF PROF'L CONDUCT R. 1.13(b) cmt. 3 (explaining that ordinarily a lawyer must accept decisions—even imprudent decisions—of agents for an organization, but that Rule 1.13(b) "makes clear" that when agents are engaged in conduct that violates a legal obligation to or on behalf of the organization, the lawyer must instead proceed in the best interests of the organization).

planned or ongoing misconduct, including up-the-ladder reporting[84] and loyal disclosure.[85] The rules were adopted in the post-Enron era to address concerns that attorneys were contributing to the bankruptcies of their corporate clients by not stopping agent fraud.[86]

Explanations for why lawyers are required to treat the organizational client as having an interest in avoiding legal liability—even when company agents believe illegal conduct will be profitable for the company—include that a company's obligation to act in compliance with law is the trade-off for limited liability[87] and that this conception protects innocent stakeholders—nonagent owners and creditors of insolvent businesses.[88]

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[84] 17 C.F.R. § 205.3(b), (c) (2016) (describing up-the-ladder reporting obligation when attorney "becomes aware of evidence of a material violation" by the issuer or an agent of the issuer); MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (providing that when an organization's attorney knows that a company agent is engaged in conduct likely to result in substantial injury to the organization that is a violation of a duty to the organization or a violation of law that reasonably might be imputed to the organization, then the attorney must proceed in the best interests of the organization including referring the matter to higher authorities in the organization).

[85] 17 C.F.R. § 205.3(d)(2)(i), (iii); MODEL RULES OF PROF'L CONDUCT R. 1.13(c); *see generally*, Harris, *supra* note 20, 600–01 (explaining that disclosure of organizational client agent wrongdoing is "loyal" to the client if it precludes or limits the entity's liability).

[86] Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1236–39 (2003) (describing post-Enron response of Congress and the SEC to address attorney obligations in the representation of corporate clients); Schaefer, *Loyal Disclosure*, *supra* note 79, at 424–32 (describing events leading up to the 2003 adoption of up-the-ladder and loyal disclosure professional conduct rules by the ABA and SEC following high profile corporate scandals in 2001).

[87] *See* Harris, *supra* note 20, at 651 ("The legitimate quid pro quo [for allowing limited liability organizations] may be that the legal system as a whole, including the lawyer engaged to represent the interests of the organization, will take that separate entity seriously.").

[88] A. V. Pritchard, *O'Melveny & Meyers v. FDIC: Imputation of Fraud and Optimal Monitoring*, *in* 4 SUPREME COURT ECONOMIC REVIEW 179, 192–99 (Harold Demsetz et al. eds., 1995) (asserting that creditors prefer a legal framework that enlists fiduciary professionals in monitoring company agents for fraud; stating that while risk is desirable to shareholders "surely shareholders do not want managers committing *fraud* on the corporation's behalf," but ultimately concluding that with the boundaries of fraud murky that perhaps shareholders prefer a rule in which attorneys do not have liability for failing to detect and prevent agent fraud); Harris, *supra* note 20, at 639–40 (explaining it has been widely held that agents of an insolvent corporation owe a fiduciary duty to the corporation's creditors).

Imputation in the *in pari delicto* context, which has the effect of barring claims against attorneys, is thus incompatible with the law of organizational attorney fiduciary duty in two key ways. First, an attorney is not permitted to follow the directions of an agent who wants to engage in conduct that will create liability for the company.[89] In other words, the law of fiduciary duty provides that company insiders lack actual and apparent authority when they ask an attorney to facilitate liability-creating conduct.[90] It is inconsistent then to attribute the conduct of these insiders to the company in order to bar the company's claim against an attorney who breached his fiduciary duty by taking direction from those very insiders. Second, the attorney's duty includes providing notice or knowledge to higher authorities within the company.[91] Imputing an agent's knowledge to the company to defeat a claim against an attorney who was required but failed to provide notice of that same information to the company is illogical.[92]

Another problem with imputation in this context is the issue of fault. For *in pari delicto* to apply, the plaintiff should be "an active, voluntary participant in the unlawful activity that is the

[89] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) (AM. LAW INST. 2000) (stating that there is an obligation to act in the best interest of the client when an agent "intends to act in a way that violates a legal obligation to the organization . . . or that reasonably can be foreseen to be imputable to the organization and likely to result in substantial injury to it"); MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (AM. BAR ASS'N 2014) (requiring attorneys to protect the organization when an agent is engaged in conduct "that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization").

[90] RESTATEMENT (THIRD) OF AGENCY § 2.01 (AM. LAW INST. 2006) (serving as actual authority); RESTATEMENT (THIRD) OF AGENCY § 2.03 (serving as apparent authority). *See also* Simon, *supra* note 80, at 490–491 (client managers who ask lawyers to engage in conduct intended to deceive should not be understood to speak for the client).

[91] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(3); MODEL RULES OF PROF'L CONDUCT R. 1.13(b).

[92] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(3); MODEL RULES OF PROF'L CONDUCT R. 1.13(b); *see also* 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 MAL. & ETHICS 318, 355 (2014) (asserting that the rationale for imputing knowledge of agent to principal breaks down in this context because the lawyer is "an additional *agent* of the corporation with reporting duties of her own.").

subject of the suit."[93] Further, a plaintiff's equal or even greater fault is traditionally a component of application of the *in pari delicto* doctrine.[94] In many cases involving clients that are individuals instead of organizational clients, equal fault of attorney and client is a point of contention.[95] The client typically argues that he or she did not know the law and was following the attorney's advice, thus the attorney has greater fault.[96] Courts' analysis often centers around whether the client knew that her conduct violated the law.[97] This kind of thoughtful analysis is typically absent in the malpractice cases involving attorneys and organizational clients.[98] Courts act as if imputation answers the question of equal fault and no further analysis is needed.[99]

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[93] Pinter v. Dahl, 486 U.S. 622, 636 (1988); *see also* BrandAid Mktg. Corp. v. Biss, 462 F.3d 216, 218 (2d Cir. 2006).

[94] *Pinter*, 486 U.S. at 632 (citation omitted) (explaining the defense is "limited to situations where the plaintiff bore 'at least substantially equal responsibility for the injury,' and where the parties' culpability arose out of the same illegal act").

[95] *See, e.g.*, Helbling v. Josselson (*In re* Almasri), 378 B.R. 550, 556 (Bankr. N.D. Ohio 2007) (denying dismissal of malpractice claim because court could not determine on the record whether client and attorney were at equal fault where client's discharge was revoked because attorney did not list bank account and business in bankruptcy petition and schedules); Choquette v. Isacoff, 836 N.E.2d 329, 334 (Mass. App. 2005) (affirming decision that *in pari delicto* barred client's malpractice claim against attorney upon determining client and lawyer were equally at fault in client's decision to commit perjury); McKinley v. Weidner, 698 P.2d 983, 986 (Or. Ct. App. 1985) (holding that trial court did not have sufficient facts before it to dismiss case on basis of *in pari delicto* in that attorney, a "presumed expert in the law" may have greater fault than plaintiff for advice that plaintiff tender check with intent to dishonor it as part of a plan to recover a boat from a third party).

[96] *Choquette,* 836 N.E.2d at 334 (involving a client that asserted that given the "complexity of bankruptcy law" he relied upon attorney's advice to lie under oath).

[97] *Id.* ("It is clear from the record that Choquette knew he was not making full disclosure and that he continued to resist making full disclosure.").

[98] For example, in *AIG I*, the court explained that "if imputation applies, AIG is deemed to have participated in its directors', officers', and employees' fraudulent schemes and AIG is deemed to have been as or more guilty of wrongdoing than its auditor, PWC, AIG is barred from recovering against PWC." 965 A.2d 723, 824 (Del. Ch. 2009). Ultimately, the *AIG I* court dismissed the case against the auditor with no analysis of relative fault. The court explained this was appropriate under New York law because the complaint contained an allegation that company insiders acted with scienter. Thus, the company and the auditor were deemed to be at least equally at fault and *in pari delicto* required the complaint be dismissed. *Id.* at 827 n.245.

[99] *See id.*

Even if the knowledge or conduct of the agent is imputed to the principal/client, it does not follow that attorney and client are equally at fault.[100] First, it is the lawyer's role to competently advise about the law.[101] Clients—and their agents—rely on attorneys to provide this advice.[102] When a lawyer does not say "this is fraud" or "this will result in liability for the company," the agent may not understand the implications of the conduct.[103] The agent may understand that the conduct is unethical, but may think that it is nonetheless technically legal—in part because of the attorney's advice or lack thereof.[104]

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[100] *See generally*, Christine M. Shepard, *Corporate Wrongdoing and the* In Pari Delicto *Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275, 324–33 (2012) (asserting that imputation should not be the basis of a determination of corporate client fault for purposes of *in pari delicto* and proposing a framework for determining fault in the context of auditor malpractice cases).

[101] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 94(1) (AM. LAW INST. 2000) (citing §§ 52, 55, 56) (stating that a lawyer is liable to a client if the lawyer counsels or assists a client to engage in conduct that violates the rights of a third person to the extent that doing so violates the lawyer's duty of care or other duty to the client under applicable law); *see also* MODEL RULES OF PROF'L CONDUCT R. 2.1 (AM. BAR ASS'N 2014) (obligating a lawyer to exercise "independent professional judgment and render candid advice").

[102] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 94(1); MODEL RULES OF PROF'L CONDUCT R. 2.1; *see also* Harris, *supra* note 20, at 642 ("A determination that constituents of the organization are engaged on behalf of the organization in crime or fraud with significant likely adverse consequences for the organization is . . . peculiarly within the province of the lawyer's expertise and duty to the client.").

[103] *See, e.g.*, Cobalt Multifamily Inv'rs I, LLC v. Shapiro, 857 F. Supp. 2d 419, 424–25 (S.D.N.Y. 2011) (involving three law firms having assisted company's agents in defrauding investors by, among other things, creating a trust that was used to conceal misappropriated funds, approving private placement memoranda that contained material misrepresentations, and failing to perform due diligence that would have revealed the company was being operated as a Ponzi scheme); *see also* Claire Hill & Richard Painter, *Of the Conditional Fee as a Response to Lawyers, Bankers and Loopholes*, 1 AM. U. BUS. L. REV. 42, 46–47 (2011–2012) (explaining the circumstances in which lawyers providing advice and assistance in transactional matters engage in "creative envelope–pushing" that may ultimately result in liability for clients).

[104] Another explanation for treating the lawyer as having greater fault when the lawyer advises or facilitates wrongful conduct is that lawyers have a greater obligation than clients to ensure the integrity of the administration of justice. Vincent R. Johnson, *The Unlawful Conduct Defense in Legal Malpractice*, 77 UMKC L. REV. 43, 73 n.185 (2008) [hereinafter Johnson, *Unlawful Conduct*] (asserting that attorney is arguably at greater fault than client when lawyer advises client to lie to the court). Taking this argument a step further, lawyers have a greater obligation than clients to ensure compliance with law.

Further, even if the lawyer properly advised the agent of the prospect of liability and the agent still insisted upon the misconduct, it is also the lawyer's obligation to provide information to other individuals in the company so that they can stop the company from engaging in the misconduct.[105] The fact that one agent insisted on misconduct is not equivalent to a case in which the company's highest authority was informed by counsel that the company could face liability and the company chose to engage in the misconduct anyway.[106]

In determining if the company is at equal or greater fault than its lawyer, insiders' understanding of the illegality and knowledge by the highest authority in the company should have a bearing on the issue. These issues are ignored, though, when a court dismisses or enters summary judgment on a legal malpractice claim based entirely on the imputation presumption.[107]

B. The Adverse-Interest Exception Does Not Apply When the Business Entity Was the "Beneficiary" of the Agent Misconduct

When the adverse-interest exception to imputation applies, the plaintiff is allowed to pursue its legal malpractice action because the agent's conduct is not imputed to the principal.[108] The narrow interpretation placed on the exception in many jurisdictions means that the business entity's attorney has little to fear.[109] *In pari delicto* will protect against liability.[110]

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[105] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(3); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.13(b).

[106] *See, e.g.*, *Cobalt*, 857 F. Supp. 2d at 424–25 (involving a complaint that alleged that law firm knew that company's agent was misusing company funds but did not inform the company or its investors of that fact).

[107] MF Glob. Holdings Ltd. v. PricewaterhouseCoopers LLP, 57 F. Supp. 3d 206, 206–09 (S.D.N.Y. 2014) (explaining that the *in pari delicto* doctrine can be applied at the motion to dismiss stage when its application is "plain on the face of the pleadings").

[108] Center v. Hampton Affiliates, Inc., 488 N.E.2d 828, 830 (N.Y. 1985) ("To come within the [adverse-interest] exception, the agent must have totally abandoned his principal's interests and be acting entirely for his own or another's purposes.").

[109] *Id.*; *see also* Kirschner v. KPMG LLP, 938 N.E.2d 941, 952 (N.Y. 2010) (asserting that the adverse-interest exception "reserves this most narrow of exceptions for those cases—outright theft or looting or embezzlement—where the insider's misconduct benefits only himself or a third party; i.e., where the fraud is committed *against* a corporation rather than on its behalf"). For a discussion of the

The adverse-interest exception provides that if the company's agent was acting adversely to the principal's interest, the agent's knowledge or conduct should not be imputed to the company for purposes of *in pari delicto*.[111] "Adverse" has been interpreted narrowly to mean acting in a manner that solely benefits the agent, such as when the agent is stealing from the company.[112] Accordingly, if a manager stole money from the company, the company would not be prohibited from suing an attorney whose negligence facilitated the theft.[113] The reasoning behind the exception is that an agent acting adverse to the principal would not have provided notice of the conduct to the principal, so imputation of knowledge is not appropriate.[114]

The adverse-interest analysis of many courts turns largely on whether the corporation received any benefit, however slight or short lived, from the agent's misconduct.[115] Any benefit to the

broader reading some jurisdictions have given the adverse-interest exception, see *infra* text accompanying notes 195–197.

