NOTES

CONWAY, IN PARI DELICTO, AND THE ADVERSE INTEREST EXCEPTION: BORROWING FROM THE ENGLISH

*Harish Sai Bhaskar**

Two recent scandals spotlighted corporate fraud: the recent Wirecard scandal, which revealed €1.9 billion of missing corporate cash, and FTX's bankruptcy scandal. Those incidents raised questions about the blameworthiness of professional third parties—lawyers, auditors, and banks, among others—who repeatedly fail to protect large public corporations from corporate fraud and misconduct. Professional third parties often are not held accountable because they can rely on the in pari delicto defense, completely shielding them from liability. Under in pari delicto, which disallows a wrongdoer from benefiting from their own wrongdoing, a corporate officer or director's fraud or corporate misconduct is imputed to the corporation. Thus, the corporation—including shareholders, liquidators, trustees, or others standing in the corporation's shoes—cannot recover from professional third parties.

The adverse interest exception mitigates in pari delicto's harshness, but it is traditionally narrow: It only applies when an agent has "totally abandoned" a principal's interest. Yet a recent New York Appellate Division decision, Conway v. Marcum & Kliegman, *signals increased judicial receptiveness to relax in pari delicto. This relaxation opens the door to holding professional third parties responsible and liable for failing to prevent the very conduct they were hired to monitor.*

This Note compares in pari delicto to the analogous English doctrine of illegality. It argues that English doctrine better encourages adherence to the gatekeeping duties owed by professional third parties. It finally recommends incorporating the English approach into in pari delicto case law by expanding the well-known fiduciary duty exception under in pari delicto to professional third parties.

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INTRODUCTION

The Wirecard scandal—a revelation that corporate cash worth €1.9 billion was missing and that one of the largest accounting firms in the world, Ernst & Young (EY), failed to notice—rocked the financial world in 2020, with some experts dubbing the scandal the "Enron of Germany."[1] More recently, FTX's bankruptcy has sparked public interest in the failure of the company's auditors and lawyers to prevent its collapse.[2] These scandals have reminded the world of the infamous WorldCom and Enron bankruptcies plaguing the 2000s.[3] Both then and now, commentators underscore the blameworthiness of professional third parties—lawyers, auditors, and banks, among others—who failed to protect these corporations from fraud and misconduct.[4] Despite failing to guard against corporate misconduct, professional third parties often are not held accountable.[5] The scandals bring again into sharp focus the

1. Ryan Browne, 'The Enron of Germany': Wirecard Scandal Casts a Shadow on Corporate Governance, CNBC (June 29, 2020), https://www.cnbc.com/2020/06/29/enron-of-germany-wirecard-scandal-casts-a-shadow-on-governance.html [https://perma.cc/5X7D-5DCW].

2. See Stephen Foley, FTX Collapse Puts Its Auditors in the Spotlight, Fin. Times (Nov. 13, 2022), https://www.ft.com/content/930c6cea-5457-4dfa-9d47-666c0698c335 (on file with the *Columbia Law Review*) ("The collapse of FTX has thrown a spotlight on two US accounting firms that the cryptocurrency exchange said it had used to audit its books."); Justin Wise, FTX Bankruptcy Law Firm Is Wrong Fit for Role, Senators Say (1), Bloomberg L. (Jan. 10, 2023), https://news.bloomberglaw.com/business-and-practice/ftx-bankruptcy-law-firm-is-wrong-fit-for-role-four-senators-say (on file with the *Columbia Law Review*) (noting Senators John Hickenlooper, Thom Tillis, Elizabeth Warren, and Cynthia Lummis's concerns over "'significant questions about [FTX's counsel Sullivan & Cromwell's] involvement,' including whether [the firm] suspected fraud at FTX," in their letter to the judge overseeing FTX's bankruptcy).

3. See Browne, supra note 1 (remembering that "Siemens was hit by a corruption scandal in the late 2000s, while Volkswagen's reputation was significantly damaged by the so-called 'Dieselgate' emissions scandal in 2015"). WorldCom's and Enron's bankruptcies were among the most notorious. See, e.g., 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, 47 (2006) (describing the Enron and WorldCom bankruptcies and convictions of high-level Enron and WorldCom officers on securities and accounting fraud charges).

4. See Paula Schaefer, In Pari Delicto Deconstructed: Dismantling the Doctrine that Protects the Business Entity's Lawyer From Malpractice Liability, 90 St. John's L. Rev. 1003, 1049 (2016) (pointing out that "lawyers shared a measure of the blame" for Enron and other scandals but "were not held accountable" and that lawyers are still not held accountable as of 2016); see also Dan Ackman, Enron's Lawyers: Eyes Wide Shut?, Forbes (Jan. 28, 2002), http://www.forbes.com/2002/01/28/0128veenron.html (on file with the *Columbia Law Review*) (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"); Ashby Jones, Where Were the Lawyers?, Wall St. J. (Jan. 2, 2007), http://blogs.wsj.com/law/2007/01/02/where-were-the-lawyers (on file with the *Columbia Law Review*) (stating that implicit in the "[w]here were the lawyers?" question in the Enron era is the "assumption that . . . lawyers could have done more to keep their companies out of hot water").

5. See Schaefer, supra note 4, at 1049–50; see also Julie Hilden, Scummery Judgment: Why Enron's Sleazy Lawyers Walked While Their Accountants Fried, Slate (June 21, 2002), http://www.slate.com/articles/news_and_politics/jurisprudence/2002/06/scummery_judgment.html [https://perma.cc/UB3U-PMP3] ("[Y]ou would think Vinson & Elkins should be accountable because it was the firm retained by Enron to investigate

role of professional third parties in protecting against company fraud.[6] At a time when public appetite has resurged in demanding accountability against these parties,[7] claims against them—often brought on behalf of the corporation or its bankruptcy representative, shareholders, or creditors—are a means to call such professionals to account.[8]

Professional third parties, however, wield the traditionally powerful shield that is in pari delicto (or *in pari delicto potior est conditio possidentis* in full): "[W]here parties are equally at fault, the defending party is in the stronger position."[9] A wrongdoer—namely, the corporation to whom its corporate officers' misconduct is imputed—cannot "seek[] redress against another alleged wrongdoer."[10] Instead, "the plaintiff should not . . . recover, and parties should be left where they are [because

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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 . . . ."). More recently, the Volkswagen scandal on cheating diesel emissions tests similarly attracted scrutiny of its lawyers walking away. See Paul Lippe, Volkswagen: Where Were the Lawyers?, ABA J. (Oct. 13, 2015), https://www.abajournal.com/legalrebels/article/volkswagen_where_were_the_lawyers (on file with the *Columbia Law Review*) (asking whether Volkswagen's lawyers knew of its engineers manipulating tests to avoid emissions standards and arguing that there should be a duty to know "what's going on"); Alice Woolley, The Volkswagen Scandal: When We Ask "Where Were the Lawyers?" Do We Ask the Wrong Question?, Slaw (Sept. 30, 2015), https://www.slaw.ca/2015/09/30/the-volkswagen-scandal-when-we-ask-where-were-the-lawyers-do-we-ask-the-wrong-question/ [https://perma.cc/AD95-YWBA] ("[The 'where were the lawyers' question] rests on the premise . . . that . . . lawyers can prevent unlawful things from happening.").

6. See Olaf Storbeck, EY Audit Failings on Wirecard Laid Bare in 'Dynamite' Report, Fin. Times (May 21, 2021), https://ft.com/content/68c699dc-7427-4c24-a57e-0980fb1371ec (on file with the *Columbia Law Review*) (pointing out that a German parliamentary special investigative report found that EY audits suffered from "serious shortcomings").

7. See id. (discussing the demands by German Members of Parliament to release the special investigative report on EY's failures). A recent securities fraud class action lawsuit filed in the Eastern District of Pennsylvania demanded accountability from EY for "fail[ing] to audit Wirecard in accordance with applicable auditing principles" such that statements "about Wirecard's business, operations, and prospects, were materially false and misleading and/or lacked a reasonable basis at all relevant times." See Complaint at 19, Brown v. Wirecard AG, No. 2:20-cv-03326-AB (E.D. Pa. July 7, 2020), 2020 WL 3816192.

8. See Christine M. Shepard, Note, Corporate Wrongdoing and the In Pari Delicto Defense in Auditor Malpractice Cases: A New Approach, 69 Wash. & Lee L. Rev. 275, 277 (2012) (sketching the "not-uncommon scenario" involving "creditors and shareholders of [a company whose stock price plummets and which eventually goes bankrupt] want[ing] to recover their losses from . . . the auditor who negligently performed [the company's] audit"); cf. Schaefer, supra note 4, at 1035 (arguing that "[i]f lawyers are never held accountable to their clients for failing to [act competently and loyally,] there is little incentive to perform this difficult job").

9. Ross v. Bolton, 904 F.2d 819, 824 (2d Cir. 1990) (citing In Pari Delicto Potior Est Conditio Possidentis, [Defendentis], Black's Law Dictionary (4th ed. 1968)); see also Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985) ("In a case of equal or mutual fault . . . the position of the [defending] party . . . is the better one." (alterations in original) (quoting In Pari Delicto Potior Est Conditio Possidentis [Defenditis], Black's Law Dictionary (5th ed. 1979))).

10. Shepard, supra note 8, at 278.

of] . . . the principle that to grant plaintiff relief would contravene the public good by aiding one to profit from [their] own wrong."[11] For example, the wrongdoing of Enron's officers—who are agents of the corporation—would be imputed to Enron. Enron itself would thus be deemed to have wronged. In pari delicto would hence disallow claims by Enron—or Enron's shareholders or bankruptcy representatives standing in its shoes—against Enron's lawyers for failing to protect against Enron's officers' corporate misconduct.

In pari delicto is an absolute bar to otherwise good claims, completely shielding professional third parties from liability.[12] Numerous exceptions, however, mitigate its harshness, the most pervasive among these being the traditionally narrow "adverse interest" exception.[13] The adverse interest exception, however, only applies when the agent has "*totally abandoned* [the] principal's interest."[14] Hence, the exception has been criticized for providing too little respite to shareholders and creditors.[15] Interestholders in succession,[16] like shareholders and creditors, are often in a far worse position than attorneys, auditors, or banks to supervise the conduct of a corporation's officers. Indeed, "the nature of today's corporations makes it increasingly unlikely that shareholders of large corporations have the ability to effectively monitor the actions of corporate officials."[17]

Numerous suggestions have been put forth to address in pari delicto's harshness[18] but with little uptake from courts.[19] The recent New York

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11. *Ross*, 904 F.2d at 824.

12. See Schaefer, supra note 4, at 1004 (noting, in the context of suits against attorneys, that "[w]hen 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" (emphasis omitted)).

13. See id. at 1006 (describing the adverse interest exception, "an exception to imputation when the agents acted adverse to the company's interests," as a "narrow one inapplicable when agents engaged in misconduct for the company's benefit").

14. Kirschner v. KPMG LLP, 938 N.E.2d 941, 952 (N.Y. 2010) (emphasis added by the New York Court of Appeals) (quoting Center v. Hampton Affiliates, Inc., 488 N.E.2d 828, 830 (N.Y. 1985)).

15. See, e.g., Schaefer, supra note 4, at 1027 (describing it as "absurd that the adverse-interest exception protects lawyers from liability in the very situation that should trigger lawyer liability"); Shepard, supra note 8, at 286 (suggesting that "reliance on the adverse interest exception by those attempting to defeat the in pari delicto defense is misplaced" (emphasis omitted)).

16. The phrase "interestholders in succession" refers to those parties standing in a corporation's shoes when bringing an action against professional third parties. The interestholders include shareholders, creditors, liquidators, or trustees.

17. NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 886 (N.J. 2006); see also infra section II.A.3.

18. See, e.g., Kevin H. Michels, The Corporate Attorney as "Internal" Gatekeeper and the In Pari Delicto Defense: A Proposed New Standard, 4 St. Mary's J. on Legal Malpractice & Ethics 318, 363 (2014) (proposing a gatekeeper imputation exception providing for no imputation of corporate manager misconduct to a corporation if

Appellate Division decision of *Conway v. Marcum & Kliegman LLP*,[20] however, signals increased judicial receptivity to better align in pari delicto with the gatekeeping duties professional third parties undertake.[21]

Juxtaposed against the American approach lies the English approach. In England and Wales, courts confronted with analogous corporate misconduct cases involving professional third parties rely on the illegality doctrine.[22] Illegality is also known as the Latin maxim *ex turpi causa non oritur actio*: "[N]o cause of action may be founded upon an immoral or illegal act";[23] "[n]o Court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act."[24] The fundamental motivation behind ex turpi causa resembles U.S. courts' justification for in pari delicto: "[A] plaintiff should not be permitted to recover damages that arise from his or her own illegal or immoral conduct."[25]

Since 2016, English law has departed starkly from prior approaches, adopting the revolutionary and flexible "trio of considerations" approach to illegality.[26] When deciding whether the illegality defense applies, English law seeks to "preserve the integrity of the justice system[,] . . . tak[ing] into account the impact that a successful application of the illegality defence will have on the 'true victim' of the wrongdoing."[27] This Note argues that *Conway* presents, in American law,

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attorneys expressly or impliedly undertook an obligation to investigate or monitor the corporation); Schaefer, supra note 4, at 1056 (proposing an alignment of in pari delicto with attorney fiduciary duty); Shepard, supra note 8, at 327 (suggesting a solution that involves measuring corporate fault through information gathering and reporting systems in place to deter and detect fraud).

