

**Suggested Reading on the *In Pari Delicto* Doctrine**  
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As the application of the *in pari delicto* doctrine in bankruptcy cases becomes more expansive, controversy about the courts' use of the doctrine continues to grow. Among the critics are two of your TACR Board members.

For those who aren't familiar with the *in pari delicto* doctrine, it is a mechanism by which courts will decline to allow litigation between parties who are "at equal fault" (which is basically what the phrase means). In its purest sense, the doctrine is easy to understand.

Say a 20-year old college student wants to buy alcohol for a big party he has planned and his 22-year old graduate student friend agrees to get it for him. The graduate student takes the money, but instead of buying the alcohol, he treats his girlfriend to a nice dinner out. If the college student sues for return of the money, his suit will be tossed because the contract was illegal. The same thing would happen if the graduate student bought the alcohol and the college student then failed to pay for it.

In bankruptcy, the facts are, naturally, much more complex. The typical scenario is that a company goes into bankruptcy and a trustee is appointed (this includes post-confirmation trustees). The trustee then sues the pre-petition lenders, professionals or others involved with the company on allegations that the defendant had harmed the corporation in some way, causing it to land in bankruptcy. The defendant responds with, "Maybe so, but the people who were running the company behaved just as badly as me and, because their acts are attributable to the corporation, it is *in pari delicto* with me and may not recover."

This sort of response has proven to be a successful one, with trustees finding their ability to recover damages in the above-described scenario stymied. Some bankruptcy practitioners, including TACR Board members Gerald Baldwin and Catherine Vance, disagree with the manner in which the courts are applying the *in pari delicto* doctrine and the results that application is bringing about.

In [\*In Pari Delicto Should Not Bar a Trustee's Recovery\*](#), Mr. Baldwin explains and takes issue with the rule that has developed that burdens the trustee with conduct that occurred before the company sought bankruptcy protection. As he states:

In the majority of bankruptcy cases, courts have recognized the trustee's standing but, nonetheless, have applied the *in pari delicto* defense to bar a recovery. Courts in these cases never examine the principles behind the defense or the inequity of its application to a trustee's claim. These courts generally conclude that permitting the trustee to avoid the defense would constitute an enlargement of the claims the debtor possessed, thus violating the tenets of [Bankruptcy Code] § 541.

Section 541, of course, defines what constitutes property of the bankruptcy estate. This would include the suits the trustee brings but also, according to the court decisions that Mr. Baldwin discusses, the defenses that could have been asserted against the company if there were no bankruptcy, including *in pari delicto*. Mr. Baldwin continues:

The purpose of the *in pari delicto* defense is to prevent the perpetrator of a fraud from benefiting from his wrongful act, not to shield a negligent defendant from all liability for his actions. The reason for the application of the defense to bar a recovery no longer exists once an innocent fiduciary has been appointed and any recovery would compensate innocent creditors. As the dissent in *Lafferty* found, equitable principles then dictate that the defense is no longer viable. If the defense remains viable in a bankruptcy, the equitable goals that created the *in pari delicto* doctrine are being ignored in the name of statutory construction. The defense was not fashioned by the courts for the protection of a negligent the accountant or lawyer.

Mr. Baldwin's article was published in the American Bankruptcy Institute Law Journal in October 2004 and, despite the passage of five years, its analysis and critique are as timely as ever, especially as *in pari delicto* has become even more expansive.

More recently, Catherine Vance asked in [In Pari Delicto, Reconsidered](#) whether "a lot of what we think we know about *in pari delicto* is wrong, that a large part of modern bankruptcy case law misapplies the doctrine." She then posits that the federal courts broke new ground in tying *in pari delicto* to agency law concepts and highlights exceptions to the doctrine that have existed since at least the 19<sup>th</sup> century, but which are all but ignored in the modern cases. Finally, Ms. Vance considered whether *in pari delicto* may be supplanting state law defenses to allegations of negligence and other conduct:

The way that we've been thinking about *in pari delicto* in bankruptcy cases is quite at odds with the comparative negligence regime, irrespective of the variances among the states. Not only does the *in pari delicto* analysis precede, rather than follow, a merits-based determination on the elements of negligence, it may be resulting in the dismissal of cases that, under state law, would allow the plaintiff to recover.

Ms. Vance more fully explored this notion of supplanting state law defenses a few weeks later in, [In Pari Delicto and a Jurisprudential House of Cards](#), which was published as a guest post to Steve Jakubowski's [Bankruptcy Litigation Blog](#). Examining a federal appellate court's invocation of *in pari delicto* notwithstanding the applicable state's adoption of a pure comparative negligence standard, Ms. Vance concluded:

[Pure comparative negligence] means, generally speaking, that the plaintiff can recover unless the plaintiff is solely and entirely to blame for

the harm it suffered. Now, based on the facts set out in the district and appellate courts' decisions, it's likely that the [plaintiff] would have lost upon proper application of the comparative negligence standard but that does not diminish the fundamental legal error both courts made. The *in pari delicto* analysis is flatly inconsistent with a pure comparative negligence regime because the latter allows recovery that is forbidden by the former. By interposing *in pari delicto* and its consequent search for equal or mutual fault, these courts have, quite literally, judicially altered New York's comparative negligence statute.

These articles are surely not the last word on *in pari delicto*. TACR is pleased that it is able to make such works available to you and invites you to join in the discussion with an article of your own. If you have an article you would like to submit, please contact Christy Canty at [ccanty@cincytacr.com](mailto:ccanty@cincytacr.com).