[110] *See, e.g.*, Hill v. Gibson Dunn & Crutcher, LLP (*In re* ms55, Inc.), 338 B.R. 883, 897–99 (Bankr. D. Colo. 2006) (granting summary judgment in favor of law firm, finding that undisputed facts reflected "valid business purposes" were at least one motivation for the allegedly fraudulent transactions facilitated by law firm).

[111] *Kirschner*, 938 N.E.2d at 952 (explaining that the law presumes the agent will communicate all information to the principal except under the narrow circumstances of the adverse-interest exception where the principal is the agent's victim).

[112] Baena v. KPMG LLP, 453 F.3d 1, 8 (1st Cir. 2006) (explaining that the adverse-interest exception applies when the agent acts to serve himself or a third party, with "the classic example being looting"); *Kirschner*, 938 N.E.2d at 952 (describing the narrow exception as encompassing theft, looting, or embezzlement).

[113] Wechsler v. Squadron, Ellenoff, Plesent & Sheinfeld, L.L.P., 212 B.R. 34, 45 (S.D.N.Y. 1997) (asserting that the adverse-interest exception may be appropriate because the Trustee alleged that the law firm defendant failed to stop an agent's looting of the client, "which would appear to satisfy the requirement of a total abandonment of [the client's] interests").

[114] Center v. Hampton Affiliates, Inc., 488 N.E.2d 828, 829–30 (N.Y. 1985) (explaining that "the presumption that knowledge held by the agent was disclosed to the principal fails because he cannot be presumed to have disclosed that which would expose and defeat his fraudulent purpose").

[115] Oppenheimer-Palmieri Fund, L.P. v. Peat Marwick Main & Co., 802 F. Supp. 804, 817 (E.D.N.Y. 1992) (stating adverse interest does not apply "when the agent acts both for himself and the principal, though his primary interest is inimical to the principal"); Stewart v. Wilmington Tr. SP Servs., Inc., 112 A.3d 271, 303 (Del. Ch. 2015) (stating adverse-interest exception is inapplicable even when the "benefit" to the plaintiff is "outweighed by the long-term damage that is done when the agent's mischief comes to light").

company results in a finding that the exception does not apply.[116] For example, while conduct amounting to agent theft from the company is the one scenario in which the adverse-interest exception usually applies,[117] even in this context, courts can deny the exception by finding that some benefit accrued to the company. In *In re Scott Acquisition Corp.*, company agents received help from company lawyers in structuring sales of company assets to the agents at amounts substantially below their fair value, followed by the company leasing the assets back from the agents.[118] Company lawyers also acted on both sides of loan transactions between the company and insiders.[119]

When the Chapter 7 bankruptcy trustee sued the lawyers for malpractice and breach of fiduciary duty, the lawyers asserted *in pari delicto* and argued that the adverse-interest exception did not apply.[120] The lawyers asserted that the company received some benefit in that the money from the transactions "helped the [company] to pay down the [company's] debt . . . and also demonstrated the [i]nsiders' good faith belief in the long term viability of the [company]."[121] The court admitted that "[t]hese benefits may seem somewhat trivial considering the alleged grandiose benefits that the insiders received from the transactions."[122] Nonetheless, the court found these trivial benefits sufficient to make the adverse-interest exception inapplicable, reasoning that the exception only applies when "the

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[116] Alberts v. Tuft (*In re* Greater Se. Cmty. Hosp. Corp.), 353 B.R. 324, 368 (Bankr. D.D.C. 2006) (explaining that acts that are "ultimately injurious" to the company do not fall within the adverse-interest exception if they provide "an immediate benefit to the debtor at the expense of innocent third parties" and comparing the harm suffered by the debtor to the harm suffered by a robber who is imprisoned for his criminal misconduct as the "price of having enjoyed the temporary benefit of his ill-gotten gains").

[117] *Baena*, 453 F.3d at 8.

[118] Claybrook v. Broad & Cassel, P.A. (*In re* Scott Acquisition Corp.), 364 B.R. 562, 564 (Bankr. D. Del. 2007) (explaining that the insiders purchased the properties from the company at an amount just sufficient for the company to pay the lender, that shareholder approval was not requested, and that several insiders flipped the properties for substantial profit).

[119] *Id.* at 564–65.

[120] *Id.* at 568.

[121] *Id.*

[122] *Id.*

agent acts entirely in his or her own interest with no benefit to the principal."[123]

The analysis is even easier when company agents engage in misconduct on behalf of the company with the assistance of counsel.[124] The United States Court of Appeals for the Seventh Circuit's *Cenco* case is often cited for the proposition that "[f]raud on behalf of a corporation is not the same as fraud against it."[125] It follows that fraud on behalf of the company is never adverse to it.[126] Even when the conduct results in substantial liability for the company—as it typically does—the adverse-interest exception does not apply.[127]

The New York Court of Appeals rejected the idea that a client's ultimate bankruptcy amounts to harm for purposes of the adverse-interest exception. The court explained that harm from discovery of the fraud cannot be the proper test because "disclosure of corporate fraud nearly always injures the corporation."[128] The court reasoned that, "[i]f that harm could be taken into account, a corporation would be able to invoke the

[123] *Id.* (citing Official Comm. of Unsecured Creditors of Grumman Olson Indus., Inc. v. McConnell (*In re* Grumman Olson Indus., Inc.), 329 B.R. 411, 426 (Bankr. S.D.N.Y. 2005)).

[124] Alberts v. Tuft (*In re* Greater Se. Cmty. Hosp. Corp.), 353 B.R. 324, 368 (Bankr. D.D.C. 2006) (quoting 3 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OR PRIVATE CORPORATIONS § 829 (rev. ed. 2010)) (asserting that "[f]raud on behalf of a corporation is not the same thing as fraud against it" and explaining that the adverse-interest exception does not apply in cases in which there is some short term benefit to the corporation by the alleged misconduct).

[125] Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 456 (7th Cir. 1982).

[126] *Id.*; *see also AIG I*, 965 A.2d 763, 827 (Del. Ch. 2009) ("[I]n applying the *in pari delicto* doctrine, New York law does not embrace the notion that any conscious act of a fiduciary causing a corporation to break the law is against the corporation's charter and best interests.").

[127] *See, e.g.*, Cobalt Multifamily Inv'rs I, LLC v. Shapiro, 857 F. Supp. 2d 419, 434–35 (S.D.N.Y. 2012) (finding that legal malpractice claims against the Certilman law firm are barred under New York law because the client benefited from the fraud—that the firm facilitated—in that some of the funds raised by the fraud were used to pay promised returns to investors and the client retained some of the money raised through the fraud). The court refused to allow the receiver to re-plead, explaining that the receiver would have to allege the company "did not receive any benefit—inadvertent or otherwise—as a result of the . . . fraud," and that such an allegation would contradict the allegations of the original complaint. *Id.* at 440; *see also infra* notes 195–197 and accompanying text for discussion of claims that were allowed to proceed under Connecticut and New Jersey law against two other law firm defendants in the *Cobalt* case.

[128] Kirschner v. KPMG LLP, 938 N.E.2d 941, 953 (N.Y. 2010).

adverse-interest exception and disclaim virtually every corporate fraud . . . as soon as it was discovered and no longer helping the company."[129] It is only when the corporation is the intended victim, rather than the intended recipient, of the agent's fraudulent scheme that the law presumes the agent will not communicate all material information to the principal.[130]

This interpretation of the adverse inference exception fails to consider an attorney's legal obligations. Competent attorneys are bound to advise their clients' agents against both stealing from the company and stealing for the company.[131] Neither is in the company's long-term financial interest.[132] One creates liability from the agent to the company and one will result in liability for the company when it is discovered.[133] It is not the lawyer's proper role to bet on nondetection of liability-creating conduct or to weigh its possible benefits to a business entity client.[134] A

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[129] *Id.*

[130] *Id.* at 952.

[131] MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (AM. BAR ASS'N 2015) (requiring attorneys to protect the organization when an agent is engaged in conduct "that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization"); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) (AM. LAW INST. 2000) (obligating a lawyer to act in the best interest of the client when an agent "intends to act in a way that violates a legal obligation to the organization . . . or that reasonably can be foreseen to be imputable to the organization and likely to result in substantial injury to it").

[132] *See, e.g.*, Baena v. KPMG LLP, 453 F.3d 1, 5 (1st Cir. 2006) (noting that even though there is intuitive appeal to the suggestion that the only victims of corporate fraud are third parties, the company may also be a victim when we consider the long term consequences, as in cases like Enron). Anytime a company is engaged in conduct that creates substantial liability to third parties, the company will suffer harm when that liability is realized, owner value decreases, fines are incurred, and/or when the company is forced into bankruptcy. *See, e.g.*, *Kirschner*, 938 N.E.2d at 945–46, 948–49. The New York Court of Appeals describes the circumstances leading to suit in the two consolidated cases. In the first case, when the Refco fraud was revealed, the resulting harm was the company's bankruptcy for the company, precipitating the Litigation Trustee to file suit against the company's lawyers and others. *Id.* at 945–46. In the other case, AIG's fraud did not result in bankruptcy but instead, a reduction in stockholder equity, litigation and regulatory proceedings, and fines. This harm was the basis of the derivative suit filed by shareholders against AIG's auditor. *Id.* at 948–49.

[133] *See supra* note 131 and accompanying text.

[134] Schaefer, *Loyal Disclosure*, *supra* note 79, at 439–40. *Cf.* Pritchard, *supra* note 88, at 186. Pritchard asserts that whether fraud benefits a corporation "depends on how often the corporation gets caught." *Id.* While this may be true as an empirical matter, this view is inconsistent with a lawyer's legal and professional conduct obligations when representing an organizational client.

competent lawyer may not simply withdraw from the representation, but is obligated to take action to protect the company's interests in the face of agent misconduct that will create liability for the company.[135]

It is absurd that the adverse-interest exception protects lawyers from liability in the very situation that should trigger lawyer liability. As a fiduciary, a lawyer must protect an organizational client from an agent that orchestrates a fraudulent scheme to enrich the client.[136] But a narrow interpretation of the adverse-interest exception provides that as long as the fraudulent scheme was meant to enrich the organization, the organization is barred from suing the attorney who failed to protect it.[137] This is nonsensical.[138]

Courts have expressed a fear that a broader reading of the adverse-interest exception would allow those who stand in the shoes of the company in litigation "to enjoy the benefit of [miscreant agent] misconduct without suffering the harm."[139] But that argument misses three important points. First, even if the adverse-interest exception is expanded, the company is not off the hook. It will still have liability to third parties harmed by the misconduct.[140] The only question in expanding the adverse-interest exception is whether attorneys should escape liability for violating a duty to a client. Second, holding outside counsel responsible to the company for his or her role in misconduct is no different from holding company insiders responsible to the

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135 RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) cmt. f (explaining steps a lawyer may take to address an organizational client's agent's misconduct and noting that "a lawyer does not fulfill the lawyer's duties to the organizational client by withdrawing from the representation without attempting to prevent the constituent's wrongful act").

136 *See supra* notes 131–135 and accompanying text.

137 *See supra* notes 115–116 and accompanying text (citing cases in which the adverse-interest exception does not apply because agents were engaged in profitable illegal conduct).

138 Harris, *supra* note 20, at 632 ("[T]he problem with imputation analysis and the doctrine of adverse interest . . . in cases . . . against an organization's lawyers, is its logical corollary: even if aware of fraud or criminal wrongdoing within an organizational client, the lawyer would have no duty to take steps to prevent that conduct (or at least no liability for failure to fulfill that duty) as long as the wrongdoers intended, however misguidedly, to benefit the organization.").

139 Kirschner v. KPMG LLP, 238 N.E.2d 941, 959 (N.Y. 2010).

140 RESTATEMENT (THIRD) OF AGENCY § 7.03(2) (AM. LAW INST. 2006) (describing principal's vicarious liability to third party harmed by agent's conduct).

company for their role in the misconduct.[141] And third, holding an attorney responsible for his or her misconduct need not mean that counsel will bear the entire loss.[142]

C. The Sole-Actor Exception to the Adverse-Interest Exception

Courts recognize an exception to the adverse-interest exception when the agent who was engaged in misconduct and the company are one and the same.[143] Because the adverse-interest exception is based on the belief that an agent engaged in misconduct would not disclose that information to the organization,[144] the sole-actor exception recognizes that if there is no one in the organization from whom knowledge can be concealed, then the organization should be imputed with knowledge.[145] If there is identity between the agent and the company, then they are treated as one and the same.[146] In short, the sole-actor exception recognizes that imputation is not appropriate when an agent is stealing from the company except when the thief is the company's sole actor.

The sole-actor inquiry is about control. Once it has been established that the agent was acting adversely to the interests of the company, the debate in these cases turns to whether there was anyone else in control in the company that could have stopped the agent.[147] The company—or the party standing in its

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[141] *See supra* note 74 and accompanying text.

[142] *See infra* note 332 and accompanying text.

[143] Hagan v. Baird, 591 F. App'x 434, 441 (6th Cir. 2015) (refusing to apply the adverse-interest exception where "agent and principal are effectively one and the same, and in such a case, the agent's fraudulent conduct will be attributed to the principal"); Mediators, Inc. v. Manney, 105 F.3d 822, 827 (2d Cir. 1997) ("[W]here the principal and agent are one and the same, the adverse-interest exception is itself subject to an exception styled the 'sole[-]actor' rule.").

[144] *See supra* note 114 and accompanying text.

[145] Tolz v. Proskauer Rose LLP (*In re* Fuzion Technologies Grp., Inc.), 332 B.R. 225, 237–38 (Bankr. S.D. Fla. 2005) (explaining that in prior decisions, the sole-actor exception was applied when the agent was "either . . . the only sole shareholder, or had no one to whom he could impart his knowledge, or from whom he could conceal it").