19. See Schaefer, supra note 4, at 1054 (noting how courts are "too rigid in following in pari delicto precedent" (emphasis omitted)).

20. 110 N.Y.S.3d 695 (App. Div. 2019).

21. See infra section II.A.4.

22. See, e.g., Singularis Holdings Ltd. v. Daiwa Cap. Mkts. Eur. Ltd. [2019] UKSC 50, [2]–[9], [2020] AC 1189, 1197–98 (appeal taken from Eng.) (concerning a suit against a bank for breaching its duty not to pay out funds where it had reasonable grounds to believe that a fraud was being carried out when the bank had complied with the company's director's instructions); Stone & Rolls v. Moore Stephens [2009] UKHL 39, [1]–[2], [2009] 1 AC 1391, 1398 (appeal taken from Eng.) (concerning a suit against an auditor for negligently failing to detect a corporate director's dishonest activities using the corporation, closely resembling *Singularis*).

23. Revill v. Newbery [1996] QB 567 at 576 (appeal taken from Eng.).

24. Holman v. Johnson (1775) 98 Eng. Rep. 1120, 1121; 1 Cowp. 341, 343 (Eng.).

25. Lincoln Caylor & Martin S. Kenney, In Pari Delicto and Ex Turpi Causa: The Defence of Illegality—Approaches Taken in England and Wales, Canada and the US, 18 Bus. L. Int'l 259, 260 (2017).

26. See Patel v. Mirza [2016] UKSC 42, [101], [2017] AC 467, 499–500 (appeal taken from Eng.) (noting the three factors—the underlying purpose of prohibiting the claim, the effect that denying a claim would have on the effectiveness of other public policies, and the possibility of overkill—to be considered).

27. Caylor & Kenney, supra note 25, at 259.

an analogous pivotal moment. With increased judicial receptiveness, in pari delicto too can transform to align itself with the gatekeeping owed by professional third parties and promote compliance with those duties.

This Note demonstrates that the English approach better promotes professional third parties' compliance with their professional duties than predominant American approaches. It recommends incorporating the English approach into in pari delicto case law by expanding the well-known fiduciary duty exception to encompass professional third parties.[28]

Part I first provides an overview of in pari delicto and the adverse interest exception in the United States.[29] It illustrates traditional in pari delicto using New York as an example[30] and then discusses three shortcomings of traditional in pari delicto.[31] Part II explores a range of alternative approaches to corporate misconduct by professional third parties. First, in section II.A, it presents three divergent approaches by leading jurisdictions seeking to address the difficulties with traditional in pari delicto—Delaware, Pennsylvania, and New Jersey.[32] It also discusses their limitations. Next, section II.A discusses how *Conway*'s expansion of the adverse interest exception showcases increased judicial receptivity to align gatekeeping duties with in pari delicto.[33] It also illustrates *Conway*'s limitations in not providing guidance on how the adverse interest exception applies beyond *Conway*'s facts.[34] Section II.B then compares in pari delicto against illegality doctrine in England and Wales. After a brief discussion of prior approaches,[35] it discusses the emergence of the trio of considerations approach in *Patel v. Mirza*.[36] Finally, section II.C illustrates the English trio of considerations approach's application in corporate misconduct cases in *Singularis Holdings Ltd. v. Daiwa Cap. Mkts. Europe Ltd.*[37] It shows how the trio of considerations approach, by aligning illegality with professional third parties' gatekeeping duties to protect against corporate misconduct, reflects the advantages professional third parties enjoy in monitoring corporate agents as against shareholders and creditors.[38] Part III illustrates how the English approach emerges superior to American approaches to in pari delicto by explicitly aligning

28. See infra sections III.C–.D.

29. See infra section I.A.

30. See infra section I.A.

31. See infra section I.B.

32. See infra sections II.A.1–.3.

33. See infra section II.A.4.

34. See infra section II.A.4.

35. See infra sections II.B.1–.2.

36. [2016] UKSC 42, [2017] AC 467 (appeal taken from Eng.); see also infra section II.B.3.

37. [2019] UKSC 50, [2020] AC 1189 (appeal taken from Eng.); see also infra section II.C.

38. See infra section II.C.

liability of professional third parties to the gatekeeping duties they undertake explicitly or impliedly in monitoring and guarding against corporate misconduct. It then argues that the fiduciary duty exception—which allows corporations to sue their fraudulent or negligent corporate officers—should be expanded to include professional third parties.

I. In Pari Delicto—The Background

This Part describes the U.S. in pari delicto doctrine, its adverse interest exception, and some shortcomings of the doctrine. Section I.A sets out in pari delicto and its adverse interest exception as it has developed in the United States. As an example, New York applies traditional in pari delicto by adopting the most restrictive approach in *Kirschner v. KPMG LLP*.[39] Section I.B then sets out three primary reasons why *Kirschner* and traditional in pari delicto more generally have been criticized. First, traditional in pari delicto makes an unprincipled distinction between a corporation's officers and professional third parties.[40] Second, professional third parties are often under a duty precisely to protect against corporate misconduct.[41] Finally, professional third parties are in a far better position than shareholders to monitor corporate officers' conduct.[42] Therefore, allowing professional third parties to escape liability when corporate misconduct takes place unduly shields professional third parties from liability.

A. *Traditional In Pari Delicto: Imputation and the Adverse Interest Exception, and* Kirschner

In pari delicto precludes liability on the grounds that a wrongdoer cannot seek redress against another wrongdoer.[43] When professional third parties defend against claims by a corporation or interestholders in succession seeking to recover lost assets from corporate misconduct, they invoke in pari delicto as a defense. The individual corporate officers engaging in misconduct are agents of the principal corporation, and "an agent's knowledge gained in the course of an agency relationship is imputed to the principal" under agency law.[44]

39. See infra section I.A.

40. See infra section I.B.1.

41. See infra section I.B.2.

42. See infra section I.B.3.

43. See supra text accompanying notes 9–11.

44. Mark J. Loewenstein, Imputation, the Adverse Interest Exception, and the Curious Case of the Restatement (Third) of Agency, 84 U. Colo. L. Rev. 305, 306 (2013). The Third Restatement of Agency says:

> For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is

Imputation generally promotes the ability of corporations to conduct business through agents. Third parties dealing with the agent rather than a principal can safely assume that information possessed by an agent binds the principal.[45] Moreover, with corporations, third parties have no choice but to deal with an agent.[46] Imputation thus enables third parties to deal with corporations in confidence that an agent's knowledge automatically binds her corporation.[47]

Further, proper risk allocation justifies why an agent's knowledge should automatically bind a principal. As a principal selects an agent,[48] they too can "monitor the agent and . . . create incentives for properly handling information," ensuring that the principal is informed of information that the agent possesses.[49] Thus, imputing knowledge of corporate misconduct to corporations under agency law results in the liberal application of in pari delicto. This operates harshly against corporations, their shareholders, and their creditors.

The adverse interest exception, however, mitigates the harshness of imputation under in pari delicto.[50] The exception arises where an agent "acts adversely to the principal in a transaction or matter, intending to act solely for the agent's own purposes or those of another person."[51] In such circumstances, the principal is the agent's intended victim:[52]

> imputed to the principal if knowledge of the fact is material to the agent's duties to the principal, unless the agent
>
> (a) acts adversely to the principal as stated in § 5.04, or
>
> (b) is subject to a duty to another not to disclose the fact to the principal.

Restatement (Third) of Agency § 5.03 (Am. L. Inst. 2006).

45. Loewenstein, supra note 44, at 307.

46. Anytime an individual deals with a corporation, she can only deal with it through a corporation's officers, who are its agents. See, e.g., Kirschner v. KPMG LLP, 938 N.E.2d 941, 950 (N.Y. 2010) ("Corporations are not natural persons. '[O]f necessity, [they] must act solely through the instrumentality of their officers or other duly authorized agents.'" (alterations in original) (quoting Lee v. Pittsburgh Coal & Mining Co., 56 How. Pr. 373, 375 (N.Y. Super. Ct. 1877), aff'd, 75 N.Y. 601 (1878))).

47. Loewenstein, supra note 44, at 307.

48. See Shepard, supra note 8, at 281 ("The principal selects, monitors, and controls his agents.").

49. Loewenstein, supra note 44, at 307 n.1; see also Off. Comm. of Unsecured Creditors of Allegheny Health, Educ. & Rsch. Found. v. PricewaterhouseCoopers, LLP (*AHERF*), 989 A.2d 313, 335 (Pa. 2010) ("[T]he underlying purpose of imputation . . . is fair risk-allocation, including the affordance of appropriate protection to those who transact business with corporations."); Restatement (Third) of Agency § 5.03 cmt. b; Shepard, supra note 8, at 280–81 ("[T]he principal is in a better position to bear the risk that his agent . . . will not convey knowledge the agent receives on his behalf . . . because of the internal relationship between principal and agent. The principal selects, monitors, and controls his agents.").

50. See supra note 13 and accompanying text.

51. Restatement (Third) of Agency § 5.04.

52. Kirschner v. KPMG LLP, 938 N.E.2d 941, 951 (N.Y. 2010).

"[W]hen an agent is engaged in a scheme to defraud [her] principal[,] . . . [s]he cannot be presumed to have disclosed that which would expose and defeat [her] fraudulent purpose."[53] Classic examples of acting solely for an agent's own purposes or those of another include outright theft, looting, or embezzlement from the corporation itself.[54] In such circumstances, the fraud is committed "against a corporation rather than on its behalf."[55] Thus, imputation cannot take place.[56] The adverse interest exception thus is a choice to reflect the risks corporations undertake in choosing agents to act on their behalf when balancing the rights of third parties against those of corporations.

The New York Court of Appeals decision of *Kirschner v. KPMG LLP* illustrates traditional in pari delicto.[57] Criticisms against *Kirschner* would thus equally apply to traditional in pari delicto.

Kirschner was triggered by Refco's collapse—an event which arose out of its executive officers orchestrating a series of loans that hid hundreds of millions of dollars of the company's uncollectible debt.[58] Refco's Litigation Trust trustee initially brought actions in Illinois state court against investment banks serving as underwriters, Refco's executives' law firms, and accounting firms employed by Refco.[59] These lawsuits were then removed to federal court and transferred to the Southern District of New York for coordinated or consolidated proceedings.[60] On the question of standing, the district court relied on the *Wagoner* doctrine.[61] *Wagoner* does not allow a bankrupt corporation, or any interestholder in succession standing in the bankrupt corporation's shoes, to recover against a third party for damage to the corporation's creditors, if the bankrupt corporation joined with the third party in defrauding its creditors.[62] State substantive law on in pari delicto, however, determines whether an exception to *Wagoner* applies.[63] As the parties agreed that New York law "determine[d] the availability of the adverse interest exception to the *Wagoner* rule," upon appeal the Second Circuit certified to the New York Court of Appeals questions concerning the district

53. Id. (quoting Center v. Hampton Affiliates, Inc., 488 N.E.2d 828, 829 (N.Y. 1985)).

54. Id. at 952.

55. Id. (emphasis omitted).

56. Id.

57. See id. at 950.

58. Id. at 945.

59. Id. at 946.

60. Id.

61. See Kirschner v. KPMG LLP, 590 F.3d 186, 187 (2d Cir. 2009) (citing Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 118 (2d Cir. 1991)).

62. *Wagoner*, 944 F.2d at 118; *Kirschner*, 938 N.E.2d at 946 n.3.

63. See *Kirschner*, 938 N.E.2d at 946 n.3; see also Schaefer, supra note 4, at 1009 & n.35. The standing issue from *Wagoner* is distinct from in pari delicto, because the latter is an affirmative defense, not a rule of standing. See id. The *Wagoner* doctrine itself is beyond the scope of this Note.

court's interpretation of New York law on the adverse interest exception.[64]

The New York Court of Appeals explained that acts performed and knowledge possessed by a principal's agents are "presumptively imputed to their principals."[65] This is particularly so for corporations: "[O]f necessity, [they] must act solely through the instrumentality of their officers or other duly authorized agents."[66] Thus, they "*must* . . . be responsible for the acts of [their] authorized agents even if particular acts were unauthorized."[67]

Imputation does *not* occur only when the corporation is the agent's intended victim,[68] because the agent has "totally abandoned [the] principal's interests."[69] *Any* benefit to both the insider and the corporation will not come within the exception—leaving only the narrowest of circumstances, such as outright theft, looting, or embezzlement.[70] Even if a fraud "was actually motivated by . . . personal gain," if it "by its nature will benefit the corporation," it will not come within the exception.[71] If the misconduct "enables the business to survive[,] . . . this test is not met."[72] In *Kirschner*, even though the insiders' fraud caused the company's ultimate bankruptcy, this did not rise to the level of total abandonment needed for the adverse interest exception to apply.[73]

The New York Court of Appeals also considered proposals to expand the adverse interest exception. First, the court considered a subjective intent approach—asking whether insiders intended to benefit themselves at the company's expense and whether they either received such a benefit or the company suffered long-term harm.[74] The court then considered New Jersey's approach of barring imputation in cases of professional negligence where the beneficiary of recovery is an innocent shareholder[75] and Pennsylvania's approach of prohibiting imputation

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64. See *Kirschner*, 590 F.3d at 194.