[146] Reider v. Arthur Andersen, LLP, 784 A.2d 464, 472 (Conn. Super. Ct. 2001) (explaining that when the sole owner loots the company, it is fair to impute "the self-dealing conduct of the looter to the looted corporation").

[147] Cobalt Multifamily Inv'rs I, LLC v. Shapiro, No. 06 Civ. 6468(KMW)(MHD), 2009 WL 2058530, at *7 (S.D.N.Y. July 15, 2009) (explaining that the sole-actor rule can apply when multiple people control the corporation, when all of those people are involved in the fraud, and that the exception does not apply when the corporation

shoes—argues that there were other individuals who could have stopped the illegal conduct if they had been informed of it.[148] The law firm or other third party defendant argues that the company was completely controlled by the individuals engaged in the misconduct.[149]

It is inconsistent with the law of organizational attorney fiduciary duty that the "sole-actor" analysis only comes into play in the narrow circumstance of insiders stealing from the organizational client.[150] A lawyer is obligated to act competently to protect the organizational client from liability anytime an insider is engaged in misconduct, whether stealing from the company or stealing for the company.[151] If the company and the

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"has owners or managers who were innocent of the fraud and could have stopped the fraud if they had been aware of . . . it"); *Fuzion Technologies*, 332 B.R. at 239 (holding that under the sole-actor exception to the exception, imputation is prohibited "[i]f there was at least one honest officer, director, shareholder, or other insider who would have taken appropriate action to rectify the wrongdoing").

[148] *Fuzion Technologies*, 332 B.R. at 238 (explaining that the trustee argued that the sole-actor exception was inapplicable because certain directors and shareholders did not know about the agent's fraud and "could and would" have taken steps to end the fraud if they had been advised of it); Sharp Int'l Corp. v. KPMG LLP (*In re* Sharp Int'l Corp.), 278 B.R. 28, 38–39 (Bankr. E.D.N.Y. 2002) (denying motion to dismiss by auditor finding allegations of complaint regarding an innocent thirteen percent shareholder on the board who could have stopped the fraud sufficient to create question of whether the sole-actor rule was applicable).

[149] *Sharp Int'l Corp.*, 278 B.R. at 38 (explaining that the defendant argued that the complaint supported the applicability of the sole-actor exception by alleging the company had only three officers who "ran the company and had control over the fraudulent transactions.").

[150] Stated another way, it would be consistent with attorney fiduciary duty for the default rule to be no imputation of agent misconduct to the company for purposes of *in pari delicto*, whether stealing from or for the company, except when the agent is the company's "sole actor." Even then, this Article would define a company controlled by a sole actor—that is, one for which imputation is appropriate—in very narrow circumstances in which the company has no other innocent stakeholders that the lawyer could have protected. *See infra* notes 327–329 and accompanying text. This is a different interpretation of sole actor than courts that attempt to broadly define sole actor as an exception to the adverse-interest exception so that imputation is appropriate. *See, e.g.*, USACM Liquidating Tr. v. Deloitte & Touche, LLP, 764 F. Supp. 2d 1210, 1221 (D. Nev. 2011) (describing interpretations of sole actor within the no innocent decision-maker rule that allow a conclusion of sole actor—and thus, allow imputation—even when there were other decision makers in the company who lacked veto power).

[151] MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (AM. BAR ASS'N 2015) (requiring attorneys to protect the organization when an agent is engaged in conduct "that is a violation of a legal obligation to the organization or a violation of law that reasonably might be imputed to the organization"); RESTATEMENT (THIRD) OF THE

bad sole actor are one and the same, then imputation may be appropriate. Otherwise, imputation should not bar a claim against counsel regardless of the variety of agent misconduct.

D. Dismissal of Such Claims Protects the Sanctity of the Courts as Bodies That Do Not Mediate Disputes Between Wrongdoers

A stated policy underlying the *in pari delicto* doctrine is protection of the sanctity of the courts.[152] Courts refuse to participate in resolving disputes between wrongdoers in order to avoid becoming a party to the misconduct.[153]

It is ironic then that courts in business lawyer malpractice cases regularly and seriously give consideration to attorney arguments that a claim should be dismissed because counsel was facilitating beneficial illegal conduct.[154] This argument is necessary to avoid the adverse-interest exception, because if illegal conduct benefited the business in the short term, then agent conduct is imputed to the company and *in pari delicto* applies.[155] But of course it is also a violation of a lawyer's fiduciary duty to her client to have participated in illegal but

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LAW GOVERNING LAWYERS § 96(2) (AM. LAW INST. 2000) (obligating lawyers to act in the best interest of the client when an agent "intends to act in a way that violates a legal obligation to the organization . . . or that reasonably can be foreseen to be imputable to the organization and likely to result in substantial injury to it").

[152] Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985) (holding that one of two underlying grounds supporting the doctrine is "that courts should not lend their good offices to mediating disputes among wrongdoers").

[153] *Id.*

[154] *See, e.g.*, Baena v. KPMG LLP, 453 F.3d 1, 7 (1st Cir. 2006) ("A fraud by top management . . . is not in the long-term interest of the company; but . . . it profits the company in the first instance and the company is still civilly and criminally liable."); Cobalt Multifamily Inv'rs I, LLC v. Shapiro, No. 06 Civ. 6468(KMW)(MHD), 2009 WL 2058530, at *7 (S.D.N.Y. July 15, 2009) (finding that the adverse-interest exception is inapplicable where the corporation benefits to any extent from agents' fraud); Kirschner v. Grant Thornton LLP, No. 07 Civ. 11604(GEL), 2009 WL 1286326, at *6–7 (S.D.N.Y. Apr. 14, 2009) (determining that the adverse-interest exception does not apply because the illegal conduct was beneficial to Refco, and noting that "[i]ndeed, the gravamen of the Trustee's allegations is not that the insiders stole assets *from* Refco, but rather that the insiders' fraudulent scheme was to steal *for* Refco").

[155] *Shapiro*, 2008 WL 833237, at *7.

profitable misconduct.[156] So, rather than avoiding entanglement in misconduct, courts are using the violation of an attorney's duty as grounds for rewarding the attorney with a dismissal.

Dismissing an attorney malpractice claim is fundamentally different from dismissing a case against a "classic" co-conspirator. Take an example from the *AIG II* case.[157] AIG had conspired with the company General Reinsurance Corporation ("Gen Re") to make it appear that AIG had a legitimate insurance contract.[158] As a result of the transaction, AIG was able to report a fake $500 million increase in its insurance reserves and premiums, while Gen Re was paid $5 million for its part in the conspiracy.[159] When the conspiracy was uncovered, both companies faced substantial liability and AIG paid an $825 million settlement.[160] When AIG shareholders filed a derivative suit against Gen Re, the Delaware Court of Chancery explained that Delaware's *in pari delicto* doctrine barred the claim.[161] Concluding that no exception should apply to allow the claim, the court explained such exceptions would require courts to engage in inefficient accounting.[162] Because both conspiring parties had their own motives, neither is the victim and could assert claims against the other.[163] In sorting out such claims, "the court would have to look at each of the corporate wrongdoers, examine how, why, and through whom each committed illegal acts, and then come to some ultimate determination of how costs should be shifted among conspirators" and may devolve to the court determining "[which company] got more of the take from the scheme relative to its harms."[164]

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[156] 32 C.F.R. § 776.69 (2016).

[157] *AIG II*, 976 A.2d 872, 877 (Del. Ch. 2009).

[158] *Id.* at 879.

[159] *Id.*

[160] *Id.*

[161] *Id.* at 883 ("In applying the doctrine [under Delaware law], there is no doubt that under the general rule, AIG is barred from recovering against the Third-Party Defendants[, including Gen Re].").

[162] *Id.* at 893.

[163] *Id.*

[164] *Id.* at 894. In contrast, the Chancery Court explained that a claim against a lawyer or auditor for malpractice is more akin to a claim against an insider for breach of fiduciary duty to which *in pari delicto* is inapplicable. *Id.* at 889–90, n.49.

Unlike the AIG-type co-conspirator, a lawyer is engaged to provide a legitimate service: legal advice and assistance to an organizational client.[165] A legal malpractice claim relies upon allegations that the lawyer failed to act in a reasonably prudent manner and the client was harmed as a result.[166] Considering the merits of such a claim is not unseemly, as it would have been in looking at AIG's claim against Gen Re; it is what courts do in any legal malpractice case.[167]

By dismissing these legal malpractice claims without consideration, the courts are signaling that there are no consequences to lawyers for violating fiduciary duties to organizational clients.[168] Ironically, the application of *in pari delicto* in these cases makes courts participants in lawyer misconduct.

E. Denying Relief to Plaintiffs in Such Cases Deters Illegality

Courts also justify the *in pari delicto* doctrine on the ground that it deters illegal conduct.[169] Courts assert that applying the doctrine incentivizes businesses to use care in selecting and supervising agents.[170] One court explained that imputation for

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[165] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 (AM. LAW INST. 2000) (describing a lawyer's duties to a client as including advancing the client's lawful objectives, acting competently and diligently, fulfilling duties of loyalty, and fulfill valid contractual obligations).

[166] *Id.* § 48 (describing the elements of a claim against a lawyer for professional negligence).

[167] *Id.*

[168] Kirschner v. KPMG LLP, 938 N.E.2d 941, 960 (N.Y. 2010) (Ciparik, J., dissenting) (asserting that the majority's holding regarding application of the *in pari delicto* doctrine creates "a per se rule that fraudulent insider conduct bars any actions against outside professionals by derivative plaintiffs or litigation trustees for complicitous assistance to the corrupt insider or negligent failure to detect wrongdoing"); *see also* Michels, *supra* note 92, at 342 (describing the *Kirschner* decision as "effectively insulat[ing] attorneys from all liability [except in the case of theft from the client] for failure to report an executive's wrongdoing to higher-ups in the organization").

[169] Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985) (finding that one of two underlying grounds underlying *in pari delicto* is that "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality").

[170] *See* Goldin v. Primavera Familienstiftung, Tag Assocs., Ltd. (*In re* Granite Partners, L.P.), 194 B.R. 318, 328 (Bankr. S.D.N.Y. 1996) (asserting that denying relief to a wrongdoer through the *in pari delicto* doctrine deters illegal conduct); *Kirschner*, 938 N.E.2d at 951 ("The risk of loss from the unauthorized acts of a dishonest agent falls on the principal that selected the agent." (quoting Andre

purposes of applying *in pari delicto* recognizes "that principals, rather than third parties, are best-suited to police their chosen agents and to make sure they do not take actions that ultimately do more harm than good."[171]

The Seventh Circuit's analysis in the *Cenco* case is often relied upon for its deterrance analysis.[172] The court framed the issue as weighing two alteratives to determine which would have a greater deterrent effect on corporate fraud: allowing the company to shift the entire cost of fraud to a negligent auditor or not allowing such cost shifting.[173] The court admitted that holding a third party auditor liable for its negligence might cause it and firms like it to be "more diligent and honest in the future."[174] But the court went on to reason that if the company is allowed to shift the cost of wrongdoing "entirely to the auditor," that would reduce the incentive to hire honest managers and monitor their behavior.[175] Even though the court recognized that many shareholders do not play an active role in hiring and supervising managers, the court explained that the shareholders delegate this duty to the board and should bear responsibility when the board-selected managers commit fraud on behalf of the company.[176] While recognizing that the company and its shareholders may not ultimately be net beneficiaries of such

Romanelli, Inc. v. Citibank, N.A., 875 N.Y.S.2d 14, 15 (N.Y. App. Div. 2009))). *But see* Welt v. Sirmans, 3 F. Supp. 2d 1396, 1402 (S.D. Fla. 1997) (asserting that permitting a bankruptcy trustee to recover against debtor's former attorneys "would not send unqualified signals to shareholders that they need not be alert to managerial fraud since they may later recover full indemnification for that fraud from third party participants").

[171] *Kirschner*, 938 N.E.2d at 953.

[172] *See, e.g.*, *id.* (relying on *Cenco* for the proposition that "the presumption of imputation reflects the recognition that principals, rather than third parties, are best-suited to police their chosen agents and to make sure they do not take actions that ultimately do more harm than good" (citing Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 455 (7th Cir. 1982))).

[173] *Cenco*, 686 F.2d at 455 ("From the standpoint of deterrence, the question is whether the type of fraud that engulfed Cenco . . . will be deterred more effectively if Cenco can shift the entire cost of the fraud from itself . . . to the independent auditor who failed to prevent the fraud. We think not.").

[174] *Id.*

[175] *Id.*

[176] *Id.* at 455–56.

fraud, the court reasoned that shareholders should not be able to escape all responsibility by holding a third party—in this case, the auditor—responsible.[177]

There are two significant flaws in this deterrence analysis. First, the company—whether through shareholders, boards, or other managers, depending on the form of the entity—typically is not in a better position than company lawyers to monitor and stop illegal conduct by agents on behalf of the company.[178] It is the lawyer's role to know the law, to advise about conduct that could result in legal liability, and to seek out higher authorities in a company who will take the steps necessary to avoid liability by correcting course.[179] Shareholders, boards, and upper-level management are much less likely to have knowledge about company agents and their conduct than the participating lawyer.[180] In fact, those other groups are relying upon the lawyers to help them monitor the insiders.[181] So, as between shareholders and boards on one hand and attorneys on the other, attorneys are in the better position to deter misconduct if they have the incentive to do so.[182]

The second flaw is in framing the question as whether the company should be able to shift "all responsibility" to third party professionals.[183] Holding attorneys liable for their negligence

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[177] *Id.* at 456.