65. *Kirschner*, 938 N.E.2d at 950.

66. Id. (alterations in original) (quoting Lee v. Pittsburgh Coal & Mining Co., 56 How. Pr. 373, 375 (N.Y. Super. Ct. 1877), aff'd, 75 N.Y. 601 (1878)).

67. Id. (emphasis added).

68. Id. at 951.

69. Id. at 952 (emphasis omitted) (quoting Center v. Hampton Affiliates, Inc., 488 N.E.2d 828, 830 (N.Y. 1985)).

70. Id.

71. Id. (citing Price v. Keyes, 62 N.Y. 378, 384 (1875)).

72. Id. at 953.

73. Id.

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

75. Id. at 955; see also infra section II.A.3 for a full discussion on the New Jersey approach.

where the outside professional "had not proceeded in material good faith."[76]

Despite acknowledging that all three approaches furthered the policies of "compensat[ing] the innocent and deter[ring] third-party professional . . . misconduct and negligence,"[77] the New York Court of Appeals was unpersuaded. It was unclear to the court "why . . . the interests of innocent stakeholders of corporate fraudsters [should] trump those of innocent stakeholders of the outside professionals who are the defendants in these cases."[78] Where "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,"[79] the court saw no need to render the adverse interest exception any more lenient. It was also unpersuaded that altering the exception would "produce a meaningful additional deterrent to professional misconduct or malpractice," since professional third parties are already at risk for large settlements and judgments.[80] Finally, it cited the importance of maintaining certainty and stability in the law.[81]

B. *Traditional In Pari Delicto's Shortcomings*

Traditional in pari delicto and *Kirschner* have both been thoroughly criticized for three main reasons. First, the distinction between professional third parties, who often wield in pari delicto as a defense, and other agents of a corporation, who cannot, is unjustified. Second, imputation's justification of risk allocation does not apply in suits against professional third parties who are under a duty precisely to guard against corporate misconduct and often are specifically hired to do so. Finally, professional third parties' advantages over shareholders or other interestholders in succession in monitoring and guarding against corporate misconduct militate against professional third parties wielding in pari delicto as a defense.

1. *Distinguishing Between Professional Third Parties and Insider Agents of a Corporation.* — The distinction between professional third parties and insider agents of a corporation is unprincipled. Unlike professional third parties, in the case of insider corporate officers, in pari delicto does not

76. *Kirschner*, 938 N.E.2d at 956 (citing *AHERF*, 989 A.2d 313, 336–38 (Pa. 2010)); see also infra section II.A.2 for a full discussion on the Pennsylvania approach.

77. *Kirschner*, 938 N.E.2d at 957–58.

78. Id. at 958.

79. Id.

80. Id. The court cited the examples of Refco's IPO underwriters agreeing to a $53 million settlement and of the $97.5 million settlement between PwC and shareholder plaintiffs in the AIG securities fraud litigation. Id.

81. Id. at 959 (quoting John T. Loughran, Some Reflections on the Role of Judicial Precedent, 22 Fordham L. Rev. 1, 3 (1953)).

apply.[82] Yet nothing justifies why the two are treated differently. Nor does *Kirschner* provide any guidance.[83] It is unclear why the interests of innocent stakeholders of corporations should trump those of innocent stakeholders of fraudulent insiders but not those innocent stakeholders of culpable professional third parties who failed to act in accordance with their professional duties to their client.[84] Allowing professional third parties to use in pari delicto to bar lawsuits by innocent shareholders or creditors, where corporate officers and directors in a similar position cannot do so, is unjustified.

2. *Inapplicability of Risk Allocation Arguments Against Professional Third Parties.* — Moreover, imputation doctrine in agency is justified on the grounds of risk allocation, namely that a principal is in a better position to monitor conduct as against third parties.[85] The doctrine, however, is not fault based.[86] In pari delicto, by contrast, hinges on fault: It is precisely because the plaintiff has wronged that the law offers her no protection.[87] Given the different underlying rationales, additional justification is needed to equate wrongdoing by a corporate agent to wrongdoing by the corporation itself.[88] Importantly, many professional parties are hired precisely to monitor corporate activities and guard against

82. See, e.g., Goldin v. Primavera Familienstiftung, Tag Assocs. (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 "the [in pari delicto] doctrine does not have force in a suit by a corporation against its own officers or employees"); Schaefer, supra note 4, at 1014 ("The law allows a company to sue its employees without imputation barring the company's claims.").

83. See Schaefer, supra note 4, at 1014–15 ("[T]here 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.").

84. Examples of innocent stakeholders of culpable professional third parties can include professional third parties' shareholders or other partners in firms using a partnership structure.

85. See supra text accompanying notes 48–49.

86. Deborah A. DeMott, When Is a Principal Charged With an Agent's Knowledge?, 13 Duke J. Compar. & Int'l L. 291, 319 (2003) ("Basic agency doctrines are not fault-based; the legal consequences of an agent's actions are attributable to a principal even when the principal was without fault in selecting or monitoring the agent."); Shepard, supra note 8, at 326 ("Fault is not necessary, nor even relevant to the process of imputation.").

87. See supra text accompanying notes 9–11.

88. See, e.g., 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."); In re Am. Int'l Grp., Inc. (*AIG I*), 965 A.2d 763, 828 n.246 (Del. Ch. 2009) (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 for professional negligence to its client corporation"), aff'd sub nom. Teachers' Ret. Sys. of La. v. PricewaterhouseCoopers LLP, 11 A.3d 228 (Del. 2011).

corporate misconduct.[89] Yet under traditional in pari delicto, a corporation can be barred from suing professional third parties specifically hired to guard against corporate misconduct and nevertheless failing to fulfill their professional duties.

This concern is acute in auditor and attorney cases.[90] Auditors and attorneys perform a gatekeeping function: a duty to protect organizational clients from misconduct or fraud.[91] Thus, hiring them is a crucial means by which corporations manage the risk of corporate misconduct.[92] To let professional third parties escape liability where they were under a duty *precisely* to guard against corporate misconduct strikes at the heart of the risk allocation justification. While corporations and their shareholders have taken reasonable efforts to mitigate the risk of misbehaving corporate agents by hiring professional third parties,[93] professional third parties themselves have failed to take reasonable efforts to perform their professional duties. Corporations, their shareholders, and creditors thus emerge far more deserving of the law's protection than professional third parties.

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89. See Sharon Tomkins, Note, Tightening Gatekeeper Liability: Should Officers' and Directors' Wrongdoing Be Imputed to the Corporation in Suits Against Third-Party Professionals?, 69 S. Cal. L. Rev. 1883, 1906 (1996) ("Third-party professionals, such as accountants and lawyers, are hired to monitor the managers of the firm. The monitors are set in place to minimize management's ability to exploit the corporation for their own self-interest rather than further the interests of the shareholders.").

90. See, e.g., *AIG I*, 965 A.2d at 828 n.246 ("[A]lthough auditors give no warranty that they can detect fraud, the requirement for public companies to employ auditors is in large measure inspired by the recognition that corporate insiders have more than rarely been known to engage in financial shenanigans."); NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 886 (N.J. 2006) ("[T]hird-party auditors are specifically retained for the task of monitoring corporate activity."); Shepard, supra note 8, at 326 (noting that in pari delicto bars claims when "an auditor, *who was retained for the very purpose of monitoring corporate activity*, failed to meet its professional standards").

For attorneys, similar principles apply: Attorneys have a duty to protect organizational clients against wrongful acts by their constituents. See Schaefer, supra note 4, at 1016 & n.77. Where a corporation's agents plan on engaging in fraudulent or criminal conduct, an attorney therefore is under a duty to inform relevant decisionmakers who can take action to protect the company. See id. at 1016–18 & nn.77–88.

91. 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, 10 (2003) (discussing the "role . . . lawyers play as gatekeepers of their corporate clients' conduct," given that "lawyers are positioned to be suspicious of and to discourage the misconduct [that the transactions through which corporations act] can disguise"); Michels, supra note 18, at 320 ("[T]he lawyer-gatekeeper serves as a voice of client restraint in preventing wrongdoing . . . . [This] includes a lawyer's effort to prevent harm to the corporation client."); Shepard, supra note 8, at 323 ("Shareholders rely on third-party professionals to monitor the officers and directors of the companies in which they invest."); see also id. at 326 (discussing how auditors are retained precisely to monitor corporate activity, and it is in these cases that in pari delicto "has worked to immunize auditors from answering for their own potential wrongdoing").

92. See infra text accompanying notes 96–102.

93. See infra text accompanying notes 98–101.

Taking Enron as an example, many criticized the fact that Enron's attorneys, despite being hired specifically to investigate internal complaints, were not liable for injury arising out of their failure to adequately investigate.[94] At the very least, Enron's attorneys are less deserving of protection than individual shareholders with no hope of overseeing Enron's corporate officers who lost vast amounts of money. This militates against allowing professional third parties to wield in pari delicto.

3. *Professional Third Parties' Advantages in Monitoring and Guarding Against Corporate Misconduct.* — Finally, the advantages professional third parties enjoy in monitoring and guarding against corporate misconduct—ones that shareholders or other interestholders do not—counsel against wielding in pari delicto as a defense. Professional third parties enjoy significant advantages over shareholders and creditors in monitoring corporate agents' conduct: "[T]he nature of today's corporations makes it increasingly unlikely that shareholders of large corporations have the ability to effectively monitor the actions of corporate officials."[95] Where professional parties are better placed to discover and guard against corporate misconduct than shareholders or creditors, they should not be allowed to rely on corporate wrongdoing to defend against otherwise good claims of negligence. In pari delicto lets them do just that.

The distinctive feature of modern publicly held corporations is the separation of ownership and control.[96] Thus, the interests of ownership and corporate managers will often diverge.[97] Principals and derivative

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94. See Schaefer, supra note 4, at 1049 & n.272 (noting that "[c]ommentators rightly insisted the lawyers shared a measure of blame . . . but . . . were not held accountable"); Hilden, supra note 5 (discussing how one would think "Vinson & Elkins should be [held] accountable because it was the firm retained by Enron to investigate Sherron Watkins' internal complaints").

95. NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 886 (N.J. 2006). By contrast, professional third parties such as auditors and attorneys are often hired for corporate monitoring purposes. See id. ("Indeed, third-party auditors are specifically retained for the task of monitoring corporate activity."); Michels, supra note 18, at 323–33 (establishing that attorneys failing to monitor corporate agents can in some circumstances constitute malpractice, which implies that they have a duty to monitor corporate agents); Shepard, supra note 8, at 303 ("[A]uditors are specifically retained to monitor corporate activity . . . ."). Even if professional third parties are not hired specifically for corporate monitoring purposes, however, good reasons exist to impose implied obligations onto professional third parties. See infra notes 97–101 and accompanying text.

96. See Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property 5 (Routledge 2017) (1932) (outlining the "revolutionary" nature of the modern, "quasi-public corporation: a corporation in which a large measure of separation of ownership and control has taken place").

97. See id. at 7 ("The separation of ownership from control produces a condition where the interests of the owner and of ultimate manager may, and often do, diverge . . . ."); Michael C. Jensen & William Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 308 (1976) ("[T]here will be some divergence between the agent's decisions and those decisions

interestholders—namely shareholders—undertake agency costs arising out of this divergence in interests, which include positive monitoring costs.[98] In publicly held corporations, where corporate misconduct cases often arise, owners are typically "a large, diffuse group of investors" who do not individually own a significant portion of shares.[99] Each individual shareholder therefore lacks the ability or incentive to exercise control, leaving it to professional managers.[100] Yet directors or other officers may exploit the corporation for their own benefit at the expense of shareholders. Professional third parties like auditors and attorneys are often hired precisely to monitor and guard against that kind of exploitation.[101] Where professional third parties expressly take on monitoring responsibilities over corporate managers, letting them escape liability when they do not adequately perform the very monitoring responsibilities they undertook militates against applying in pari delicto.[102]

Further, even if professional third parties do not expressly undertake corporate monitoring duties, good reasons exist to impose implied monitoring duties on them. First, professional third parties enjoy low-cost access to firm information, such as financial statements and other document records, because of contractual or informal relationships.[103] Second, professional third parties, being outsiders, have interests and reputations beyond those of the agents of the firm engaged in misconduct and stand to lose those interests and reputations if word of their wrongdoing gets out.[104] Finally, professional third parties are unlikely to engage in recidivist behavior, given the risk of discovery and subsequent reputational damage that could hurt future business with potential clients.[105] Given the low costs of corporate monitoring and the incentives professional third parties have to monitor corporate (mis)conduct, implied monitoring obligations should be imposed on professional third parties rather than on individual shareholders who lack the ability to

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which would maximize the welfare of the principal."); Tomkins, supra note 89, at 1905 ("[A]gency costs are most notable when there is a separation of ownership and control.").