[178] Pritchard, *supra* note 88, at 197 ("[S]hareholders are not realistically in any position to monitor their managers' conduct toward third parties, and shareholders might well be willing to pay higher fees to accountants and lawyers who help ferret out fraud by the corporation."); DeMott, *supra* note 60, at 348–49 (discussing that organizational clients in these cases had contracted for "expert monitoring services that shareholders and directors lack expertise to provide").

[179] *See supra* notes 131–135 and accompanying text.

[180] *See supra* note 178.

[181] Michels, *supra* note 92, at 356 (acknowledging the rationale that imputation encourages principals to monitor agents, but noting the "irony of allowing this rationale to justify the wholesale rejection of a corporation's claims against their failed lawyer gatekeeper"); *see supra* note 178.

[182] Recent Case, Kirschner v. KPMG LLP*, 938 N.E.2d 941 (N.Y. 2010)*, 124 HARV. L. REV. 1797, 1802–03 (2011) (asserting that the *Kirschner* decision will not have the desired effect of deterring corporate wrongdoing because it denies recovery to the company who hired outside professionals to ensure legal compliance while immunizing professionals who were in a position to prevent wrongdoing).

[183] *See, e.g.*, Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 455–56 (7th Cir. 1982).

does not mean that the full responsibility for damages arising out of corporate fraud will be shifted to attorneys.[184]

Greater deterrence of illegal conduct could be accomplished by not permitting the *in pari delicto* defense in these cases. A lawyer, as a fiduciary, has an obligation to act competently and loyally to protect an organizational client from liability at the hands of misguided insiders.[185] If lawyers are never held accountable to their clients for failing to do so, there is little incentive to perform this difficult job.[186] Civil liability is a powerful enforcement mechanism.[187] The prospect of malpractice liability would give lawyers a strong financial incentive to fulfill fiduciary duties to their clients.[188]

Courts sometimes assert that lawyers already have adequate incentives to fulfill these duties. These incentives include potential suits by the victims of the fraud, the prospect of professional discipline, and the possibility of criminal liability.[189]

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[184] *See infra* notes 330–332 and accompanying text.

[185] *See supra* notes 75–86 and accompanying text.

[186] The lawyer-advisor's job is particularly difficult because of the strong pressure to please client decision makers. *See* Donald C. Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture, and Ethics of Financial Risk Taking*, 96 CORNELL L. REV. 1209, 1245 (2011) (describing the psychological risk involved in anxious-to-please lawyers " 'get[ting] comfortable' with what the client proposes"). In order to protect business clients from fraud liability, lawyers must not focus on technical compliance with some aspect of the law but rather upon moral intuition about whether clients are engaged in a misrepresentation that may amount to fraud. Eric C. Chaffee, *An Interdisciplinary Analysis of the Use of Ethical Intuition in Legal Compliance Decisionmaking for Business Entities*, 74 MD. L. REV. 497, 523–25 (2015) (describing how a lawyer's "[m]oral [i]ntuition [h]elps to [p]rotect [b]usiness [e]ntities").

[187] In contrast, if we conceptualize the attorney's duty to intervene to prevent serious misconduct as solely an ethical obligation to protect the public, then it is unlikely that lawyers will take the duty seriously because of the lack of consequences. *See* COFFEE JR., *supra* note 76, at 230 ("Academics with tenure are notoriously demanding of practitioners struggling to survive in competitive markets. But the overlooked problem with their prescription is its implementation. Ethical norms lack any meaningful mechanism for their enforcement, and bar associations are not about to take action against attorneys for failing to consider the public interest.").

[188] The *Cenco* court, which ultimately barred an auditor malpractice claim based on *in pari delicto*, acknowledged that allowing the claim to proceed would incentivize auditors to be "more diligent and honest in the future." *Cenco*, 686 F.2d at 455.

[189] *See, e.g.*, Kirschner v. KPMG LLP, 938 N.E.2d 941, 958 (N.Y. 2010) ("[A]n outside professional . . . whose corporate client experiences a rapid or disastrous decline in fortune precipitated by insider fraud does not skate away unscathed. In short, outside professionals—underwriters, law firms and especially accounting

This argument overlooks the rarity of these other forms of liability.[190] It also fails to recognize that civil liability would provide an added incentive for law firms—not just individual lawyers—to manage risk in this area, which may result in greater protection of business clients.[191] Finally, discipline, criminal liability, and civil liability to third parties do not compensate the victim of the lawyer's professional failing: the organizational client.[192] The client should be compensated for the harm caused by its fiduciary's failures, irrespective of the prospect of other liability for the lawyer.[193]

III. *IN PARI DELICTO* VARIATIONS: ARE THESE APPROACHES MORE CONSISTENT WITH BUSINESS ATTORNEY FIDUCIARY DUTY?

Some jurisdictions have taken a more flexible approach to *in pari delicto* in the context of business entity claims against attorneys and auditors who have failed to protect their business clients from liability.[194] Some jurisdictions have created new exceptions to the doctrine, while others have found the doctrine inapplicable against certain categories of plaintiffs. In exploring

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firms—already are at risk for large settlements and judgments in the litigation that inevitably follows the collapse of an Enron, or a Worldcom or a Refco or an AIG-type scandal.").

[190] *Id.* (noting that many third party professionals have settled suits with shareholders in the same cases, but the lawyers are not listed among those who settled). Of course, attorney Joseph Collins was convicted for his role in the fraud. *See supra* note 28 and accompanying text. Such convictions would have a deterrent effect on attorney participation in client fraud if they were not so rare.

[191] Law firms have civil liability exposure for their lawyers' malpractice, but do not face professional discipline. MODEL RULES OF PROF'L CONDUCT R. 8.4 (AM. BAR ASS'N 2014) (providing for discipline for lawyers, and not law firms); *see also* Vincent R. Johnson, *Legal Malpractice in a Changing Profession: The Role of Contract Principles*, 61 CLEV. ST. L. REV. 489, 492–93 (2013) (asserting that despite the existence of other attorney conduct enforcement mechanisms, discipline and malpractice suits "form the essential backbone of modern legal ethics").

[192] NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 887 (N.J. 2006) (allowing an auditor to escape liability for its negligence violates principles of fairness and does nothing to deter auditor wrongdoing in the future).

[193] It is a valid concern that uncapped exposure to liability may have negative implications for lawyers, auditors, and their clients. *See, e.g.*, *AIG I*, 965 A.2d 763, 828 n.246 (Del. Ch. 2009). However, there are ways to address these concerns short of insulating lawyers and auditors from malpractice liability.

[194] As in the prior Part, this Part also considers auditor cases in addition to lawyer cases. *See supra* notes 58–59 and accompanying text (explaining that the cases are analogous).

these and other variations, this Part considers whether these approaches are more consistent with attorney fiduciary duty than the stricter approach discussed above.

A. *Broader Reading of the Adverse-Interest Exception*

Some jurisdictions have interpreted the adverse-interest exception broadly enough to encompass conduct that only provides the "benefit" of temporarily extending the life of an insolvent company.[195] In other words, the agent misconduct will be treated as adverse to the company if temporary life support was the only benefit provided.[196] The impact of this exception will mean no imputation, and as a result, the possibility of liability for lawyers.[197]

Expanding the adverse-interest exception to include agent misconduct when the only benefit is temporarily delaying the company's death is more consistent with an attorney's obligations to act in the best interests of clients in the face of an agent's liability-creating conduct.[198] It recognizes that the client's cause of action against an attorney should not be foreclosed when the only benefit to the client was a meaningless one.

However, this exception misses the mark by not going far enough. For example, assume that a solvent company's agents seek an attorney's assistance defrauding third parties for the benefit of the company. Even though an attorney has a fiduciary duty to the company to protect it in this situation,[199] an attorney who instead facilitates the misconduct could successfully invoke the *in pari delicto* defense if sued for malpractice. Even if the jurisdiction employs an expanded adverse-interest exception like

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[195] Schacht v. Brown, 711 F.2d 1343, 1347–48 (7th Cir. 1983) (prolonging company's insolvency is a detriment to the company); Cobalt Multifamily Inv'rs I, LLC v. Shapiro, 857 F. Supp. 2d 419, 431–32 (S.D.N.Y. 2012) (explaining that under Connecticut and New Jersey law, the adverse-interest exception is available if the fraudulent conduct only extended the life of an insolvent company); *NCP Litig. Tr.*, 901 A.2d at 888 ("[W]e find that inflating a corporation's revenues and enabling a corporation to continue in business 'past the point of insolvency' cannot be considered a benefit to the corporation.").

[196] *Schacht*, 711 F.2d at 1348.

[197] *Cobalt Multifamily Inv'rs I, LLC*, 857 F. Supp. 2d at 435 (allowing the Receiver's claims to proceed against law firms under Connecticut and New Jersey law).

[198] *See supra* notes 131–135 and accompanying text.

[199] *See supra* notes 131–135 and accompanying text.

that described here, it would not apply in our hypothetical scenario because the fraud was not used merely to extend the life of an insolvent company.[200] Accordingly, this expansion is a step in the right direction, but does not fully address the issue.[201]

B. Bad Faith Exception

In *Official Committee of Unsecured Creditors of Allegheny Health Education & Research Foundation v. PricewaterhouseCoopers, LLP* ("*AHERF*"),[202] the Pennsylvania Supreme Court held that an agent's fraud will not be imputed to the principal in cases in which a third party does not deal in good faith with the principal.[203] In the case, AHERF's auditor Coopers & Lybrand ("C&L") allegedly colluded with AHERF's CFO to misrepresent the company's finances.[204] The court noted that public policy considerations should come into play in determining the availability of *in pari delicto* and acknowledged the competing policies at play.[205] The court explained the important role that imputation plays in protecting people who transact business with corporations.[206] From there, the court determined that imputation of agent misconduct is appropriate when the

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[200] *Cf. supra* note 195 and accompanying text.

[201] Another interpretation of the adverse-interest exception that is more consistent with attorney fiduciary duty is found in Colorado where the exception encompasses fraudulent conduct. *See* Okimoto v. Yougjun Cai, No. 13 Civ. 4494(RMB), 2015 WL 3404334, at *4 (S.D.N.Y. May 21, 2015) (acknowledging that Colorado extends the adverse-interest exception to include not only fraud and looting but also fraud related misconduct, such as agents making fraudulent misrepresentations in corporate filings). To the extent that this exception would still allow the imputation of profitable but illegal—but not fraudulent—misconduct of company agents, this exception is not fully aligned with the law of attorney fiduciary duty.

[202] 989 A.2d 313, 313 (Pa. 2010). In the case, the Pennsylvania Supreme Court accepted certification of two questions on petition of the Third Circuit of the U.S. Court of Appeals. *Id.* at 318.

[203] *Id.* at 339.

[204] *Id.* at 317 (describing how AHERF's CFO allegedly "knowingly falsified corporate finances" with the assistance of C&L agents who issued a "clean" audit despite their knowledge of the fraud, resulting in the AHERF board's deception to the detriment of AHERF).

[205] *Id.* at 330–31. The court concluded that the state does not agree with the degree to which the *Cenco* decision prioritizes "incentivizing internal corporate monitoring over the objectives of the traditional schemes governing liability in contract and in tort, including fair compensation and deterrence of wrongdoing." *Id.* at 332.

[206] *Id.* at 335.

third party acted in good faith, even if the third party was negligent.[207] Thus, *in pari delicto* would continue to be available in such cases.[208]

The court concluded that a different rule should apply in cases of collusion between auditor and company agent, because the justification for imputation—protecting third parties who rely on the agent's authority—is absent.[209] The court reasoned it would be "ill advised, if not perverse," to impute knowledge to the corporation when the auditor "actively and intentionally" prevented the corporation's governing body from receiving knowledge of the fraud.[210] The court asserted that its holding is supported by agency principles, arguing that such principles do not justify imputation when secretive, collusive activity occurred between auditor and agent.[211] Accordingly, the court held that "defensive imputation" is available to a defendant who dealt with the principal in good faith and is unavailable where the defendant "materially has not dealt in good faith with the principal."[212]

There is a principled reason to expand the imputation exception beyond cases of attorney bad faith. The *AHERF* court attempts to draw a line between cases when the third party professional should or should not be protected in his or her reliance upon agent authority.[213] The problem with this line drawing in the case of an attorney is that an attorney is never justified in relying upon the agent's authority to engage in misconduct on the company's behalf.[214] Whether the attorney is

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[207] *Id.* This is the appropriate outcome considering the principal's responsibility for empowering the agent and determining it does not undermine tort and contract law to deny recovery where the agent's culpability exceeded that of the defendant.

[208] *Id.*

[209] *Id.* at 336.

[210] *Id.*

[211] *Id.* at 337.

[212] *Id.* at 339; *see also* Kirschner v. K&L Gates LLP, 46 A.3d 737, 764 (Pa. 2012) (concluding that allegations that law firm favored interests of company CEO over that of the client during its investigation of CEO's alleged fraud amounted to an allegation of bad faith sufficient to overcome imputation under Pennsylvania law).

[213] *See supra* notes 206–212 and accompanying text.

[214] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) cmt. d (AM LAW INST. 2000) ("[A] lawyer is not bound by a constituent's instruction to a lawyer to . . . assist future or ongoing acts that the lawyer reasonably believes to be unlawful. Such an instruction also does not remove the lawyer's duty to protect the best interests of the organizational client.").

negligent in failing to report the agent's misconduct up-the-ladder or intentionally colludes with the agent to hide the misconduct from higher authorities in the company, the outcome is the same for the organizational client: the attorney has deprived the principal/client of information that the attorney had a legal obligation to provide.[215] In both cases—negligent conduct and intentional misconduct—the attorney had a duty not to allow the misguided agent to speak on behalf of the principal/client.[216] The attorney should have liability in both cases[217] and should find no shelter by imputing the insider's misconduct to the organizational client.

C. *The Innocent Decision-Maker Exception*

Some courts within the United States Court of Appeals for the Second Circuit have recognized an "innocent decision-maker" exception to the *in pari delicto* doctrine.[218] Courts applying this exception have refused to impute agent fraud to the company when there was at least one decision maker among the company's managers or shareholders who was both innocent of the misconduct and could have stopped it if he or she had been

[215] MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (AM. BAR ASS'N 2014) (describing professional conduct obligation to report agent misconduct up-the-ladder); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(3) (explaining the attorney's obligation to act in the best interests of the organizational client in the face of conduct that will cause substantial liability to or for the organization).

[216] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(3).

[217] *Id.* § 96, cmt. f (discussing whether a lawyer should have liability for failing to take appropriate measures to address constituent misconduct is judged by whether the attorney violated the duty of care—that is, whether the attorney acted with the competence normally exercised under similar circumstances by lawyers).

[218] Sharp Int'l Corp. v. KPMG LLP (*In re* Sharp Int'l Corp.), 278 B.R. 28, 36–39 (Bankr. E.D.N.Y. 2002) (refusing to dismiss case where plaintiff alleged presence of an innocent shareholder on the board with the ability to end the fraudulent activity); Sec. Inv'r Prot. Corp. v. BDO Seidman, LLP, 49 F. Supp. 2d 644, 651 (S.D.N.Y. 1999) (permitting plaintiff to re-plead to allege innocent manager who could have prevented fraud in auditor malpractice case); Wechsler v. Squadron, Ellenoff, Plesent & Scheinfeld, L.L.P., 212 B.R. 34, 36 (S.D.N.Y. 1997) (allowing plaintiff to amend complaint to allege existence of innocent member of management who could have prevented fraud if he had known of it); CEPA Consulting, Ltd. v. Touche Ross & Co. (*In re* Wedtech Secs. Litig.), 138 B.R. 5, 9 (Bankr. S.D.N.Y. 1992) (refusing to dismiss accountant malpractice case on basis that agents engaged in misconduct were not the company's sole shareholders).

made aware of it.[219] The Second Circuit has not had occasion to resolve the issue,[220] but has noted the possibility that the rule is an outgrowth of a misunderstanding about the sole-actor exception.[221] Outside of the Second Circuit, it does not appear that courts recognize such an exception.[222]

This innocent decision-maker exception aligns well with lawyer fiduciary duty. As noted earlier, lawyers have a duty to act prudently to protect an organizational client from liability.[223] One step toward fulfilling this obligation is reporting concerns of agent misconduct up-the-ladder to higher authorities in the organization.[224] This allows the innocent decision makers in the company to protect it from liability.[225] Even when company management refuses or fails to address the misconduct, professional conduct rules in some jurisdictions permit lawyers to protect entity clients by taking the additional step of revealing information outside of company management, such as to a shareholder who could pressure the company to address the issue.[226]

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[219] *Wechsler*, 212 B.R. at 36 (deciding that imputation is only appropriate if "*all* relevant shareholders and/or decisionmakers are involved in the fraud").

[220] CBI Holding Co., Inc. v. Ernst & Young, 529 F.3d 432, 447 (2d Cir. 2008) (finding the adverse-interest exception applicable and concluding it was unnecessary to address an innocent-insider exception); Bennett Funding Grp., Inc. v. Kirkpatrick & Lockhart LLP, 336 F.3d 94, 101 (2d Cir. 2003) (deciding it was unnecessary to resolve the legal issue of an innocent decision-maker exception because there was no innocent decision maker under the facts).

[221] *CBI Holding Co., Inc.*, 529 F.3d at 470 n.5.

[222] Baena v. KPMG LLP, 453 F.3d 1, 8–9 (1st Cir. 2006) (finding no authority for an innocent decision-maker exception under Massachusetts law); USACM Liquidating Tr. v. Deloitte & Touche, LLP, 764 F. Supp. 2d 1210, 1221 (D. Nev. 2011) ("To the extent some courts have fashioned an innocent[-]insider exception to imputation or in pari delicto, as opposed to the sole[-]actor rule, the Court concludes Nevada would not follow those decisions."); Cohen v. Morgan Schiff & Co., Inc. (*In re* Friedman's Inc.), 394 B.R. 623, 633–34 (Bankr. S.D. Ga. 2008) (noting that its decision does not turn on an innocent decision-maker exception to imputation).

[223] *See supra* notes 75–86 and accompanying text.

[224] *See supra* notes 75–86 and accompanying text.

[225] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96 cmt. f (AM. LAW INST. 2000) (describing steps the lawyer may take to protect the organization as including referring the matter to "someone within the organization having authority to prevent the prospective harm" or seeking intervention from the board or independent directors).

[226] 17 C.F.R. § 205.3(d)(2)(i), (iii) (2016); MODEL RULES OF PROF'L CONDUCT R. 1.13(c) (AM. BAR ASS'N 2015); *see also* Schaefer, *Loyal Disclosure*, *supra* note 79 (discussing that, when confidentiality rules do not prohibit disclosure, a lawyer's

When a lawyer does not give an innocent decision maker the opportunity to act, the lawyer has deprived the company of the opportunity to avoid liability. In this scenario, it is sensible that the lawyer should not be allowed to invoke the *in pari delicto* defense; even though some of its agents were involved in misconduct, other agents may have acted to protect it if they had been given the opportunity.[227]

Courts and commentators have dismissed the innocent decision-maker exception as a misunderstanding of the sole-actor exception to the adverse-interest exception.[228] They note that the innocent decision-maker exception is the flip side of the sole-actor exception—and the sole-actor exception only comes into play when an agent is stealing from the company and not when the agent is engaged in misconduct for the benefit of the company.[229]

A misunderstanding may very well be the origin of the innocent decision-maker exception.[230] Nonetheless, the innocent decision-maker exception achieves a result consistent with attorney fiduciary duty. It recognizes: (1) that both stealing from and stealing for the organizational client are against client interests, and (2) if the lawyer could have told an innocent decision maker who could have protected the client but did not,

fiduciary duty to organizational client obligates lawyer to disclose confidences when doing so will protect the organizational client).

[227] See *supra* notes 89–91 and accompanying text, for reasons why conduct should not be imputed to the organizational client under such circumstances. It is arguable that the existence of an innocent stakeholder—even one who has no management role and thus is not a decision maker—is grounds to avoid imputation. For additional discussion, see *infra* notes 328–329 and accompanying text.

[228] CBI Holding Co., Inc. v. Ernst & Young, 529 F.3d 432, 448 n.5 (2d Cir. 2008) (finding the district court judge's analysis of an innocent decision-maker exception "and its likely genesis as a product of courts' confusion regarding the relationship between the normal rule of imputation, the adverse[-]interest exception to that rule, and the sole[-]actor exception to be extremely persuasive"); Am. Int'l Grp., Inc. v. Greenberg, 965 A.2d 763, 825 (Del. Ch. 2009) (finding that the trend in New York is "strongly against" an innocent insider exception); Jonathan Witmer-Rich & Mark Herrmann, *Corporate Complicity Claims: Why There Is No Innocent Decision-Maker Exception to Imputing an Officer's Wrongdoing to a Bankrupt Corporation*, 74 TENN. L. REV. 47, 91 (2006) (arguing that the innocent decision-maker exception is a doctrinal error mischaracterizing the sole-actor exception and should be rejected).

[229] *CBI Holding Co., Inc.*, 529 F.3d at 447 n.5; *Am. Int'l Grp., Inc.*, 965 A.2d at 825; Witmer-Rich & Herrmann, *supra* note 228, at 91.

[230] The authorities cited at *supra* note 228 are certainly persuasive that this is the reason the exception developed. But the fact that the exception was arrived at through a misunderstanding does not undercut the fact that it is legally sound for the reasons explained here.

the lawyer has not fulfilled the duty owed to his or her organizational client.[231] As long as courts continue to categorize some agent misconduct as being in the company's interest,[232] courts will not recognize the logic of a broad innocent decision-maker exception. After all, what is the value of an attorney alerting an innocent decision maker in an effort to stop what may be considered beneficial misconduct?

D. Special Treatment for Claims Brought by Bankruptcy Trustees or Receivers

Section 541 of the bankruptcy code provides that the property of the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[233] Most courts have concluded that anyone standing in the shoes of the company is subject to all defenses against it at the time the case commenced—that is, those defenses that would have been good against the company—including *in pari delicto*.[234] However, a minority of courts have determined that bankruptcy trustees should not be subject to the *in pari delicto* defense, reasoning that it is equitable to allow the trustee to recover on behalf of the innocent creditors.[235]

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[231] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2), (3) (AM. LAW INST. 2000).

[232] *See supra* notes 115–130 and accompanying text (discussing courts' distinction between profitable and harmful illegal conduct).

[233] 11 U.S.C.A. § 541(a)(1) (West 2014).

[234] Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards, 437 F.3d 1145, 1150 (11th Cir. 2006) (noting that a claim subject to the defense of *in pari delicto* at commencement of bankruptcy is subject to the same defense when brought by the bankruptcy trustee); Official Comm. of Unsecured Creditors v. RF Lafferty & Co., Inc., 267 F.3d 340, 357 (3d Cir. 2001) (holding that § 541 expresses Congress's intent that the bankruptcy trustee have the same claims and be subject to the same defenses as the debtor at the commencement of the bankruptcy); Hill v. Gibson Dunn & Crutcher, LLP (*In re* ms55, Inc.), 338 B.R. 883, 893 n.4 (Bankr. D. Colo. 2006) ("Whether subjecting the bankruptcy trustee to an *in pari delicto* defense is good policy or bad, it is good bankruptcy law.").

[235] *See, e.g.*, Tolz v. Proskauer Rose LLP (*In re* Fuzion Techs. Grp., Inc.), 332 B.R. 225, 231 (Bankr. S.D. Fla. 2005). Two law review articles have influenced courts' debate about the wisdom of applying *in pari delicto* to bankruptcy trustees: Tanvir Alam, *Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How* In Pari Delicto *Has Been Perverted To Prevent Recovery for Innocent Creditors*, 77 AM. BANK. L.J. 305, 330 (2003) (asserting bankruptcy trustee should not be subject to *in pari delicto* because it is an equitable defense and the beneficiaries of the claim are innocent creditors), and Jeffrey Davis, *Ending the Nonsense: The* In Pari Delicto

Outside of the § 541 setting, some courts have determined that receivers, in various contexts, should not be subject to the *in pari delicto* defense on public policy grounds.[236] For example, in *Reneker v. Offill*, a Northern District of Texas court determined that a court-appointed special receiver in an SEC enforcement action should not be barred by *in pari delicto* from pursuing client AmeriFirst's legal malpractice claims.[237] The receiver asserted that the lawyers had committed malpractice by failing to properly advise AmeriFirst in offering securities for sale to the public, resulting in liability to third parties.[238] The law firm asserted that *in pari delicto* applied because two AmeriFirst agents were engaged in fraudulent conduct related to offering the securities.[239] The court did not impute the agents' conduct to AmeriFirst, reasoning that the distinction between agents and corporation is reinforced by appointment of a receiver and that *in pari delicto* would undermine the goal of the receivership, which is ultimately to turn over proceeds to the receivership estate for the defrauded investors and other innocent victims.[240]

Doctrine Has Nothing to Do with What Is § 541 Property of the Bankruptcy Estate, 21 EMORY BANKR. DEV. J. 519, 522 (2005) (arguing that as a matter of federal bankruptcy policy, *in pari delicto* should not bar claims brought by the bankruptcy trustee who is acting on behalf of innocent creditors). *See also* Marc S. Kirschner, In Pari Delicto *Doctrine in Lawsuits Against Third Parties After Failed Leveraged Buyouts*, 23 NORTON J. BANKR. L. & PRAC. ART. 2, at *6 (2014) (discussing public policy arguments favoring innocent trustees as representatives of creditors not being subject to the *in pari delicto* defense).

[236] *See, e.g.*, Scholes v. Lehmann, 56 F.3d 750, 754–55 (7th Cir. 1995) (finding that, in the context of fraudulent conveyance action, appointment of receiver removed the wrongdoer such that *in pari delicto* should not bar the claim); Klein v. Widmark, No. 2:11–cv–01097, 2015 WL 5038543, at *5 (D. Utah Aug. 26, 2015) (allowing receiver to pursue a fraudulent transfer claim without the bar of *in pari delicto*, reasoning that the recovered funds would not benefit the wrongdoer); Zayed v. Associated Bank, N.A., Civ. No. 13–232(DSD/JSM), 2015 WL 4635789, at *3 (D. Minn. Aug. 4, 2015) (denying motion to dismiss, reasoning that appointed receiver was not subject to *in pari delicto* defense). While the foregoing cases are not malpractice claims, they are relevant to the present Article because of the special treatment for receivers in bringing claims that would otherwise be barred by *in pari delicto*.

[237] No. 3:08–CV1394–D, 2012 WL 2158733, at *26–27 (N.D. Tex. June 14, 2012). "AmeriFirst" as used in this Article includes three separate AmeriFirst entities referred to in the court's opinion as the "AmeriFirst Clients." *Id.* at *1.

[238] *Id.*

[239] *Id.* at *26.

[240] *Id.* at *26–27.

While a bankruptcy trustee or receiver is innocent, he or she is not particularly special in this regard. The true plaintiffs in all of these cases are businesses,[241] all of which the lawyer should understand as having an interest in avoiding legal liability.[242] While some owner-agents of the business may have engaged in misconduct, other stakeholders may not have. Those who have not engaged in misconduct legitimately expect their investment in the business to be protected by all of its agents—inside managers and outside counsel alike.[243] So even though the business is appropriately held accountable to third parties for its agents' misconduct,[244] it does not follow that the business should be barred from pursuing claims against its agents—outside and inside—who caused it to suffer that liability.[245] At the end of the day, a trustee or receiver exception does not address the underlying problem: the mechanical application of agency principles in legal malpractice cases deprives every business of the ability to sue its outside counsel for malpractice.