98. Jensen & Meckling, supra note 97, at 308; Tomkins, supra note 89, at 1905.

99. See Tomkins, supra note 89, at 1906.

100. Id.

101. Id.

102. Id.

103. See Reinier H. Kraakman, Corporate Liability Strategies and the Costs of Legal Controls, 93 Yale L.J. 857, 891 (1984) (arguing that outside professionals should be "targets" of "gatekeeper liability" because they have "low-cost access to information about firm delicts"); Tomkins, supra note 89, at 1909 ("Third-party professionals are . . . good gatekeepers because they have low-cost access to firm information.").

104. Tomkins, supra note 89, at 1909; see also Kraakman, supra note 103, at 891 (noting that outside professionals' incentives "differ systematically from those of inside managers").

105. Tomkins, supra note 89, at 1909–10.

individually take on monitoring responsibilities.[106] Professional third parties fill the gap, playing a central role in reducing the agency costs of public corporations by fulfilling their monitoring responsibilities.[107] Professional third parties' crucial monitoring responsibilities, coupled with the ineffectiveness of shareholders to individually take on monitoring roles, justifies the imposition of costs onto professional third parties as against shareholders and creditors. Thus, in pari delicto should not shield professional third parties from liability when they fail to do the very duties they take on expressly or should implicitly take on.

The distinction between professional third parties—who can wield in pari delicto as a defense—and other agents of a corporation—who cannot—is unjust because professional third parties have a duty to guard against corporate misconduct and often are specifically hired to perform this duty. That professional third parties enjoy great advantages in monitoring and guarding against corporate misconduct as against shareholders or other interestholders further militates against traditional in pari delicto. Other American jurisdictions have thus sought to mitigate traditional in pari delicto's harshness, albeit inadequately.

II. CURRENT AMERICAN SOLUTIONS, THEIR SHORTCOMINGS, AND ENGLISH ILLEGALITY

Section II.A discusses three leading jurisdictions: Delaware,[108] Pennsylvania,[109] and New Jersey.[110] All three jurisdictions have relaxed traditional in pari delicto's requirements, yet these solutions prove inadequate. Section II.A then discusses the recent New York Appellate Division decision of *Conway v. Marcum & Kliegman LLP*,[111] which signaled increased judicial receptivity to reinterpreting in pari delicto to better accord with the gatekeeping duties professional third parties undertake.[112] Yet *Conway* provides unclear guidance on how the adverse interest exception will expand. Instead, a solution closely aligning professional third parties' gatekeeping duties with in pari delicto is needed. Section II.B compares in pari delicto against the analogous illegality doctrine in England and Wales. It first showcases the traditional reliance[113] and policy approaches[114] in England and underscores the difficulties of

106. Id. at 1906.
107. Id.
108. See infra section II.A.1.
109. See infra section II.A.2.
110. See infra section II.A.3.
111. 110 N.Y.S.3d 695 (App. Div. 2019).
112. See infra section II.A.4.
113. See infra section II.B.1.
114. See infra section II.B.2.

these approaches, which motivated a revolution in English law.[115] Section II.B then introduces the illegality doctrine's now-dominant trio of considerations approach in *Patel v. Mirza*.[116] Finally, section II.C illustrates the doctrine's application in the corporate misconduct context in *Singularis Holdings Ltd. v. Daiwa Cap. Mkts. Europe Ltd.*[117]

A. *American Solutions to Traditional In Pari Delicto and Shortcomings*

Three leading jurisdictions—Delaware, Pennsylvania, and New Jersey—have recognized traditional in pari delicto's harshness and sought to relax it.[118] Yet (1) Delaware's fiduciary exception and public policy exception apply to discrete circumstances not encompassing professional third parties;[119] (2) Pennsylvania's good faith approach excuses and encourages professional third party incompetency by incentivizing against inquiring too closely into possible corporate misconduct;[120] and (3) New Jersey's approach is limited to auditor negligence cases and does not extend to other professional third parties equally undeserving of in pari delicto protection.[121] These solutions therefore prove inadequate. Finally, the New York Appellate Division's decision in *Conway* indicates increased judicial receptivity to aligning in pari delicto with gatekeeping duties professional third parties undertake.[122] *Conway*, however, provides unclear guidance on how the adverse interest exception will expand. Instead, a solution explicitly aligning professional third parties' gatekeeping duties with in pari delicto is needed.

1. *Delaware: More of the Same?* — Unlike New York, in pari delicto in Delaware possesses three carveouts: (1) the adverse interest exception;[123] (2) the fiduciary exception;[124] and (3) the public policy exception.[125]

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115. See infra section II.B.3.

116. [2016] UKSC 42, [2017] AC 467 (appeal taken from Eng.); see also infra section II.B.3.

117. [2019] UKSC 50, [2020] AC 1189 (appeal taken from Eng.); see also infra section II.C.

118. See infra sections II.A.1–.3.

119. See infra section II.A.1.

120. See infra section II.A.2.

121. See infra section II.A.3.

122. See Conway v. Marcum & Kliegman LLP, 110 N.Y.S.3d 695, 697 (App. Div. 2019); see also infra section II.A.4.

123. The adverse interest exception kicks in when an agent "abandons the principal's interests" or was acting "solely to advance his own personal financial interest, rather than that of the corporation itself." See Stewart v. Wilmington Tr. SP Servs., 112 A.3d 271, 303 (Del. Ch. 2015) (emphasis omitted) (internal quotation marks omitted) (quoting *AIG II*, 976 A.2d 872, 891 & n.50 (Del. Ch. 2009)).

124. See id. at 304 (citing *AIG II*, 976 A.2d at 876, 889–95) ("[R]eceivers, trustees, and stockholder derivative plaintiffs must be able to act on the corporation's behalf to hold faithless directors and officers accountable.").

The adverse interest exception itself is construed narrowly: It only applies to cases where a corporate fiduciary totally abandons their principal. This requires a "highly unusual case," such as "siphoning corporate funds or other outright theft,"[126] resembling the narrow test from traditional in pari delicto.[127] The Delaware Court of Chancery has also refused to create an auditor exception, unlike approaches in New Jersey or Pennsylvania.[128] The court reasoned in *Stewart v. Wilmington Trust SP Services* that other remedies against corporate insiders exist and an auditor exception would create an imbalance in allowing suits against professional third parties and disallowing suits against true third-party co-conspirators.[129] Finally, despite acknowledging the policy of encouraging auditors to better perform their monitoring roles, the court pointed to the "already well-covered field" of regulation by governmental and non-governmental bodies and argued that there is not "much to add."[130]

The same criticisms applicable to the New York approach persist here, since Delaware's approach ultimately is extremely similar: (1) it is unclear what distinguishes professional third parties from a corporation's own directors and officers;[131] and (2) when auditors and other gatekeeping professional third parties are often hired specifically to monitor corporate activities, the breach of that very duty would nevertheless not give rise to a claim.[132]

While the fiduciary duty exception appears to give hope, it has been construed narrowly. The fiduciary duty exception is generally limited only to a corporation's officers and directors.[133] In *Stewart*, the Court of Chancery extended its application to claims against "defendants like auditors" for aiding and abetting fiduciary duty breaches.[134] This decision was justified on the grounds that in pari delicto's policy goals were outweighed by the court's interest in adjudicating "core fiduciary duty

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125. Id. ("[T]he exception . . . applies 'when another public policy is perceived to trump the policy basis for the doctrine itself.'" (quoting *AIG II*, 976 A.2d at 888)). Courts defer to policy in statutory schemes that rely on private causes of action for enforcement when setting in pari delicto aside. Id. at 304–05.

126. Id. at 309 (internal quotation marks omitted) (quoting *AIG II*, 976 A.2d at 891).

127. Cf. *AIG II*, 976 A.2d at 895 & n.60 (discussing the options available to AIG to go after its own agents: "its own directors, officers, and employees," and further, corporate agents "like outside auditors"). Suits against outside auditors and similarly situated professional third parties are consistent with the traditional acceptance of derivative suits against corporate insiders, and promoting gatekeepers to comply with their duties would "foster, not impede[,] society's interest in corporate law compliance." Id.

128. *Stewart*, 112 A.3d at 315–18.

129. Id. at 317.

130. Id. at 317–18.

131. See infra section II.B.1.

132. See infra section II.B.2.

133. See supra note 82 and accompanying text.

134. See *Stewart*, 112 A.2d at 319.

claims."[135] Yet there is no reason why ordinary negligence claims against auditors or other professional third parties—as apart from aiding and abetting claims—should not equally justify refusing the application of in pari delicto. Failure to perform one's professional duties is rarely, if ever, justified.[136] Delaware's approach does not go far enough, and its approach to the adverse interest exception falls prey to the same criticisms as New York.[137]

2. *Pennsylvania: Good Faith or Not.* — Pennsylvania's test for the adverse interest exception, on its face, resembles New York's test:

> Where an agent acts in his own interest which is antagonistic to that of his principal, or commits a fraud for his own benefit in a matter which is beyond the scope of his actual or apparent authority or employment, the principal who has received no benefit therefrom will not be liable for the agent's tortious act.[138]

The Pennsylvania courts, however, have relaxed the limitations on what amounts to a "benefit."[139] Whether the principal gained a "benefit" must be related back to the underlying purpose of imputation: fair risk allocation.[140] Thus, a distinction is drawn between good faith actors and actors lacking such good faith.[141]

With good faith actors, the "traditional, liberal test for corporate benefit" persists.[142] This consideration entails evaluating benefit from the reasonable perspective of a third party in dealings with the agent, asking whether there is "sufficient lack of benefit (or apparent adversity)" to

135. Id.

136. See Schaefer, supra note 4, at 1039 ("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."). With auditors and attorneys, however, the classic example involves a distinction between negligent failure to discover corporate misconduct occurring in the company and positive acts in breach of duty. Yet this distinction is irrelevant: Both intentional and negligent failures to perform duties are failures to perform duties, and there is no reason why attorneys and auditors, often hired precisely to guide conduct and discover or prevent misconduct, should not be liable for negligence. See id. at 1040 (discussing the irrelevance of the distinction between intent and negligence as both result in a failure to perform an attorney's duty); see also supra notes 49–51 and accompanying text.

137. See supra section I.B.

138. Todd v. Skelly, 120 A.2d 906, 909 (Pa. 1956); see also *AHERF*, 989 A.2d 313, 336 (Pa. 2010) (citing *Todd* for Pennsylvania's "traditional, liberal test for corporate benefit").

139. The Supreme Court of Pennsylvania distinguished between good faith and bad faith third party professionals for in pari delicto's application. *AHERF*, 989 A.2d at 319–20, 335 (responding to the district court's finding that even a "peppercorn" of "benefit to the corporation is sufficient to negate the adverse-interest exception").

140. Id. at 335.

141. Id.

142. Id. at 336.

justify not imputing knowledge to the principal.[143] In pari delicto will therefore apply unless the professional third party knows or has reason to know that an agent is not acting with a principal's authority.[144] Where actors lacking good faith are involved,[145] by contrast, the traditional justification of protecting third parties breaks down.[146] There is no need to protect third parties who are aware that the corporate officer has no authority to engage in corporate misconduct.[147] In pari delicto should not apply: "Such an application . . . seems ill-advised, if not perverse."[148]

While Pennsylvania's approach is a step in the right direction, it nevertheless falls short. Professional third parties failing to perform their professional duties is rarely, if ever, justified.[149] Moreover, Pennsylvania's approach incentivizes against inquiring too closely and thus encourages incompetence. Given the risk of placing themselves on notice as to corporate misconduct and having their conscience bound by bad faith, professional third parties are less likely to incur liability when they do not inquire too closely, encouraging willful blindness.[150] Allowing professional third parties to invoke in pari delicto in good faith only excuses and encourages incompetency.[151] By creating perverse incentives against professional third parties performing their duties to monitor and guard against corporate misconduct adequately, Pennsylvania's approach too falls short.

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143. Id. at 338.

144. Id. (citing Restatement (Third) of Agency § 5.04 cmt. b. (Am. L. Inst. 2006)).

145. The example confronting the Pennsylvania Supreme Court in *AHERF* was where auditors colluded with AHERF's officers to fraudulently misstate its finances. *AHERF*, 989 A.2d at 316.

146. See id. at 336.

147. Id. ("[S]uch principles do not (and should not) apply in circumstances in which the agent's authority is neither actual nor apparent, as where both the agent and the third party know very well that the agent's conduct goes unsanctioned by one or more of the tiers of corporate governance.").

148. Id.

149. See supra note 136 and accompanying text.

150. See John C. Coffee, Jr., Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms, 84 B.U. L. Rev. 301, 345 (2004) ("[P]olicy must seek to minimize the perverse incentives that induce the gatekeeper not to investigate too closely . . . . For example, . . . the defense . . . frequently raised by . . . auditors [is] that they were deceived by corrupt managements on whom they had justifiably relied . . . . [I]t can . . . create an incentive not to inquire too closely . . . .").