E. No Imputation Against Innocent Claimants

In the case *NCP Litigation Trust v. KPMG LLP*,[246] the New Jersey Supreme Court considered whether a litigation trust, as successor to the corporation's claims, could bring a malpractice claim against an auditor who negligently failed to detect company fraud.[247] The fraud was related to the company's reported revenues and expenses; when the fraud was revealed,

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[241] *See supra* note 13–14 and accompanying text (describing who files suit on behalf of the businesses in these cases).

[242] Schaefer, *Loyal Disclosure*, *supra* note 79, at 423 (explaining that attorneys should understand that organizational clients have an interest in avoiding legal liability).

[243] RESTATEMENT (THIRD) OF AGENCY § 8.08 (AM. LAW INST. 2006) (stating that an agent has a duty to act with care, competence and diligence); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 52 (AM. LAW INST. 2000) (defining standard of care owed by attorney to client for purposes of a claim of professional negligence or breach of fiduciary duty).

[244] RESTATEMENT (THIRD) OF AGENCY § 7.03 (describing principal's liability for tortious acts of agent).

[245] *See supra* note 72 and accompanying text (explaining that the law has always allowed inside agents to be sued in this context).

[246] 901 A.2d 871 (N.J. 2006).

[247] The Trust alleged claims of "negligence, negligent misrepresentation, breach of contract, and breach of fiduciary duty." *Id.* at 876.

the company was forced to declare bankruptcy.[248] The court decided that the trustee should be allowed to pursue the cause of action, but that individuals who participated in or could have prevented the fraud should not be able to enjoy a recovery.[249] The court explained that imputing an agent's conduct to a principal makes sense in the context of protecting innocent third parties, such as a party who negotiates a contract with the company's agent, but that the rationale for imputation breaks down in the *in pari delicto* context.[250] This is because imputing the agent's conduct to the principal results in absolving the negligent auditor.[251] On this basis, the court held that a party who contributes to the misconduct—in this case, the auditor—cannot invoke imputation, so a claim can be brought for damages proximately caused by that party.[252]

Turning to the issue of whether the trust should be allowed to bring the claim, the *NCP* court rejected the United States Court of Appeals for the Seventh Circuit's application of Illinois law in the seminal *Cenco* case.[253] The *NCP* court noted that events in the twenty years since *Cenco* was decided indicate that auditors need to be more alert to corporate fraud and courts must take steps to address that fraud.[254] The court explained *Cenco's* concern with compensating agents who had participated in the fraud, but rejected the idea that the solution is to bar any recovery.[255] For this reason, the *NCP* court determined that only innocent shareholders should have a recovery and that imputation is appropriate to bar claims by shareholders who participated in the fraud, those who should have been aware of

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[248] *Id.* at 873.

[249] *Id.*

[250] *Id.* at 879–80. The court does not actually use the phrase *in pari delicto* but instead discusses imputation for purposes of determining if an auditor malpractice claim should be dismissed.

[251] *Id.* at 880. "Allowing KPMG to avoid liability for its allegedly negligent conduct would not promote the purpose of the imputation doctrine—to protect the innocent." *Id.* at 882.

[252] *Id.*

[253] *Id.* at 885.

[254] *Id.*

[255] *Id.*

the fraud because of their role in the company, and those who own a large enough block of stock that they have the ability to conduct oversight.[256]

The New York Court of Appeals recently rejected the *NCP* approach.[257] The New York court framed the issue as a dispute between innocent stakeholders of the company and innocent stakeholders of the outside professionals.[258] The court reasoned that the company's agents were more culpable than the outside professional's agents in most cases, and concluded the company's innocent stakeholders should not prevail over the professional's innocent stakeholders.[259]

The New York Court of Appeals' analysis overlooks the critical fact that the outside professional was hired by the company for the purpose of competently representing the company's interests.[260] If that professional failed to act competently and the company suffered damage as a result, the company's innocent owners can trace their injury to the conduct of the professional. It follows that the negligent professional should pay the client for the damage caused, and the innocent owners should enjoy their proportionate share of that recovery.[261] Even if the company's inside agents were more culpable than the outside professionals, that is not a justification for allowing the professionals to avoid being held accountable to the company.[262] As to why the innocent owners of a professional firm should suffer a loss via the professional firm's liability in this scenario,

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[256] *Id.* at 885–86.

[257] Kirschner v. KPMG LLP, 938 N.E.2d 941, 958–59 (N.Y. 2010).

[258] *Id.* at 958 ("[W]hy should the interests of innocent stakeholders of corporate fraudsters trump those of innocent stakeholders of the outside professionals who are the defendants in these cases?").

[259] *Id.* ("[T]he corporation's agents would almost invariably play the dominant role in the fraud and therefore would be more culpable than the outside professional's agents who allegedly aided and abetted the insiders or did not detect the fraud at all or soon enough.").

[260] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 (AM. LAW INST. 2000) (describing an attorney's duties to a client).

[261] *Id.* § 48 (discussing that a lawyer has liability to a client for professional negligence if the lawyer fails to exercise the competence and diligence normally exercised by lawyers in similar circumstances and that failure is the legal cause of the client's injury).

[262] Of course, fault could be apportioned between inside and outside professionals in the company's lawsuit against both groups. *See infra* notes 330–332 and accompanying text.

this is when basic agency principles should come into play. The professional firm is liable because its agent created liability for the firm while acting within the scope of his or her professional duties.[263]

The "innocent claimant" rule announced by the *NCP* court does not address some concerns, however. First, the plaintiff asserting a malpractice claim against a professional typically is either the client or a third party standing in the shoes of the client, such as a trustee or receiver, and not a third party who is not in privity with the professional, such as a shareholder of the client.[264] While a shareholder may ultimately receive any recovery by the client in a malpractice case, shareholders are not the plaintiffs in these actions. Yet, the *NCP* court does not explain how or why it would be appropriate to examine the misconduct of such shareholders separately for purposes of imputation.[265] Second, the court holds that noninnocents entitled to no recovery include "shareholders who engaged in the fraud . . . those who, by way of their role in the company, should have been aware of the fraud[, and those] . . . shareholders [who], by virtue of their ownership of a large portion of stock, have the ability to conduct oversight."[266] Even if it were possible to treat different shareholders differently for purposes of recovery,[267] it would not be consistent with the law of attorney fiduciary duty to prevent recovery to those shareholders who should have known about the misconduct and those who should have been able to conduct oversight because of their size.[268] An attorney who—

[263] RESTATEMENT (THIRD) OF AGENCY § 7.03 (AM. LAW INST. 2006) (describing principal's liability for tortious acts of agent).

[264] *See, e.g.*, *In re* MF Glob. Holdings Ltd. Inv. Litig., 611 F. App'x 34, 37–38 (2d Cir. 2015) (finding that claims brought on behalf of audit client's customers were properly dismissed because auditor cannot be sued for professional negligence except by client or someone with a relationship "so close as to approach that of privity"); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 48 (describing that a plaintiff in a professional negligence action is a person to whom a lawyer owes a duty of care). The professional's duty of care is owed to the client and not to owners of the client. *Id.* §§ 50, 51 (describing lawyer's duty of care to clients and a narrowly defined list of nonclients, which would not include owners of a client).

[265] NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 885–86 (N.J. 2006).

[266] *Id.* at 886.

[267] The dissent questions how thousands of such determinations would be made and calls the majority approach impracticable. *Id.* at 905 (Rivera-Soto, J., dissenting).

[268] *See supra* notes 75–86 and 91–92.

even negligently—failed to protect the company against agent misconduct should not be able to avoid paying those who should have known of the misconduct. It is the company's attorney these owners should have been able to rely upon in this regard.[269]

IV. THE CASE FOR ALIGNING THE *IN PARI DELICTO* DOCTRINE WITH ORGANIZATIONAL ATTORNEY FIDUCIARY DUTY

Following news of Enron and other high-profile corporate scandals in 2001, commentators asked, "Where were the lawyers?"[270] Why didn't lawyers stop fraudulent conduct by insiders and protect these companies from financial ruin?[271] Commentators rightly insisted the lawyers shared a measure of the blame for these cases of misconduct and the subsequent bankruptcies, but noted that lawyers were not held accountable.[272]

Sixteen years after Enron, not much seems to have changed.[273] Other companies have faced substantial liability and

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[269] *See supra* notes 75–86 and 91–92.

[270] Ashby Jones, *Where Were the Lawyers?*, WALL ST. J. (Jan. 2, 2007, 8:52 AM), http://blogs.wsj.com/law/2007/01/02/where-were-the-lawyers (stating that implicit in the question "[w]here were the lawyers?" in Enron era is the "assumption that lawyers . . . could have done more to keep their companies out of hot water"); *see also* Dan Ackman, *Enron's Lawyers: Eyes Wide Shut?*, FORBES (Jan. 28, 2002, 12:16 PM), http://www.forbes.com/2002/01/28/0128veenron.html (asserting that Enron attorneys Vinson & Elkins "asked few real questions, failed to talk to obvious key witnesses and then blessed Enron's treatment of controversial partnerships").

[271] Ackman, *supra* note 270.

[272] Julie Hilden, *Scummery Judgment: Why Enron's Sleazy Lawyers Walked While Their Accountants Fried*, SLATE.COM (June 21, 2002, 10:45 AM), http://www.slate.com/articles/news_and_politics/jurisprudence/2002/06/scummery_judgment.html ("[Y]ou would think Vinson & Elkins should be accountable because it was the firm retained by Enron to investigate Sherron Watkins' internal complaints. The law firm's investigation was inarguably a disaster for the company. But in the end, Enron got what they paid for—and thus it seems Enron, not V & E, should be faulted for the fact that the investigation did not go further than it did . . . .").

[273] Paul Lippe, *Volkswagen: Where Were the Lawyers?*, ABA J. (Oct. 13, 2015, 9:05 AM), http://www.abajournal.com/mobile/article/volkswagen_where_were_the_lawyers (asserting that if Volkswagen's lawyers had been "engaged enough" in the business to know about the software the company had installed in eleven million diesel cars to cheat emissions tests then they likely would have prevented it); Alice Woolley, *The Volkswagen Scandal: When We Ask "Where Were the Lawyers?" Do We Ask the Wrong Question?*, SLAW: COLUMN (Sept. 30, 2015), http://www.slaw.ca/2015/09/30/the-volkswagen-scandal-when-we-ask-where-were-the-lawyers-do-we-ask-the-wrong-question (stating that the "where were the lawyers" question suggests that lawyers can do better by preventing unlawful things from happening).

have been destroyed by fraudulent schemes of company insiders.[274] But lawyers have largely escaped liability to the clients they have harmed.[275] The *in pari delicto* doctrine is the reason. Even when lawyers fail to fulfill their duties to organizational clients, they are not held accountable because *in pari delicto* provides a complete defense.[276]

This has broad implications for the legal profession. Basic fiduciary duty principles dictate that an attorney should act as a competent, loyal lawyer would to protect an organizational client from agent misconduct that will result in liability—and often bankruptcy—when discovered.[277] Yet, the *in pari delicto* defense has been a roadblock to a robust body of case law developing in this area.[278] Decisional law could explain the contours of a lawyer's fiduciary duty and help lawyers and law firms develop best practices for addressing misconduct of an organizational client's agents.[279]

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[274] *See* Lippe, *supra* note 273 (regarding the Volkswagen emissions scandal and likely legal liability for the company).

[275] The Refco case provides an example. Joseph Collins engaged in criminal misconduct with his client's agents that ultimately bankrupted the client, yet the *in pari delicto* doctrine provided a complete defense to his client's legal malpractice action against Collins and his law firm. Kirschner v. KPMG LLP, 626 F.3d 673, 674, 677–78 (2d Cir. 2010) (affirming dismissal of malpractice claims against Mayer Brown on the ground that the adverse-interest exception does not apply).

[276] *Id.* at 678.

[277] FDIC v. O'Melveny & Myers, 969 F.2d 744, 749 (9th Cir. 1992) ("Part and parcel of effectively protecting a client, and thus discharging the attorney's duty of care, is to protect the client from the liability which may flow from promulgating a false or misleading offering to investors."); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2), (3) (AM. LAW INST. 2000); s*ee also supra* notes 75–86 and accompanying text.

[278] For example, the Restatement of the Law Governing Lawyers describes the lawyer's duty to act in the best interests of the organizational client in the face of insider conduct that will create liability to or for the client, but the notes to that section only cite a small number of cases that stand for that proposition. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) cmt. f (citing six cases that stand for the proposition that an attorney has a duty to protect the organizational client against wrongful acts by constituents). Even though there is such a duty, *in pari delicto* largely prevents such cases proceeding and resulting in reported decisions.

[279] Among other issues, such cases would reference expert testimony on the duty of a reasonably prudent attorney addressing insider crime and fraud. *See, e.g.*, FDIC v. Clark, 978 F.2d 1541, 1550–51 (10th Cir. 1992) (noting conflicting expert testimony on whether attorneys breached duty to client bank by failing to "ferret out" client's agent's fraud, that jury was properly instructed, and that adequate proof supported jury verdict of lawyer negligence). The development of such case

Without that body of case law or, more significantly, the prospect of liability, lawyers are unlikely to take the fiduciary duty to protect organizational clients seriously.[280] Saying no to a scheme to defraud third parties is difficult, as is up-the-ladder reporting and loyal disclosure.[281] Even though upholding these obligations can protect an organizational client from liability, lawyers risk losing a client by fulfilling these duties.[282] If there is no downside to lawyers turning a blind eye to, or even facilitating, agent misconduct, then lawyers will be disinclined to meet their legal obligations as fiduciaries.[283]

Deconstructing the pillars of the *in pari delicto* defense in business attorney malpractice cases reveals a great irony. The attorney's defense depends upon principles that are inconsistent with the attorney's legal duty to the organizational client. To fulfill a fiduciary duty to an organizational client whose agents are engaged in fraudulent or criminal conduct, a lawyer is required to disregard instructions of those agents and take steps—including advising against misconduct and up-the-ladder reporting—to protect the client from liability, without regard to

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law, including law in cases in which the fraud was intended to enrich the organizational client, would further the interests of the legal profession and organizational clients.