151. See NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 886 (N.J. 2006) ("[M]any investors play a passive role in the oversight of a firm's day-to-day operations, relying instead on third-party professionals to assist in monitoring the corporation's officers and directors."); Kirschner v. KPMG LLP, 938 N.E.2d 941, 962 (N.Y. 2010) (Ciparick, J., dissenting) ("Investors rely heavily on information prepared by or approved by auditors, accountants, and other gatekeeper professionals."); Shepard, supra note 8, at 323 ("Shareholders rely on third-party professionals to monitor the officers and directors of the companies in which they invest. In reality, most shareholders have no control over management . . . .").

3. *New Jersey: Asking Whether a Defendant "Contributed" to the Fraud.* — In New Jersey, in pari delicto is unavailable to "contribut[ors] to" the fraud.[152] In *NCP Litigation Trust v. KPMG LLP*, the New Jersey Supreme Court concluded that in pari delicto may be brought against third-party auditors on behalf of a corporation for damages "proximately caused by . . . negligence."[153] The New Jersey Supreme Court properly acknowledged the "nature of today's corporations" that makes it "increasingly unlikely that shareholders . . . have the ability to effectively monitor the actions of corporate officials."[154]

On the question of corporate benefit, the court noted the difficulty in differentiating between harming and benefitting the corporation under traditional in pari delicto analysis.[155] Thus, on *NCP Litigation Trust*'s facts—involving two corporate officers intentionally misrepresenting details of a corporation's financial status to an auditing firm—inflating revenues and allowing a corporation to "continue in business 'past the point of insolvency' [could not] be considered a benefit to the corporation."[156] New Jersey's approach ensures that auditors, specifically retained to monitor corporate officers, are held liable for negligence.[157]

Yet one subsequent New Jersey Superior Court Appellate Division decision, *Bondi v. Citigroup, Inc.*,[158] confines *NCP Litigation Trust*'s application only to the auditor negligence context. *Bondi* emphasized that in *NCP Litigation Trust*, the corporation's agents defrauded the corporation and its creditors only, and so the auditor was not "a victim of the fraud in need of protection."[159] Further, in *NCP Litigation Trust*, KPMG had an "independent contractual obligation" to detect the fraud and allegedly failed to do so.[160] Thus, *Bondi* effectively restricted *NCP Litigation Trust* to auditor negligence and the case's particular facts.

Bondi by contrast concerned an Italian corporation, Parmalat, which had taken on financing from a variety of lenders, including Citigroup, Inc. and Citibank N.A. (collectively Citi).[161] After Parmalat's collapse, the

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152. *NCP Litig. Tr.*, 901 A.2d at 882 ("[O]ne who contributed to the misconduct cannot invoke imputation."). While *NCP Litigation Trust* describes the imputation defense, it is effectively the same doctrine as in pari delicto coupled with the adverse interest exception, asking when imputing an agent's misconduct to a corporation will bar an otherwise good suit. See Shepard, supra note 8, at 301 n.142 ("The [New Jersey Supreme Court's] analysis of whether the defendant may invoke imputation tracks an analysis of when to apply *in pari delicto* and has been cited in this context.").

153. 901 A.2d at 882.

154. Id. at 886; see also supra section I.B.3.

155. *NCP Litig. Tr.*, 901 A.2d at 887–88.

156. Id. at 888 (quoting Schacht v. Brown, 711 F.2d 1343, 1348 (7th Cir. 1983)).

157. Id. at 886.

158. 32 A.3d 1158 (N.J. Super. Ct. App. Div. 2011).

159. Id. at 1176 (quoting *NCP Litig. Tr.*, 901 A.2d at 882).

160. Id. (quoting *NCP Litig. Tr.*, 901 A.2d at 882).

161. See id. at 1162.

Italian government appointed one Enrico Bondi as Parmalat's administrator.[162] Bondi alleged that Citi facilitated, covered up, and profited from illegal financial manipulations by Parmalat's founder and key managers.[163] Citi asserted in pari delicto as a defense.[164] In turn, Bondi argued that the founder's and key managers' fraudulent acts fell within the adverse interest exception, as those acts were "solely for their benefit."[165]

The trial judge found that Bondi could not demonstrate that the officers' acts fell within the adverse interest exception.[166] This was because Parmalat's vendors, customers, employees, and consumers benefited from the officers keeping the corporation afloat. New Jersey's intermediate appellate court endorsed this reading: That the company or its shareholders received substantial benefits, "even if . . . for a finite period pending the bankruptcy," justifies imputation and in pari delicto's application.[167] The court did not inquire into whether any professional duties were owed by Citi; it merely distinguished *NCP Litigation Trust* because in that matter, there existed a specific contractual obligation to monitor corporate compliance.[168]

Not all professional third parties, however, primarily perform corporate monitoring or gatekeeping duties as a service and thus will lack specific contractual provisions providing for gatekeeping duties. Attorneys, for example, perform gatekeeping functions ancillary to their predominant functions.[169] Thus, gatekeeping obligations undertaken by attorneys for their corporate clients will often not be found straightforwardly in specific contractual obligations.[170] Attorneys, however, possess

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162. See id. at 1163.

163. See id. at 1172.

164. Id. at 1172.

165. Id.

166. See id. at 1173 ("Judge Harris found that Bondi pursued only corporate interests and could not demonstrate that the corporate mismanagers were so far a field [sic] of advancing Parmalat's business interests that the so-called adverse interest exception applies." (internal quotation marks omitted) (quoting Bondi v. Citigroup, Inc., No. BER-L-10902-04, 2008 WL 1772647, at *16 (N.J. Super. Ct. Law Div. Apr. 15, 2008) (misquotation)).

167. Id. at 1177.

168. Id. at 1176 (quoting NCP Litig. Tr. v. KPMG LLP, 901 A.2d 871, 882 (N.J. 2006)).

169. See Coffee, supra note 150, at 309 ("[T]he attorney is primarily an advocate or a transaction engineer and only sometimes a gatekeeper."). This is not necessarily true, however: Attorneys can also expressly assume a gatekeeping role, as they do when taking on investigative or monitoring functions. See Michels, supra note 18, at 363 ("A lawyer *expressly* assumes a gatekeeping role when she agrees to undertake an investigation or monitoring role.").

170. Some lawyer professional ethics rules can impose an implied duty to undertake an investigation or monitor roles in limited circumstances, including, for example, Rule 1.13 of the Model Rules of Professional Conduct. Michels, supra note 18, at 364. Rule 1.13 imposes a duty to act "as is reasonably necessary in the best interest of the organization" if an attorney knows that a corporate officer or employee intends to engage in corporate

implied obligations to engage in corporate monitoring efforts even when not being hired specifically to do so.[171] *Bondi* leaves unclear whether New Jersey case law extends beyond the auditor negligence context to contexts where implied obligations are undertaken.[172]

Traditional in pari delicto and the divergent approaches in Delaware, Pennsylvania, and New Jersey, have shown themselves inadequate. The recent New York Appellate Division decision of *Conway v. Marcum & Kliegman LLP*,[173] however, provides hope for judicial receptivity to a new approach that more closely aligns with the gatekeeping duties professional third parties owe corporations.

4. *Expanding the Adverse Interest Exception:* Conway v. Marcum & Kliegman LLP. — *Conway* forms a recent development opening the door to an expansion of the adverse interest exception in the United States. *Conway* has done so by accepting ongoing fraud and continued corporate existence as in principle amounting to "total abandonment" of a principal's interests for the purpose of the adverse interest exception.[174] The decision, however, provides little guidance about what counts as total abandonment.

In *Conway*, the Appellate Division, First Department confronted an appeal against summary judgment. The plaintiffs, liquidators of several hedge funds, had alleged that the defendant auditors "failed to uncover fraudulent activity by the funds' investment managers."[175] The issue before the court was whether the "adverse interest exception to the equitable defense of in pari delicto bars the defense."[176]

Conway departed from a narrow construction of the adverse interest exception as in *Kirschner*. It instead rejected the defendants' argument that the fraudulent conduct enabled the principal hedge funds to survive

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misconduct, among other things. See Model Rules of Pro. Conduct r. 1.13 (Am. Bar Ass'n, Discussion Draft 1983). This must include a duty to investigate so as to act as reasonably necessary. See Michels, supra note 18, at 364. In contrast with Kevin Michels, Paula Schaefer argues that an attorney's fiduciary duties owed to an organizational client, wider in scope than professional conduct rules, can impose a duty to act competently and loyally to protect a corporate client from liability through investigation and corporate monitoring. See Schaefer, supra note 4, at 1057–58. Regardless of which view is preferred, the key point is that gatekeeping obligations arise not out of contractual provisions, but out of other sources of monitoring and investigative duties.

171. See supra notes 103–107 and accompanying text; see also Michels, supra note 18, at 358 (pointing out how "an attorney's compliance with the internal-gatekeeping requirements of the ethics rules and statutory duties can be an important part of the corporation's monitoring efforts").

172. See *NCP Litig. Tr.*, 901 A.2d at 888 (focusing on "the scope of the engagement" the auditors entered into with the corporation).

173. 110 N.Y.S.3d 695 (App. Div. 2019).

174. See supra notes 49–56 and accompanying text.

175. *Conway*, 110 N.Y.S.3d at 696.

176. Id.

and thus constituted a benefit for purposes of in pari delicto.[177] The "mere continuation of a corporate entity does not per se constitute a benefit."[178] Therefore, the adverse interest exception's application could not be precluded.[179] While on its face endorsing *Kirschner*, *Conway* significantly departs from *Kirschner* in reality. *Conway* specifically states that "an ongoing fraud and a continued corporate existence may harm a corporate entity."[180] Yet this position is exactly what *Kirschner* rejected.[181] If mere continuation no longer constitutes a benefit, the adverse interest exception is no longer limited to situations of "total abandonment" under *Kirschner*'s definition. *Conway*'s refusal to follow *Kirschner* in spirit showcases increased judicial willingness to hold professional third parties accountable for their failures to perform duties owed by them to corporations.

Conway, however, leaves unclear how the adverse interest exception will expand. It provides little guidance on what constitutes "total abandonment" such that in pari delicto does not apply. There is no reason to assume subsequent decisions would align total abandonment with professional third parties' gatekeeping duties, nor does the total abandonment test necessarily promote compliance with those duties they owe. Moreover, professional third parties need not "totally abandon" the interests of their corporation to be negligent; they merely need not perform up to the mark. Even then, no reason exists to excuse professional third parties' incompetence or negligence where they undertake duties precisely to monitor and guard against corporate misconduct.[182] *Conway*'s expansion of what counts as total abandonment does not go far enough; a solution that explicitly aligns in pari delicto with professional third parties' gatekeeping duties is needed.

B. *English Illegality Doctrine and the Trio of Considerations Approach*

This section juxtaposes American in pari delicto case law against the analogous illegality doctrine and the trio of considerations approach's emergence in England and Wales. First, it discusses the traditional approaches in illegality: the reliance[183] and traditional policy[184] approaches.

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177. Id. at 697.

178. Id.

179. See id. ("[W]e conclude that the mere continuation of a corporate entity does not per se constitute a benefit that precludes application of the adverse interest exception.").

180. Id.

181. See Kirschner v. KPMG LLP, 938 N.E.2d 941, 953 (N.Y. 2010) ("So long as the corporate wrongdoer's fraudulent conduct enables the business to survive—to attract investors and customers and raise funds for corporate purposes—this test is not met." (citing Baena v. KPMG LLP, 453 F.3d 1, 7 (1st Cir. 2006))).

182. See supra note 136 and accompanying text.

183. See infra section II.B.1.

184. See infra section II.B.2.

Thereafter, it sets out the revolutionary trio of considerations approach in *Patel v. Mirza*,[185] as the United Kingdom Supreme Court sought to resolve conflicting judgments applying the traditional approaches.[186]

The English approach to illegality, or ex turpi causa, dominates all of English civil law. Much of the leading case law derives from cases beyond the corporate misconduct context.[187] This section will first explain the two traditional approaches to illegality pre-*Patel*: the reliance approach[188] and the traditional policy approach.[189] Nevertheless, uncertainty as to when each approach applies resulted in conflicting United Kingdom Supreme Court judgments in *Hounga v. Allen*,[190] *Les Laboratories Servier v. Apotex Inc.*,[191] and *Bilta (UK) Ltd. v. Nazir (No 2)*.[192] A panel of nine Supreme Court justices was convened to resolve these conflicts in *Patel v. Mirza*.[193] Examining the reliance and traditional policy approaches and their difficulties illustrates *Patel*'s revolutionary nature in setting out the new trio of considerations approach that now dominates all case law concerning illegality, from tort cases to corporate misconduct claims.

1. *The Reliance Approach:* Stone & Rolls v. Moore. — The reliance approach was noteworthily laid out in *Tinsley v. Milligan*.[194] The majority judgment, set out by Lord Nicolas Browne-Wilkinson, presented the key test in determining if illegality bars relief: Does the plaintiff have to rely on the underlying illegality to set out the claim?[195]

Its application is well illustrated in *Stone & Rolls v. Moore*,[196] an auditor negligence case involving corporate misconduct. The claimant[197]

185. [2016] UKSC 42, [2017] AC 467 (appeal taken from Eng.).

186. See infra section II.B.3.

187. See, e.g., Patel v. Mirza [2016] UKSC 42, [11], [2017] AC 467, 477 (appeal taken from Eng.).

188. See infra section I.B.1.

189. See infra section I.B.2.

190. [2014] UKSC 47, [2014] 1 WLR 2889 (appeal taken from Eng.).

191. [2014] UKSC 55, [2015] AC 430 (appeal taken from Eng.).

192. [2015] UKSC 23, [2016] AC 1 (appeal taken from Eng.).

193. [2016] UKSC 42, [2017] AC 467 (appeal taken from Eng.). A panel of nine justices is particularly significant in the United Kingdom, where not all Supreme Court justices sit on all cases. The greater the number of justices sitting on a case, generally the greater the importance of the case. See Panel Numbers Criteria, Sup. Ct., https://www.supremecourt.uk/procedures/panel-numbers-criteria.html [https://perma.cc/5H3M-YVJV] (last visited Oct. 2, 2022).

194. [1994] 1 AC 340 at 371 (appeal taken from Eng.).

195. Id.

196. [2009] UKHL 39, [2009] 1 AC 1391 (appeal taken from Eng.).

197. Since 1998, in England and Wales, the word "claimant" replaces "plaintiff'" when describing the person initiating a civil claim in law. See Plaintiff, Inc. Council of L. Reporting Eng. & Wales, https://www.iclr.co.uk/knowledge/glossary/plaintiff/ [https://perma.cc/W6NV-N4EH] (last visited Oct. 8, 2022).

corporation, Stone & Rolls—owned, controlled, and managed solely by one Zvonko Stojevic—employed the defendant auditors.[198] After Stone & Rolls went bankrupt, its liquidators brought proceedings alleging that auditors were negligent in failing to detect and prevent Stojevic's dishonest activities.[199] While the auditors admitted breaching a duty to exercise reasonable care and skill in carrying out their duties as auditors, they argued that Stojevic's illegality, which could be attributed to the claimant corporation, operated to defeat an otherwise good claim.[200] The House of Lords had to determine whether illegality denied the corporation's claims against the auditors.

By a 3-2 majority, the House of Lords found that illegality should bar the company's claim.[201] Stojevic, as the corporation's "sole will and mind and beneficial owner," participated in the illegal conduct forming the basis of the claim.[202] Imputation of Stojevic's conduct to the corporation need not take place; this was instead a *primary* wrong perpetrated *by* the corporation itself.[203] Lords Robert Walker and Simon Denis Brown held that *Tinsley v. Milligan*'s reliance approach was applicable. Thus, illegality's applicability depended on whether Stone & Rolls had to rely on its own illegality.[204] As the corporate misconduct was Stone & Rolls' *primary* wrong, the corporation (or liquidator standing in the corporation's shoes) had to rely on its own misconduct. Illegality hence barred the claim.[205]

All three Lords acknowledged that the defendant had a duty to protect against corporate misconduct.[206] The argument was nevertheless

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198. *Stone & Rolls*, UKHL 39 [4], 1 AC at 1399.

199. Id. [3], AC at 1398–99.

200. Id. [1], AC at 1398.

201. The minority considered this to be an inappropriate lifting of the corporate veil. See id. [118], AC at 1478; Paul S. Davies, Auditors' Liability: No Need to Detect Fraud?, 68 Cambridge L.J. 505, 506 (2009).

202. *Stone & Rolls*, UKHL 39 [86], 1 AC at 1470.

203. Id. [51], [54]–[56], AC at 1460–61. The Lords noted the analogy to in pari delicto case law in the United States, where the "sole actor" exception to the adverse interest exception prevails in one-person company cases. In one-person company cases, the principal and agent are one and the same. Thus, the justification that an agent would not disclose her knowledge to her principal is irrelevant. Id. [163], AC at 1492–93 (citing In re The Mediators, 105 F.3d 822, 827 (2d Cir. 1997)). Noteworthily, Lord Robert Walker acknowledges that the English authorities on illegality and U.S. case law are in line with each other and broadly support the same general principle. Id. [162], AC at 1492.

204. Id. [129]–[131], AC at 1481.

205. Id. [161], [168], [173]–[174], AC at 1492–93, 1496. Lord Nicholas Addison Phillips asked whether the auditors' monitoring duties were owed to the corporation's creditors, who stood to benefit from the lawsuit's success. As the duty did not extend to creditors, illegality barred the claim. Id. [68], [85]–[86], AC at 1422–23, 1427.

206. See id. [179], AC at 1498. The court had to confront the tort law principle that where a duty exists to prevent harm caused by a third party, a defendant cannot excuse herself by saying that it was caused by the third party. See id.; see also Corr v. IBC Vehicles [2008] UKHL 13, [29], [2008] AC 884, 908; Reeves v. Comm'r of Police of the Metropolis [2000] 1 AC 360 at 374.

rejected on multiple grounds, namely: (1) that the presence of a duty could not justify auditors' liability for the full amount of damages, and contributory negligence could not appropriately apportion an amount;[207] (2) that protecting against corporate misconduct "is not [an auditor's] sole or primary task."[208]

The reliance approach, however, has since been much criticized.[209] Even in *Stone & Rolls* itself, the reliance test was described as a "blunt instrument," being "unforgiving and uncompromising."[210] Using "procedural criteria" and failing to engage with "relevant policy considerations" resulted in arbitrariness and uncertainty as to whether illegality will bar a claim.[211] In *Stone & Rolls*, for example, there was little consideration of the nature and content of the auditors' gatekeeping duties owed to the corporation, nor was there an explanation of why Stojevic's role as the directing mind and will justified treating the company as a *primary* wrongdoer.[212]

2. *The Traditional Policy Approach:* Gray v. Thames Train. — In other areas of law—such as contract, tort, and unjust enrichment—the traditional policy test emerged as an alternative approach. One such example is *Gray v. Thames Train*, a tort law case.[213]

In *Gray*, the claimant, a "decent and law-abiding citizen," had suffered post-traumatic stress disorder arising out of the Ladbroke Grove rail crash.[214] Thus, he underwent a significant personality change,

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207. *Stone & Rolls*, UKHL 39 [62], 1 AC at 1391.

208. See id. [179], AC at 1498.

209. Patel v. Mirza [2016] UKSC 42, [20], [2017] AC 467, 479 (appeal taken from Eng.) (noting that *Tinsley v. Milligan* "has been the subject of much criticism . . . for its reasoning").

210. *Stone & Rolls*, UKHL 39 [185], 1 AC at 1499.

211. See, e.g., Ernest Lim, A Critique of Corporate Attribution: "Directing Mind and Will" and Corporate Objectives, J. Bus. L. 333, 336 (2013) [hereinafter Lim, Critique] (critiquing *Stone & Rolls*'s failure to engage with the context that justified attribution of the sole director's knowledge to a one-person company and to elucidate policy or normative reasons justifying attribution); Law Commission, The Illegality Defence, 2009-10, HC 412, ¶ 2.13 (UK) (criticizing the fact that whether "illegality has any effect on the recognition or enforcement of the trust does not depend on the merits of the parties or the policies that underlie the illegality defence"); Hugh Stowe, The 'Unruly Horse' Has Bolted: *Tinsley v. Milligan*, 57 Mod. L. Rev. 441, 446 (1994) (pointing out the "unfortunate" nature of the "public policy rule . . . [being] based on procedural criteria completely divorced from relevant policy considerations").

212. See Lim, Critique, supra note 211, at 336 ("[I]t is one thing to say that Mr. Stojevic was the 'directing mind and will' of the company. It is another thing to attribute that to the company.").

213. [2009] UKHL 33, [2009] 1 AC 1339 (appeal taken from Eng.).

214. Id. [2], AC at 1344. For information about the Ladbroke Grove train crash, see generally Greg Treverton-Jones, 'A Body Drifted Past the Window': Surviving the Ladbroke Grove Train Crash, Guardian (Oct. 17, 2019), https://www.theguardian.com/uk-news/2019/oct/17/ladbroke-grove-paddington-train-crash-inquiry [https://perma.cc/

eventually resulting in him stabbing a stranger to death.[215] The claimant was convicted of manslaughter on grounds of diminished responsibility and sentenced to detainment in a hospital.[216] He thereafter sought a claim for general damages for detention, conviction, feelings of guilt, and an indemnity against claims that may be brought against him by the dependents of his victim.[217] The defendants accepted liability for the rail crash and loss of earnings up to the date of the killing. The defendants, however, rejected liability for any loss of earnings after that date or for general damages, relying on the illegality defense to preclude liability.[218] The question for the Lords was whether the illegality defense operated to defeat the otherwise good claim for loss of earnings post-killing and the general damages claim.

The House of Lords held that the illegality defense applied both to the claim of loss of earnings post-killing and to general claims based on the killing and conviction.[219] Lord Leonard Hoffman set out two policy justifications for illegality: the narrow form and the wide form.[220] The narrow form disallowed recovery "for damages which flows directly from loss of liberty, a fine or other punishment lawfully imposed upon [someone] in consequence of [their] unlawful act."[221] This was justified on the basis of consistency: Where the law inflicts the damage in question, it would be inconsistent for the law to require compensation for that damage.[222] Thus, the loss of earnings after the date of the killing and the general damages for the conviction and detention were not recoverable because it was the law that imposed the conviction and detention.[223] The wide form of the defense disallowed "recover[ing] compensation for loss which [one] has suffered in consequence of [their] own criminal act."[224] This intuition was grounded on the basis that it would be "offensive to public notions of the fair distribution of resources" to allow a claimant to be compensated for the consequences of her own criminal conduct.[225] While acknowledging difficult issues of

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7PEV-B2RQ] (noting that the Ladbroke Grove train crash killed thirty-one and injured hundreds of others).

215. *Gray*, UKHL 33 [2], 1 AC at 1344.

216. Id. [3], AC at 1344.

217. Id. [23], AC at 1368–69.

218. Id. [4], AC at 1344.

219. Id. [50], [55], AC at 1359–61.

220. Id. [29], AC at 1370.

221. Id.

222. Id. [33]–[50], AC at 1371–76 (noting the inconsistency of the law "imprison[ing] or detain[ing] someone on the grounds that he was responsible for a serious offence and then . . . compensat[ing] him for the detention" (quoting Law Comm'n, Consultation Paper No. 160: The Illegality Defence in Tort ¶ 4.100 (2001) (UK))).

223. Id.

224. Id. [29], AC at 1370.

225. Id. [51], AC at 1376.

causation, the court had to decide whether the damage should be deemed to have been caused by the criminal act of the claimant or by the tortious act of the defendant.[226] Here, the wide version of the defense ruled out the claim for general damages for feelings of guilt and the claim for an indemnity against claims by dependents of the victim.[227]

Gray frustrated commentators for its failure to discuss the reliance approach beyond the bare assertion that one could not "simply . . . extrapolate rules applicable to a different kind of situation" facing the House of Lords in *Tinsley*.[228] *Gray* thus left uncertain when the reliance approach applied, and when the traditional policy approach applied. By contrast, the reliance approach was used in *Stone & Rolls*, even though that concerned illegality in a contract and tort case[229]—when the traditional policy approach would supposedly apply. Arbitrariness and uncertainty as to when each approach applied rendered illegality doctrine unsatisfactory. This confusion motivated the United Kingdom Supreme Court to revisit the issue in a series of conflicting judgments ultimately cumulating in *Patel v. Mirza*.

3. *The Trio of Considerations Approach:* Patel v. Mirza. — The United Kingdom Supreme Court initially issued a series of conflicting judgments that muddied illegality.[230] To conclusively resolve the issue of illegality, and in responding to Lord David Neuberger's urging of a convening of a

226. Id. [54], AC at 1377.

227. Id. [51]–[55], AC at 1376–77.

228. Id. [31], AC at 1371.

229. See Stone & Rolls v. Moore [2009] UKHL 39, [3], 1 AC 1391, 1398–99 (appeal taken from Eng.).

230. See Patel v. Mirza, [2016] UKSC 42 [164], [2017] AC 467, 515 (appeal taken from Eng.) (Lord David Neuberger noted that "the different approaches adopted . . . in the recent cases of *Hounga v. Allen*[,] . . . *Les Laboratoires Servier v Apotex Inc*[,] . . . and *Bilta (UK) Ltd v. Nazir (No 2)* . . . have left the law on the topic in some disarray"); Ernest Lim, Ex Turpi Causa: Reformation Not Revolution, 80 Mod. L. Rev. 927, 928 (2017) [hereinafter Lim, Ex Turpi Causa] (citing Lord Neuberger's comment in *Patel*).