[280] Harris, *supra* note 20, at 638 (explaining that taking the entity theory of organizational client seriously means recognizing that the lawyer has a duty to prevent and/or limit the consequences of client crime or fraud); Hill & Painter, *supra* note 103, at 43 (asserting that malpractice law theoretically discourages incompetent legal advice—that is, advice that ignores the true meaning of the law and ultimately contributes to a company's bankruptcy—but that the *in pari delicto* doctrine makes it difficult to pursue these claims); *see also* TAMAR FRANKEL, TRUST & HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD 136–51 (2006) (describing the expectations of those who deal with fiduciaries and the adverse consequences of treating lawyers and other professionals not as fiduciaries but as businesses).

[281] *See, e.g.*, Rutheford B. Campbell, Jr. & Eugene R. Gaetke, *The Ethical Obligation of Transactional Lawyers To Act as Gatekeepers*, 56 RUTGERS L. REV. 9, 38–42 (2003) (discussing the financial disincentive to lawyers acting in the best interests of the organizational client).

[282] *Id.*

[283] Pritchard, *supra* note 88, at 192 ("The *Cenco* imputation rule invites fiduciaries to neglect their duty to ferret out fraud by corporate insiders because even if they are negligent, there will be no damages assessed against them for their malfeasance. A rule that is not backed by a monetary sanction is likely to have a very low rate of compliance.").

whether the conduct is profitable in the short run.[284] Ironically, a lawyer who negligently or intentionally ignores this obligation can invoke the *in pari delicto* defense knowing that courts will: (1) attribute an agent's misconduct to the organizational client, even where the lawyer took no steps, such as up-the-ladder reporting, to protect the client,[285] and (2) treat profitable illegal conduct as being in the company's interest.[286] It makes no sense that the very reasons the lawyer should face liability are the reasons lawyers are given a complete defense to liability.[287] And though it would be logical to do so, courts act as if refusing imputation in this context is akin to denying that gravity

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[284] MODEL RULES OF PROF'L CONDUCT R. 1.13(b) cmt. 3 (AM. BAR ASS'N 2015) ("When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. . . . Paragraph (b) makes clear, however, that when the lawyer knows that the organization is likely to be substantially injured by action of an officer or other constituent that violates a legal obligation to the organization or is in violation of law that might be imputed to the organization, the lawyer must proceed as is reasonably necessary in the best interest of the organization."); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) (AM. LAW INST. 2000) (stating that if a lawyer knows that a constituent of an organization intends to act in a way that violates an obligation to the organization or that will be imputed to the organization and likely to result in substantial injury to it, then "the lawyer must proceed in what the lawyer reasonably believes to be the best interests of the organization"); *id.* § 96(3) (describing steps lawyer must take in the interest of the client, including up-the-ladder reporting); *id.* § 96(3) cmt. d (explaining that an agent's instruction to the organization's lawyer to perform, counsel, or assist in an unlawful act does not bind the lawyer and "does not remove the lawyer's duty to protect the best interests of the organizational client").

[285] *See supra* notes 61–70 and accompanying text.

[286] *See supra* notes 108–130 and accompanying text. For example, in *Kirschner*, the court asserts that for the adverse-interest exception, we cannot find that the exception applies based on the harm that flows from the discovery of the fraud. The court asserts that "[i]f that harm could be taken into account, a corporation would be able to invoke the adverse-interest exception and disclaim virtually every corporate fraud—even a fraud undertaken for the corporation's benefit—as soon as it was discovered and no longer helping the company." Kirschner v. KPMG LLP, 938 N.E.2d 941, 953 (N.Y. 2010). But this is not an outrageous proposition that the company lawyer who is supposed to protect the organizational client from even profitable illegal conduct should have liability for failing to do so. *See supra* note 284 and accompanying text.

[287] A similar irony exists in the case of auditors' protection from malpractice liability. Shepard, *supra* note 100, at 326 (explaining that "it is only in those cases where the very thing auditors are retained to help guard against—fraud—exists that the *in pari delicto* defense has worked to immunize auditors from answering for their own potential wrongdoing").

exists.[288] Imputing agent conduct to a principal makes sense when a third party is injured by the acts of an agent,[289] but that does not mean these same principles should be applied for purposes of *in pari delicto*.

There are strong policy grounds for changing course from current *in pari delicto* precedent. Policy matters in the *in pari delicto* context. The United States Supreme Court has refused to apply *in pari delicto* when doing so undermines a policy that would be furthered by allowing a co-conspirator to bring a cause of action.[290] On this basis, the Court has found the doctrine should not bar claims of co-conspirator plaintiffs in the areas of securities law and antitrust law.[291] Likewise, other courts should refuse to apply the doctrine in this organizational attorney legal malpractice context. Here, the important public policy is that lawyers should have an incentive to act competently to protect

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[288] Stewart v. Wilmington Tr. SP Servs., Inc., 112 A.3d 271, 303 (Del. Ch. 2015) (describing imputation in the *in pari delicto* context as harsh to the innocent corporation, but "essential to the continued tolerance of the corporate form"); *Kirschner*, 938 N.E.2d at 950–51 (explaining why agent conduct should be imputed to principal and concluding that, "[i]n sum, we have held for over a century that all corporate acts—including fraudulent ones—are subject to the presumption of imputation"). *But see AIG I*, 965 A.2d 763, 828 n.246 (Del. Ch. 2009) (explaining that whether an auditor should face malpractice liability in such cases is a "policy judgment" and need not be answered by "some rote conflation of contextually different questions of agency").

[289] *See* RESTATEMENT (THIRD) OF AGENCY §§ 6.01–6.03, 7.03–7.08 (AM. LAW INST. 2006); *see also id.* ch. 2, intro. note ("This Chapter states . . . the three distinct bases on which the common law of agency attributes the legal consequences of one person's action to another person. . . . The three distinct bases for attribution are actual authority, apparent authority, and respondeat superior. . . . The legal consequences that these doctrines attribute to a principal are not consequences of agency doctrine itself but of other bodies of law."). Even the *Kirschner* court, which was rigid in its insistence upon relying upon imputation in the *in pari delicto* context, appears to recognize that advocates for a different rule are not suggesting that agency principles be jettisoned in this context. *See Kirschner*, 938 N.E.2d at 954 ("No one disputes that traditional imputation principles . . . should remain unchanged—indeed, are essential—in other contexts."); *see also* sources cited *supra* note 288.

[290] Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 311 (1985) (determining that *in pari delicto* should bar a co-conspirator's private securities fraud cause of action only if preclusion would not significantly interfere with the policy underlying federal securities laws and the co-conspirator bears at least substantially equal responsibility for the violation).

[291] *Id.* at 315 (determining that denying *in pari delicto* defense was appropriate to advance policy of protecting the investing public that underlies securities fraud law).

their organizational clients against the liability that flows from agents engaging in misconduct.[292] Only if the "co-conspirator"—that is, the company or its successor in interest—is allowed to bring this cause of action will that policy be advanced.[293] While courts have traditionally asserted that applying *in pari delicto* deters misconduct, that is not the case in this context. In fact, the opposite is true: allowing these legal malpractice cases to proceed would give lawyers an incentive to say no to the schemes of their clients' agents.[294] Further, reaching the merits of these cases will not amount to courts mediating disputes between wrongdoers.[295] Instead, it will bolster the reputation of the courts if they hold lawyers accountable for their roles in corporate client crime and fraud.[296]

The problem is more complicated than courts mistakenly relying on agency principles in these cases or being too rigid in following *in pari delicto* precedent. The decisions denying organizational clients a legal malpractice action reflect skepticism that lawyers are responsible for the damages suffered

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[292] A related benefit would be discouraging corporate crime and fraud. But the focus of the malpractice action itself is preventing harm to the corporate client that the lawyer was hired to serve competently.

[293] In the securities fraud context of the Supreme Court's *Bateman* decision, there are other possible avenues of enforcing securities fraud laws other than allowing those who participated in the misconduct to proceed as plaintiffs. Nonetheless, the Court determined that securities fraud policy was advanced by allowing plaintiffs who had traded on inside information to bring a securities fraud claim. *Bateman*, 472 U.S. at 315 (discussing the SEC's limited resources in detecting and pursuing claims of such fraud and concluding that allowing co-conspirator security fraud claims promotes the policy underlying securities fraud law). In contrast, in this context, only a so-called co-conspirator organizational client could bring a cause of action for legal malpractice against an attorney who did not act competently to protect it from legal liability. In other words, the public policy of attorneys acting competently to protect organizational clients from liability is furthered only if this cause of action is allowed, providing even stronger grounds than in Bateman for allowing such cases to proceed.

[294] *See supra* notes 185–193 and accompanying text. *Cf.* Shepard, *supra* note 100, at 337 (asserting that current application of the *in pari delicto* defense to auditors "as it relates to the very thing they were hired to help monitor eliminates a large incentive to do a good job").

[295] *See supra* notes 152–168 and accompanying text.

[296] Some may conclude that courts' refusal to hold lawyers accountable is evidence of the bias judges, as lawyers themselves, have in favor of lawyers. BENJAMIN H. BARTON, THE LAWYER-JUDGE BIAS IN THE AMERICAN LEGAL SYSTEM 2–3 (2013).

by clients in these cases.[297] For example, in *Kirschner*, the New York Court of Appeals asserts that a company suing its outside professionals for malpractice is akin to an injured robber suing the police or the singed arsonist suing the fire department.[298] But these are not fair comparisons.[299] Unlike the robber or the arsonist, the organizational client hired the lawyer for the purpose of competently representing its interests.[300] Even if some of the organization's agents believe it is in the company's interests to push the limits of the law, the lawyer knows—and is required to assure the insiders understand—that it is in the company's interest to avoid criminal and fraudulent conduct.[301]

[297] *Cf. supra* notes 1–2 and accompanying text. The *Kirschner* court relies on the *Cenco* court's statement that fraud on behalf of a corporation is different than fraud for it. Kirschner v. KPMG LLP 938 N.E.2d 941, 952–53 (N.Y. 2010) (citing Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 456 (7th Cir. 1982)). But an attorney is not allowed to view the world that way. An attorney is required to disregard the instructions of agents that want to commit fraud against it and for it. It is unsurprising that a court that takes this view would not impose liability on a lawyer who failed to protect an organizational client from liability stemming from fraud intended to enrich the client. *Kirschner*, 938 N.E.2d at 959. It is also predictable that lawyers share the view that they should not be liable for this failure. *See, e.g.*, Kelli M. Hinson et al., *Professional Liability*, 66 SMU L. REV. 1055, 1059–60 (2013) (describing a case in which a court refused to grant summary judgment in favor of lawyers on the basis of *in pari delicto* as "a cautionary tale of how courts sometimes step in and hold lawyers accountable when clients go bad"); Craig D. Singer, *When the Client Is a Fraud: Defending Professionals and Firms Following a Client's Misconduct*, 42 LITIG. J. 35, 38 (2015) ("[A] corporation charged with primary responsibility for fraud should not be permitted to recover against another party—the professional defendant—for damages caused by the professional's failure to stop the corporation's own fraud.").

[298] *See supra* note 22 and accompanying text.

[299] Another common description of the scenario is a client attempting to hold the lawyer accountable for failing to "ferret out" the client's fraud. This presumes that the lawyer never plays an active role in the misconduct in these cases, which of course, is contradicted by the facts of these cases. *See, e.g.*, *supra* note 28 and accompanying text (describing the active, criminal role Joseph Collins played in the Refco fraud that bankrupted the company). Further, even if the lawyer was only negligent in not detecting agents' fraudulent scheme, such negligence still violates a duty the lawyer was arguably hired to perform. Determining the appropriateness of recovery are more appropriately determined by a fact finder considering issues of duty and causation than by a judge dismissing on the basis of *in pari delicto*.

[300] *See generally* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 16 (AM. LAW INST. 2000) (listing duties to clients); *id.* § 94 (stating that a lawyer can have liability to a client for advising the client to violate duties to third parties when doing so violates the duty of care to the client).

[301] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96(2) (stating that a lawyer must act in the best interests of the client which is defined as protecting it from agent conduct that will "violate[] a legal obligation to the

Unlike the company's inside agents who are not experts in law, the company's lawyer is obligated to advise about the risks of such liability, to advise against such conduct again and again through increasingly higher authorities if necessary and perhaps even outside of the company, and to refuse to participate in such behavior.[302] When competent lawyers take these steps, companies can avoid substantial liability and their destruction. When a lawyer fails to act competently in this regard, either by negligence or through intentional participation in insider misconduct, the lawyer should be accountable to the company whose legal interests a competent lawyer would have protected.[303]

Once courts recognize a lawyer's legal obligation to an organizational client, they should be willing to align the application of the *in pari delicto* doctrine with attorney fiduciary duty. Such an alignment would be accomplished with the following formulation: agent conduct will not be imputed to the organizational client for purposes of *in pari delicto* when an organizational client[304] alleges that its lawyer failed to act competently[305] to protect the organization against committing a

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organization" or that is "imputable to the organization and likely to result in substantial injury to it"); FDIC v. O'Melveny & Myers, 969 F.2d 744, 748 (9th Cir. 1992) (asserting that the presence of client fraud does not cancel the attorney's duty of care); *see also* Schaefer, *Loyal Disclosure*, *supra* note 79, at 423 (explaining that attorneys are obligated to treat organizational clients as having an interest in avoiding legal liability).