First, in *Hounga v. Allen*—a statutory unlawful discrimination tort case—the Supreme Court took a flexible approach, asking (1) what public policies founded the illegality defense; and (2) whether there were other conflicting public policies militating against the defense's application. Hounga v. Allen [2014] UKSC 47, [42], [2014] 1 WLR 2889, 2903; Lim, Ex Turpi Causa, supra note 230, at 929. By contrast, in *Les Laboratoires Servier v. Apotex Inc.*, a majority of the United Kingdom Supreme Court endorsed the characteristically "strict" reliance approach in *Tinsley* and *Stone & Rolls*, whilst acknowledging its indiscriminate or capricious outcomes. See Les Laboratoires v. Apotex Inc. [2014] UKSC 55, [16], [2015] AC 430, 441 (citing Tinsley v. Milligan [1994] 1 AC 340 at 364 (appeal taken from Eng.)); Lim, Ex Turpi Causa, supra note 230, at 928. Finally, in *Bilta (UK) Ltd. v. Nazir (No 2)*, the justices adopted alternative approaches: Lords Roger Toulson and Patrick Hodge endorsed the flexible approach, but Lord Jonathan Sumption endorsed the strict reliance approach. See Bilta (UK) Ltd. v. Nazir (No 2) [2015] UKSC 23, [15], [2016] AC 1, 12 (appeal taken from Eng.).

seven- or even a nine-justice panel,[231] a nine-justice panel was convened in *Patel v. Mirza*.[232]

Patel endorsed the essential rationale of illegality as being that "it would be contrary to the public interest to enforce a claim if to do so would be harmful to the integrity of the legal system."[233] In assessing whether it would be harmful to the integrity of the legal system:

> [I]t is necessary a) to consider the underlying purpose of the prohibition which has been transgressed and whether that purpose will be enhanced by denial of the claim, b) to consider any other relevant public policy on which the denial of the claim may have an impact and c) to consider whether denial of the claim would be a proportionate response to the illegality, bearing in mind that punishment is a matter for the criminal courts.[234]

This trio of considerations approach was applied to a restitution claim by the claimant, Chandrakant Patel, for a payment to the defendant, Salman Mirza, to bet on share prices using inside information.[235] Mirza, however, never placed the bet and refused to return the money back to Patel.[236] The United Kingdom Supreme Court held that it was not contrary to public interest to allow Patel to recover money paid for an illegal purpose but was not actually used for that purpose, because he was seeking to unwind the illegal arrangement, not profit from it.[237]

The trio of considerations approach has revolutionized illegality in England and Wales. Commentators have largely welcomed the new approach for promoting transparency on the policy rationales and countervailing policies underpinning illegality's application,[238] and the

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231. *Bilta (UK) Ltd.*, UKSC 23 [15], AC at 12 (Lord Neuberger P) (appeal taken from Eng.).

232. *Patel*, UKSC 42 [81], AC at 495 (discussing the "sharp division of opinion about the proper approach to the defence of illegality" and Lord Neuberger's desire to address the issue "as soon as appropriately possible").

233. *Patel*, UKSC 42 [120], AC at 504.

234. Id.

235. Id. [116], AC at 504. This behavior amounted to a conspiracy to commit the offence of insider trading contrary to § 52 of the Criminal Justice Act 1993. Id. [12], AC at 477 (Lord Toulson SCJ).

236. Id. [11], AC at 477 (Lord Toulson SCJ).

237. Id. [115], AC at 503 (Lord Toulson SCJ).

238. See, e.g., Andrew Burrows, Illegality After *Patel v Mirza*, 70 Current Legal Probs. 55, 56 (2017) ("I regard *Patel v Mirza* as a triumph . . . . [I]t wipes the slate clean of the existing rules (or purported rules) and requires the courts . . . to reach the best decision on illegality by transparently applying and balancing a range of factors culled from past cases and from . . . the Law Commission."). Professor Andrew Burrows now sits as a justice of the Supreme Court. Press Release, Prime Minister's Off., Appointments to the Supreme Court: 24 July 2019 (July 24, 2019), https://www.gov.uk/government/news/appointments-to-the-supreme-court-24-july-2019 [https://perma.cc/G2ZC-GM4V] ("Lord Justice Hamblen,

likelihood of less uncertainty than previous approaches.[239] Its application in the corporate misconduct context is best understood through *Singularis Holdings Ltd. v. Daiwa Capital Markets Europe Ltd.*[240]—a case of corporate misconduct and subsequent suit against a professional third party.[241]

C. *The English Trio of Considerations Approach Applied:* Singularis Holdings

Singularis Holdings applied the trio of considerations approach to a claim against a professional third party in the corporate misconduct context. There, a claimant company was wholly owned by one Maan Al Sanea with sole signing powers over bank accounts.[242] On Al Sanea's instructions, the defendant bank paid out funds in the company's account to entities with which Al Sanea was associated.[243] Liquidators standing in the corporation's shoes later sought recovery alleging that the defendant had breached a duty of care owed by a bank to its customer to refrain from executing an instruction to make a payment out of the customer's account when it had reasonable grounds to believe that a fraud was being carried out.[244] The United Kingdom Supreme Court thus had to decide if illegality barred the corporation's claim against the bank.[245]

The United Kingdom Supreme Court endorsed the first instance judge's application of the trio of considerations approach.[246] The illegality relied upon was Al Sanea's breach of a professional duty toward the company, and the purpose of the prohibition on breach of the bank's obligation was to protect a company from becoming the victim of

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Lord Justice Leggatt and Professor Andrew Burrows will join the Supreme Court as justices on 13 January, 21 April and 2 June 2020 respectively.").

239. See, e.g., Lim, Ex Turpi Causa, supra note 230, at 941 ("[The trio of considerations] approach . . . is likely to result in significantly less uncertainty than the minority's rule-based approach.").

240. [2019] UKSC 50, [2020] AC 1189 (appeal taken from Eng.).

241. See infra section II.C.

242. *Singularis*, UKSC 50 [2], AC at 1197 ("Mr Al Sanea was its sole shareholder . . . . Very extensive powers were delegated to Mr Al Sanea to take decisions on behalf of the company, including signing powers over the company's bank accounts.").

243. *Singularis*, UKSC 50 [4], AC at 1197–98.

244. Id. [1], AC at 1197 (noting that the claim was brought for a "breach of the so-called *Quincecare* duty of care"). The duty owed by the bank is a *Quincecare* duty unique to English law that is designed to "protect a bank's customers from the harm caused by people for whom the customer is, one way or another, responsible." See id. [23], AC at 1202. It arises only where a reasonable banker or broker would have had reasonable grounds for believing there was a serious or real possibility that payment instructions were fraudulent. Id. at [1], AC at 1197.

245. Id.

246. Id. [21], AC at 1201.

the wrongful exercise of power by officers of the company.[247] Under the first prong of the trio of considerations approach, the prohibition's purpose would "not be enhanced by preventing the company from getting back the money which had been wrongfully removed from its account."[248] Under the second prong, while a policy of "protecting the bank would be enhanced by denial of the claim," the bank's duty of care "struck a careful balance between the interests of the customer and the interests of the bank."[249] Denying the claim would also materially impact other public policy considerations: namely, the "growing reliance on banks and other financial institutions to play an important part in reducing and uncovering financial crime and money laundering."[250] Finally, under the third prong, it would be "an unfair and disproportionate response to [the company's] wrongdoing."[251]

Singularis squarely addressed the same issue as *Stone & Rolls*: whether the fraud of the sole director and owner in a one-person company should be attributed to said company when suing a third party.[252] It, however, rejected the *very* principle set out in *Stone & Rolls*—namely that the fraud of the sole director *necessarily* means the one-person company commits a primary wrong.[253] Instead, the trio of considerations approach required an assessment "in consideration of the context and the purpose for which the attribution is relevant."[254] The relevant context in *Singularis* was the nature of the duty owed by the bank and whether the duty's purpose was "to protect the company against just the sort of misappropriation of its funds as took place here."[255] To attribute the fraud to the company would "denude the duty of any value in cases where it is most needed."[256] In effect, the trio of considerations approach pays close attention to whether disallowing the claim would allow the professional third party to avoid liability precisely when they had failed to perform a gatekeeping duty they owed the corporation. *Singularis* thus all but overruled *Stone & Rolls*.[257]

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247. See id. [16], AC at 1200.

248. Id.

249. Id.

250. Id. [17], AC at 1200–01.

251. Id. [18], AC at 1201.

252. Ivan Sin, Corporate Attribution and the Fallacy of the "One-Man Company": Finale of an Unfortunate Saga, 7 J. Bus. L. 542, 550 (2020).

253. See supra section II.B.1.

254. *Singularis*, UKSC 50 [34], AC at 1205 (quoting Singularis Holdings Ltd. v. Daiwa Cap. Mkts. Eur. Ltd. [2017] EWHC (Ch) 257, [182], [2017] 2 All ER (Comm) 445, 494).

255. Id. [35], AC at 1205.

256. Id. (quoting *Singularis*, EWHC (Ch) 257 [184], 2 All ER (Comm) at 495).

257. Id. [34], AC at 1205 (Lady Brenda Hale proclaimed that *Stone & Rolls* "can finally be laid to rest").

Singularis illustrates how the trio of consideration approach applies in corporate misconduct cases involving suits against professional third parties. It also showcases the revolution in English law that has taken place: The very outcome reached by the reliance approach in *Stone & Rolls* has now been rejected. The key emphasis is on aligning liability of professional third parties with the gatekeeping duties they owe and may have failed to perform.

III. BORROWING FROM THE ENGLISH

This Part shows that the English approach as applied in corporate misconduct cases emerges superior to American approaches to in pari delicto. First, section III.A illustrates how the English approach better aligns with the gatekeeping duties owed by professional third parties and promotes compliance with those duties. Section III.B notes the utility of incorporating the English approach into U.S. case law. Section III.C discusses the fiduciary duty exception, which allows corporations to sue their fraudulent or negligent corporate officers. Finally, section III.D recommends the fiduciary duty exception's expansion to professional third parties, based on a case-by-case examination of (1) the nature of the duty that the professional third party was under; (2) whether the duty's purpose would be enhanced by disapplying in pari delicto, and whether monitoring efforts by shareholders or independent directors will be enhanced by applying in pari delicto; and (3) any other countervailing policy considerations.

A. *The English Approach: Superior?*

The English approach emerges superior in aligning with the gatekeeping duties owed by professional third parties and promoting compliance with those duties. It does so by engaging with the duties owed by professional third parties and the policies justifying those duties. In *Singularis Holdings*, for example, the United Kingdom Supreme Court noted that to deny the claim would defeat the *very purpose of the duty imposed* and would detract from the policy which the duty was intended to further:[258] reliance on banks and financial institutions in combating financial crime.[259] The English approach thus addresses the very criticism mounted against traditional in pari delicto: the inapplicability of risk allocation arguments where professional third parties are hired precisely to guard against the corporate misconduct perpetrated.[260]

The English approach does not stop short at aiding and abetting fiduciary duty breaches, departing from Delaware. Moreover, unlike New

258. Id. [17], [35], AC at 1200–01, 1205.
259. Id. [17], AC at 1200–01.
260. See supra section I.B.2.

Jersey's approach, the English approach extends across all professional third parties. It does not require an independent contractual obligation between the professional third party and the corporation. It instead scrutinizes the nature of the duty owed by professional third parties and whether the duty appropriately calibrates the interests of the professional third party as against that of corporate clients. Where the corporate misconduct is of the kind that the professional third party was precisely under a duty to guard against, the defense is not available.

The trio of considerations approach also approximates suggestions in secondary literature in the United States. For example, Professor Paula Schaefer has argued to align in pari delicto with organizational attorney fiduciary duty, with professional conduct rules reflecting the duties owed to organizational clients.[261] Professor Kevin Michels has suggested a narrower "gatekeeper imputation exception," providing for in pari delicto not to operate where there is an express or implied obligation undertaken by attorneys.[262] Both approaches, while distinct, attempt to align in pari delicto's application to the content of gatekeeping duties owed by attorneys.[263] Yet there is no reason to confine this approach to attorneys: In pari delicto's application should only depend on whether a professional third party had a duty to discover, investigate, report, or otherwise act in circumstances where the corporate misconduct occurred.[264]

The English approach emerges superior to traditional in pari delicto and the approaches of leading states. It encapsulates the central thrust of approaches in academic literature: By taking into account the content of express and implied duties owed by professional third parties and asking whether any countervailing policy considerations militate otherwise, the

261. Schaefer, supra note 4, at 1049–61. Professor Schaefer notes that her formulation would enable the opportunity to present what a reasonably prudent, loyal attorney would have done in the circumstances, regardless of a specific undertaking to do so. Id. at 1058.

262. Michels, supra note 18, at 363 (internal quotation marks omitted). Implied obligations can be "derived from certain ethics rules . . . which require the attorney to undertake specific investigation or reporting efforts in carefully delimited instances." See id. at 364. In contrast to Professor Michels, Professor Schaefer repudiates the limitation to only circumstances where an express or implied obligation can be found: As her argument stems from the notion that an attorney's duty to monitor and intervene in corporate misconduct originates from an attorney's fiduciary duty of care and loyalty, the only question to be answered is what a reasonable attorney in that position would have done. See Schaefer, supra note 4, at 1057–58.