[302] *See supra* notes 75–86 and accompanying text. With no realistic threat of legal malpractice liability, there is little incentive for lawyers to wrestle with whether they are competently advising their corporate clients about the serious liability consequences of contemplated transactions. *See* Hill & Painter, *supra* note 103, at 46 (describing situations in which lawyers advise and facilitate organizational client misconduct—and liability—because the lawyers focus on technical compliance with particular laws and loopholes).

[303] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS §§ 48, 49 (AM. LAW INST. 2000) (discussing a lawyer's liability to the client for professional negligence or breach of fiduciary duty that is the legal cause of client injury); *see also* Harris, *supra* note 20, at 658 ("[I]f one sees the proper role of a transactional lawyer for an organization as including vigilance for the proper, legal conduct of the organization's business within the scope of her engagement, it is natural that the lawyer should be liable when failure to reasonably fulfill that role results in harm to her client.").

[304] This rule would also apply to a successor in interest to an organizational client.

[305] An allegation that an attorney did not act competently is generally described as a cause of action for professional negligence or malpractice. RESTATEMENT OF THE LAW GOVERNING LAWYERS § 48 (AM. LAW INST. 2000) (discussing failure to exercise

crime or fraud,[306] and that failure was the legal cause of the client's injury, such as liability or bankruptcy.[307] This formulation effectively aligns both bodies of law by not imputing agent conduct to organizational client under circumstances when the attorney would not be allowed to do so.[308] Ultimately, this formulation allows plaintiffs the opportunity to present their case that a reasonably competent attorney would have protected the organizational client, irrespective of any explicit undertaking to do so.

Professor Kevin Michels has suggested a "gatekeeper-imputation exception" that would provide for no imputation of agent conduct to the corporate client in a legal malpractice case if (1) the lawyer agreed to undertake an investigation or monitoring role; or (2) if there is an implied obligation to investigate and monitor that can be "derived from certain ethics rules, such as RPC 1.13 or . . . RPC 2.1, and statutory provisions (such as the Sarbanes Oxley reporting requirements) which require the attorney to undertake specific investigation or reporting efforts in carefully delimited instances."[309] Professor Michels asserts, "[I]t seems that something more than the duty of care alone should be required to imply [an investigating and monitoring] duty" and that "ethics rules that are roughly analogous to the duty of care that attaches to all representations, such as the duty of competence and communication requirements of RPC 1.1 and RPC 1.4, respectively, should not, standing alone, trigger the gatekeeper imputation exception."[310] In contrast, the formulation suggested in this Article is based on the understanding that a lawyer's fiduciary duties of care and loyalty

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care which is defined as the competence and diligence normally exercised by lawyers under the circumstances). The allegation could also or alternatively be that the attorney breached fiduciary duty or contractual obligations to the organizational client in failing to protect it from liability. *Id.* §§ 49, 55(1); *see also supra* note 6 (explaining ways that the cause of action could be framed).

306 Such failures could include failing to report misconduct up-the-ladder, failing to advise against illegal conduct, and even intentionally participating in such conduct. *See supra* notes 75–86 and accompanying text.

307 Causation and damages are elements of a claim for professional negligence and breach of fiduciary duty. *See* RESTATEMENT OF THE LAW GOVERNING LAWYERS § 53 (AM. LAW INST. 2000).

308 *See supra* notes 284–286 and accompanying text.

309 Michels, *supra* note 92, at 363–64.

310 *Id.*

impose an obligation to protect an organizational client from liability at the hands of agents.[311] Professional conduct rules are not the original source of a duty to act competently and loyally to protect the organizational client from liability. Rather, the professional conduct rules are reflective of fiduciary duties owed to an organizational client.[312] The formulation suggested in the present Article would provide plaintiffs the opportunity to present, through expert testimony, evidence that a reasonably prudent, loyal lawyer would have taken steps to protect the organizational client under the circumstances presented in a given case, irrespective of a specific undertaking to do so and regardless of whether a specific professional conduct rule addresses the issue.[313]

As a result of the change in the law of imputation suggested in this Article, the *in pari delicto* doctrine could not be invoked by lawyers to seek dismissal, judgment on the pleadings, or summary judgment on the basis that company agents were participants in misconduct.[314] In most situations, these cases would proceed to trial and an attorney would defend by presenting evidence that the attorney did not breach duties to the organizational client or that any such breach did not cause damages to the client.[315] Just as in any other malpractice case, the client—or successor—and lawyer would rely upon expert testimony regarding what a reasonably prudent lawyer should

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[311] *See supra* notes 75–86 and accompanying text. *But see supra* note 278 and accompanying text (acknowledging that little case law explains this obligation because the *in pari delicto* defense has barred pursuit of claims for breaching the duty).

[312] *See supra* notes 82–85 and accompanying text; *see also* Simon, *supra* note 80, at 503 (asserting that fiduciary duty owed to the organizational client is even broader than that described in Model Rule 1.13(b), but that the rule is sometimes mistakenly interpreted as stating the full extent of the lawyer's obligation in the face of agent misconduct).

[313] *See infra* note 316 and accompanying text.

[314] As a matter of civil procedure, prior to trial, courts must accept the truth of the allegations of a complaint. FED. R. CIV. P. 12(b)(6), 12(c), 56. Under the proposed change in the law, proof satisfactory to the finder of fact would be the only route to a defense victory based on imputation. See *infra* notes 327–329 and accompanying text, for scenarios in which such proof could be established.

[315] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS §§ 48, 49 (AM. LAW INST. 2000) (describing elements of proof for claims of professional negligence and breach of fiduciary duty).

have done under the circumstances.[316] Taking away *in pari delicto* does not guarantee a finding of malpractice under these facts, but simply provides the opportunity for the client or its successor to prove its case.[317]

This doctrinal approach—of not presumptively imputing agent conduct to principal for purposes of *in pari delicto* in such cases—is preferable to other efforts to limit the breadth of the defense. Expansion of the adverse-interest exception[318] and creation of a bad faith exception[319] do not get to the heart of the issue: it is not appropriate or fair to impute agent conduct to the principal if it was the attorney's obligation to protect the principal from that agent.[320] While the innocent decision-maker exception could ultimately accomplish the same goal as refusing imputation,[321] it is unnecessarily complicated in that the default rule would still be imputation,[322] and would be subject to doubt because of its origin of arising out of a misunderstanding of the

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[316] RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 52, cmt. g (alleging professional negligence or breach of fiduciary duty ordinarily introduces expert testimony on the standard of care); *see, e.g.*, FDIC v. Clark, 978 F.2d 1541, 1550–51 (10th Cir. 1992) (noting conflicting expert testimony on the issue of whether attorneys had breached duty of care to bank client in how attorneys handled client's agent's fraud and determining adequate evidence supported jury's verdict against attorneys). This is an example of how the law of attorney fiduciary duty can address new problems in the representation of entity clients by referring to core values of competence and loyalty. *See* Tamar Frankel, *Fiduciary Law in the Twenty-First Century*, 91 B.U. L. REV. 1289, 1290 (2011) ("Fiduciary law can accommodate new situations . . . yet maintain its core values and norms.").

[317] Thus, it is not the all-or-nothing proposition posed by some commentators. *See, e.g.*, Pritchard, *supra* note 88, at 198–99 (asserting that shareholders may prefer the *Cenco* imputation rule, which would bar a professional negligence cause of action, because "putting professionals on the hook for negligently failing to uncover . . . 'fraud' " would cause attorneys to refuse representations now that the boundaries of fraud have become murkier). But the issue is not whether lawyers should always or never have liability when they fail to protect against client fraud. The question is whether liability should be a possibility or should always be prohibited based on imputation. Allowing the possibility of liability seems a more sensible solution if we want lawyers to fulfill their fiduciary duties to organizational clients.

[318] *See supra* Section IV.A.

[319] *See supra* Section IV.B.

[320] *See supra* notes 89–90 and accompanying text.

[321] *See supra* Section IV.C.

[322] *See supra* note 218 and accompanying text.

law.[323] In all of these cases, chipping away at imputation through exceptions is not as sensible as refusing imputation on a principled basis in the first instance.

Further, allowing only so-called innocents, namely bankruptcy trustees or receivers,[324] or the innocent ultimate claimants to any recovery,[325] to pursue claims without the bar of *in pari delicto* disregards the fact that the organization itself is an innocent in this context. The organizational client has an interest in avoiding liability at the hands of its agents and hires a lawyer to further this interest.[326] If fiduciary duty law is to effectively impose this conception of organizational clients upon lawyers, it is essential that organizational clients be allowed to pursue these claims.

The question remains whether there is a possible factual scenario in which agent knowledge or conduct should be imputed to the organizational client for purposes of *in pari delicto*. For example, if the facts reveal that company's lawyer took concerns of liability-creating conduct up-the-ladder to the highest authority in the company but those individuals still insisted upon engaging in the misconduct with counsel's assistance,[327] should the lawyer be allowed to invoke *in pari delicto*? The answer should turn on whether the entity has innocent stakeholders. As long as someone with a stake in the company has an interest in the company avoiding legal liability, then the company's lawyer should not be allowed to escape liability through imputation of agent knowledge to the entity.[328] In contrast, if the solvent

[323] *See supra* note 228 and accompanying text.

[324] *See supra* Section IV.D.

[325] *See supra* Section IV.E.

[326] *See supra* notes 87–88 and accompanying text.

[327] In this scenario, the lawyer has arguably violated the standard of care by participating in client misconduct, but has informed the company's highest authority of the potential for liability, thus providing the basis for an argument that the client had knowledge of and participated in the misconduct. *Cf. supra* notes 91–92 and accompanying text (arguing that it is unfair to impute agent conduct to principal when lawyer did not fulfill duty of up-the-ladder reporting).

[328] *See supra* note 88 and accompanying text (explaining the significance of innocent stakeholders); *see also* Harris, *supra* note 20, at 643 (summarizing duties of lawyer who becomes aware of agent crime or fraud for solvent and insolvent organizations); *id*. at 646 (asserting that agent conduct should not be imputed to organizational client to bar a cause of action against attorney in the case of a solvent organization unless either "wrongdoing representatives were 100 percent owners of the organization," or the lawyer disclosed information about the wrongdoing to all

company is truly the "evil zombie" or alter ego of fully informed agent-owners, imputation for purposes of *in pari delicto* is arguably appropriate.[329]

Abandoning imputation in most cases—and the resulting loss of the *in pari delicto* defense—does not mean that the lawyers must bear the full responsibility for organizational client misconduct.[330] Organizations and their successors already have the ability to pursue claims against the insiders who played a role in the misconduct.[331] Whether these insiders are sued in separate cases or as part of the same case, fact finders should be asked to assess the damages each agent caused to the company and hold the lawyer accountable only for his or her share.[332]

CONCLUSION

Sometime soon, another corporate scandal will break and the public will ask, "Where were the lawyers?" The honest answer to that question should embarrass the legal profession. Lawyers

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affected stakeholders who agreed further disclosure was unnecessary, while in the case of in insolvent organization, imputation would only be appropriate if the lawyer disclosed the misconduct "to affected parties outside of the organization").

[329] Freeman v. Dean Witter Reynolds, Inc., 865 So. 2d 543, 551 (Fla. Dist. Ct. App. 2003) ("In this case, NorthAmerican was controlled exclusively by persons engaging in its fraudulent scheme and benefitting from it. NorthAmerican was not a large corporation with an honest board of directors and multiple shareholders, suffering from the criminal acts of a few rogue employees in a regional office. It is clear from the allegations of the amended complaint that it was created by the Grazianos to dupe the customers. This corporation was entirely the robot or the evil zombie of the corporate insiders.").

[330] This has been a frequent argument against abandoning *in pari delicto*. *See, e.g.*, Kirschner v. KPMG LLP, 938 N.E.2d 941, 957 (N.Y. 2010) ("This case reduces down to whether, and under what circumstances, we choose to reinterpret New York common law to permit corporations to shift responsibility for their own agents' misconduct to third parties.").

[331] *See supra* note 72 and accompanying text.

[332] There is some appeal to framing the issue as one that can be resolved through the law of comparative fault applicable in the vast majority of U.S. jurisdictions. Johnson, *Unlawful Conduct*, *supra* note 104, at 78–79 (asserting that unlawful conduct defenses, including *in pari delicto*, are inconsistent with "the strongest trend in modern American tort law" of comparing fault rather than focusing solely on the plaintiff's fault as in former contributory fault systems). However, there is dissonance in imputing the insiders' conduct to the client for purposes of comparative fault but not for purposes of *in pari delicto*. Even without asking a jury to compare fault of the "organizational client" and lawyer, it seems workable for a jury to award to the client only the damages proximately caused by the lawyer's breach and not by the breach of any other agent.

are fiduciaries who owe their clients duties of competence and loyalty. If lawyers would uphold these duties, many business scandals could be prevented. But there is no real incentive for lawyers to get it right. The reason is the *in pari delicto* doctrine.

The *in pari delicto* defense depends on a great irony. The facts that should trigger liability for the lawyer—that the lawyer did not act reasonably to stop insider misconduct aimed at enriching the entity client—are the basis for the lawyer's defense. This is because the *in pari delicto* doctrine imputes agent conduct to the principal in the very circumstance when a competent, loyal lawyer is supposed to stop listening to company agents. In short, the lawyer's failure becomes his salvation. The client cannot sue the lawyer because the lawyer did not do his job.

The law of *in pari delicto* should be aligned with attorney fiduciary duty. Doing so would mean that in most cases, agent misconduct would not be imputed to the organizational client. This change would result in the business client or its successor having a fair opportunity to pursue a claim against its lawyer for legal malpractice. This would further the interests of business clients and the legal profession. When attorneys know their fiduciary duty is not just theoretical but a possible basis of liability, they will have an incentive to protect their business clients from misguided agent conduct.