263. Professor Michels' approach appears not to require scrutiny of what a reasonable lawyer would have done and determines the content of an attorney's duty by looking at whether there existed a duty to investigate, arising out of an express obligation or implied obligation. Professor Schaefer, by contrast, examines the content of the duty by reference to "reasonableness." Their disagreement is not really concerned with in pari delicto but about what the content of an attorney's duty is. A consideration of the content of the duties of all professional third parties is, however, beyond the scope of this Note.

264. See supra sections II.A.2–.3.

English approach aligns with the gatekeeping duties owed by professional third parties and promotes compliance with those duties. The English approach's superiority justifies its incorporation into *in pari delicto* in U.S. case law.

B. *Incorporating the English Approach Into In Pari Delicto*

Despite vast literature and copious criticism of traditional approaches, in pari delicto remains difficult to reform. There exists, at the time of writing, no jurisdiction where statutory reform of in pari delicto has been undertaken. Attempts at reimagining in pari delicto and its adverse interest exception have been sought, such as in the Restatement (Third) of Agency.[265] Yet the Restatement's efforts have enjoyed little success.[266]

The New York Appellate Division's decision in *Conway*, however, showcases an increased judicial appetite for change.[267] Hence, this Note proposes a common law solution that aligns in pari delicto with gatekeeping duties owed by professional third parties like the English approach. This Note recommends an expansion of the fiduciary duty exception to professional third parties as a persuasive common law solution that American courts are likely to be receptive to.

C. *The "Fiduciary Duty" Exception*

When suits are brought against a corporation's officers by corporations themselves—or interestholders standing in the corporation's shoes—in pari delicto does not shield directors and officers.[268] Absent an exception, however, in pari delicto should operate in the following way: The wrong committed by the corporation's officers would be imputed to the corporation, and thus, it, as a wrongdoer, cannot receive assistance from the law to sue another wrongdoer.[269] The fiduciary duty exception to in pari delicto allows a corporation, or interestholders in succession

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265. See Restatement (Third) of Agency § 5.04 (Am. L. Inst. 2006) (incorporating the adverse interest exception to imputation doctrine and incorporating the good faith requirement on the part of third parties). The good faith approach, as adopted in Pennsylvania, however, does not go far enough. See supra section II.A.2.

266. See Loewenstein, supra note 44, at 364 (positing that § 5.04 of the Restatement has not formed persuasive authority in courts because it is "neither clear in its meaning nor accurate in its restatement of the law").

267. Courts, as Schaefer notes, often suffer from being "too rigid in following *in pari delicto* precedent." See Schaefer, supra note 4, at 1054.

268. See, e.g., *AIG II*, 976 A.2d 872, 876 (Del. Ch. 2009) (determining that AIG's suits were allowed to proceed against the corporation's own officers and employees without considering in pari delicto as "the doctrine does not have force in a suit by a corporation against its own officers or employees"); see also Schaefer, supra note 4, at 1014 ("The law allows a company to sues its employees without imputation barring the company's claims.").

269. See supra notes 9–11 and accompanying text.

standing in the shoes of a corporation, to sue a corporation's own fiduciaries—its own directors and officers.[270] As an exception to in pari delicto, the fiduciary duty exception must be justified on policy; it is not a mechanical application of imputation.[271] The exception is justified on the ground that "a corporation must act through its human agents, and that if those agents act in an ultra vires capacity and injure the corporation, those agents should bear responsibility to the [corporation]."[272] Otherwise, "fiduciaries [would be able to] immunize themselves through their own wrongful, disloyal acts," a "'transparently silly' result."[273] Fraud or disloyalty, however, is not needed. The fiduciary duty exception applies even if a corporation seeks to recover against an independent director who *negligently* failed to prevent harm by disloyal fiduciaries.[274] The duty breached is not a duty of loyalty,[275] but merely a duty of care.[276]

D. *Expanding the "Fiduciary Duty" Exception to Professional Third Parties*

In contrast to current case law and secondary literature—which have sought either to expand the adverse interest exception or create new exceptions[277]—this Note recommends expanding the fiduciary duty exception to encompass professional third parties beyond Delaware's approach. Professional third parties, such as attorneys, auditors, and banks, are not "the same as genuine third parties."[278] They are not

270. In re Walnut Leasing Co., No. 99-526, 1999 WL 729267, at *5 (E.D. Pa. Sept. 8, 1999) ("Vis-a-vis their corporations, insiders cannot avoid the consequences of their own handiwork."); 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."); *AIG II*, 976 A.2d at 889 ("[I]t is generally accepted that a derivative suit may be asserted by an innocent stockholder on behalf of a corporation against corporate fiduciaries who knowingly caused the corporation to commit illegal acts and, as a result, caused the corporation to suffer harm.").

271. 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.").

272. *AIG II*, 976 A.2d at 889.

273. Stewart v. Wilmington Tr. SP Servs., 112 A.3d 275, 304 (Del. Ch. 2015) (quoting In re HealthSouth Corp. S'holders Litig., 845 A.2d 1096, 1107 (Del Ch. 2003), aff'd, 847 A.2d 1121 (Del. 2004)).

274. *AIG I*, 965 A.2d 763, 828 n.246 (Del. Ch. 2009); see also Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985). In *Smith*, a company's directors were found to breach their fiduciary duties by acting grossly negligently when approving a CEO's plan to sell the company. Id. at 880. Breaching a director's duty of care in Delaware requires gross negligence: *Smith* would equally apply to officers who are merely negligent but breaching their duty. Id. at 873.

275. An alleged breach of a duty of loyalty typically involves allegations of fraud, bad faith, or self-dealing. *Smith*, 488 A.2d at 873.

276. Id. at 872–73.

277. See supra section II.A; see also supra notes 261–263 and accompanying text.

278. *AIG I*, 965 A.2d at 828 n.246.

entitled to deal with the corporation's officers on the assumption that their knowledge binds the principals, as they possess gatekeeping duties to monitor and investigate.[279] Like directors and officers, allowing professional third parties to wield in pari delicto is to allow them to immunize themselves through their own wrongful acts. It is equally silly to allow that result. Professional third parties are at least as well positioned as, and often more well placed than, independent directors to monitor and investigate corporate misconduct.[280] There is nothing justifying distinguishing between the former and the latter.

One might respond that unlike independent directors of corporations, many professional third parties are not fiduciaries.[281] Therefore, the argument goes, professional third parties should rely on in pari delicto where they did not undertake fiduciary obligations that directors and officers undertook. The distinctive element of a fiduciary relationship, however, is the obligation of loyalty.[282] While fiduciary duties of care may arise out of a relationship that also gives rise to fiduciary duty of loyalty, they much more closely resemble common law duties of care.[283] Such a

279. See supra sections II.B.2–.3.

280. See *AIG I*, 965 A.2d at 828 n.246 (endorsing this proposition in the case of auditors). This proposition should also extend to other professional third parties like attorneys or banks who enjoy the advantages of low-cost access to information and possess reputations and interests beyond the firm. See supra notes 103–105 and accompanying text.

281. Noteworthily, attorney–client relationships are fiduciary relationships, so the argument does not extend to attorneys and would only apply to auditors and banks. See Restatement (Third) of the L. Governing Laws. § 16(2)–(3) & cmt. b (Am. L. Inst. 2000) (defining an attorney's fiduciary duty as one that requires complying with confidentiality, avoiding conflicts of interest, dealing honestly with the client, and not taking advantage of the relationship). Since this Note seeks a unified approach across all professional third parties, it will nevertheless deal with this argument.

282. See, e.g., Deborah A. DeMott, Beyond Metaphor: An Analysis of Fiduciary Obligation, 1988 Duke L.J. 879, 915 (arguing that a director's duty of care to the corporation is "not distinctively fiduciary," since individuals can also owe duties of care to persons without being in fiduciary relationships with them); William A. Gregory, The Fiduciary Duty of Care: A Perversion of Words, 38 Akron L. Rev. 181, 183–88 (2005) (implying that a breach of the duty of care is not necessarily a fiduciary breach, because the latter requires disloyalty or infidelity (citing Mothew v. Bristol & West Bldg. Soc'y [1998] Ch 1, 18 (Eng.))). Moreover, under American agency law, the duty of loyalty is characterized as the sole fiduciary duty. See Christopher M. Bruner, Is the Corporate Director's Duty of Care a "Fiduciary" Duty? Does It Matter? 48 Wake Forest L. Rev. 1027, 1038 (2013) (noting that the Restatement (Third) of Agency characterizes only the duty of loyalty as a fiduciary duty and characterizes the duty of care as a duty of performance (citing Restatement (Third) of Agency §§ 8.01, 8.08 (Am. L. Inst. 2006))).

283. See, e.g., D. Gordon Smith, The Critical Resource Theory of Fiduciary Duty, 55 Vand. L. Rev. 1399, 1406–07, 1409 (2002) (noting that a duty of care is not distinctly fiduciary, since "the intensity of the duty of care is not dependent on whether the person is acting as a fiduciary"). This distinction supports the fact that fiduciary duties of care resemble common law duties of care. It is also consistent with most other common law jurisdictions—including the United Kingdom, Australia, and Canada—which do not consider the duty of care as uniquely "fiduciary" and treat it as being more akin to common law duties of care. See, e.g., Bruner, supra note 282, at 1028 & n.6, 1034–36.

position is taken in other common law jurisdictions, including the United Kingdom, Australia, and Canada.[284] These jurisdictions do not treat the duty of care associated with fiduciaries as being uniquely "fiduciary;" they instead treat such duties as akin to common law duties of care.[285] Thus, there exists no principled distinction between fiduciary duties of care and common law duties of care that professional third parties undertake, and the fact that independent directors are fiduciaries is irrelevant to whether in pari delicto should apply.

A common law approach expanding the fiduciary duty exception requires a court to assess whether in a particular case the professional third party should come within the exception. A court should, akin to the English approach,[286] assess (1) the nature of the duty that the professional third party was under, including whether the professional third party was under an express or implied obligation to monitor and guard against corporate misconduct; (2) whether the duty's purpose would be enhanced by disapplying in pari delicto, and whether monitoring efforts by shareholders or independent directors will be enhanced by applying in pari delicto; and (3) any other countervailing policy considerations. In many cases involving professional third parties, all three conditions will be satisfied. The professional third party will be under an express or implied obligation to monitor and guard against corporate misconduct. The duty's purpose will be to promote the protection of corporations against corporate misconduct. And monitoring efforts by shareholders would not be enhanced given that professional third parties are precisely hired to protect against misconduct. In such cases, the fiduciary duty exception should generally be applied. This approach also allows categories of professional third parties falling under the fiduciary duty exception to develop incrementally and analogically. Courts will ask whether a principled distinction exists that justifies treating a professional third party differently from corporate directors and officers.

Some courts have already acknowledged that the justifications for disallowing corporate directors and agents from relying on in pari delicto equally apply to professional third parties.[287] Moreover, *Conway*'s expansion implies that courts, even when purporting to apply traditional in pari delicto, are receptive to reinterpreting old doctrines to promote

284. See, e.g., Bruner, supra note 282, at 1028 & n.6, 1034–36.

285. Id.

286. See supra section II.C.

287. See *AIG I*, 965 A.2d 763, 828 n.246 (Del. Ch. 2009) (citing concerns with traditional in pari delicto as applied in New York, owing to the fact that a corporation's fiduciaries—its officers and agents—have never been allowed to rely on in pari delicto); see also *AIG II*, 976 A.2d 872, 890 n.49 (Del. Ch. 2009) ("[T]he policy basis for allowing such derivative suits can easily be seen as justifying claims against corporate agents . . . . If [professional third parties] fail in their duties as gatekeepers, there is a strong argument to be made that they ought to be accountable for their malpractice . . . .").

alignment with the gatekeeping duties that professional third parties owe. The fiduciary duty exception's expansion emerges as the strongest contender for a solution *explicitly* aligning in pari delicto with professional third parties' gatekeeping duties.

This Note, therefore, recommends that corporations or interestholders in succession not rely on the adverse interest exception in subsequent lawsuits, but instead reinterpret the fiduciary duty exception to encompass professional third parties that have undertaken gatekeeping duties to monitor and guard against corporate misconduct.

CONCLUSION

This Note has illustrated that traditional in pari delicto and the adverse interest exception are subject to three criticisms. In sum, they allow professional third parties to escape liability precisely when they fail to perform their duties. The three divergent approaches in leading jurisdictions also prove inadequate. While *Conway* illustrates an expansion of traditional in pari delicto, it leaves much to be desired as to how the adverse interest exception expands beyond its facts. It also fails to properly engage with the nature of the duty that professional third parties owe to corporations. By comparison, the English trio of considerations approach better engages with the calibration between protecting professional third parties and incentivizing professional third parties to perform their duties for the benefit of corporations and interestholders in succession. It also aligns with prior scholarship that has proposed numerous changes to the adverse interest exception or creating new exceptions altogether. Owing to the lack of meaningful legislative change to in pari delicto, incremental change through judicial decisionmaking emerges as the last resort. This Note thus has proposed a possible common law solution to approximate what the trio of considerations approach has achieved in England and Wales, relying on an expansion of the fiduciary duty exception. It is hoped that this Note will contribute to scholarship in the field and motivate interpretive changes to in pari delicto.