

Doctrine of In Pari Delicto Did Not Bar Trustee's Claims

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In re Hoang, ___ B.R. ___, 2011 WL 1237652 (Bankr. D. Md. 2011)

Brief Summary

A Maryland bankruptcy court held that the doctrine of *in pari delicto* did not apply to bar a Chapter 7 bankruptcy trustee's claims against a title company and a law firm, and that the "sole actor" exception, which itself is an exception to the "adverse interest exception," was inapplicable. Defendants' motion to dismiss plaintiff's claims was thus denied.

Complete Summary

Plaintiff was a Chapter 7 bankruptcy trustee who filed a multicount complaint against a title company, and a law firm and a lawyer (collectively "the law firm"), alleging that defendants knowingly aided and abetted the debtor in an asset-concealment scheme after she filed bankruptcy and while she served as debtor-in-possession.

The debtor filed a petition for relief under Chapter 11 of the U.S. Bankruptcy Code on May 10, 2005. She served as debtor-in-possession until the trustee was appointed a Chapter 11 trustee on August 31, 2005. Shortly thereafter, the case was converted to Chapter 7 and the trustee was appointed the Chapter 7 trustee. Before filing bankruptcy, the debtor engaged in a massive asset-concealment scheme and allegedly relied on defendants in carrying it out. Since 1998, the debtor had purchased distressed real estate at foreclosure and sold those properties at a profit. She concealed those assets through sham entities and paperless transactions in an effort to impede judgment creditors from executing on any judgments.

The debtor used the title company as the settlement company in the purchase and sale of hundreds of properties. She also used an attorney trust account maintained by the law firm as a private bank account exclusively for her benefit. The debtor continued her asset-concealment scheme after she filed her bankruptcy petition. It was the debtor's and defendants' post-petition conduct that formed the basis for the trustee's claims.

The trustee alleged that defendants aided and abetted the debtor's fiduciary breach in concealing and funneling ownership interests in various parcels of property and "sham" partnerships to entities controlled by the debtor.

The court considered whether the wrongful acts committed by the debtor post-petition while she was also serving as a debtor-in-possession should be imputed to the trustee, as Chapter 7 trustee, so as to bar recovery under the doctrine of *in pari delicto*. Defendants argued that the trustee stood in the debtor's shoes because the debtor had allegedly committed the wrongful acts while serving as debtor-in-possession, and the trustee is the successor to the debtor-in-possession. According to defendants, under the doctrine of *in pari delicto*, the debtor would be barred from recovering for wrongful conduct in which she participated, and the trustee should thus also be barred from recovering from defendants. The trustee argued that the doctrine did not apply to post-petition actions by a debtor-in-possession.

The court noted that "[i]n *pari delicto potior est conditio defendantis*" translates to mean "[i]n a case of equal or mutual fault . . . the position of the [defending] party . . . is the better one." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985) (citing Black's Law Dictionary 711 (5th ed.1979)). "The doctrine of *in pari delicto* provides that a plaintiff may not assert a claim against a defendant if the plaintiff bears fault for the claim." *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 354 (3d Cir.2001). "The defense is grounded on two premises: first, that courts should not lend their good offices to mediating disputes among wrongdoers; and second, that denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality." *Bateman Eichler*, 472 U.S. at 306 – 07.

The court then recognized that the application of the *in pari delicto* doctrine to claims by a trustee grounded in a debtor's pre-petition activities seems fairly well settled. The doctrine is often applied to bar claims of a trustee against third parties. As noted, however, the trustee asserted claims against defendants based on their involvement in the debtor's post-petition activities. The court stated that although defendants cited numerous cases that address the application of *in pari delicto* to actions that arose pre-petition, they cited no cases that address the application of the doctrine to claims against third parties based on their involvement with post-petition misconduct by a debtor-in-possession.

The court concluded that the doctrine of *in pari delicto* does not bar a Chapter 7 bankruptcy trustee from pursuing claims against third parties who participate in fraud or other misconduct post-petition. The court added that it would reach the same conclusion by applying the imputation principles that courts consider under the *in pari delicto* doctrine. Under the law of imputation, an agent's fraud or applicable misconduct will be imputed to the principal if the agent commits the fraud (1) in the course of employment and (2) for the benefit of the principal. *Lafferty*, 267 F.3d at 359 (discussing imputation law in context of officer/corporation relationship). The court concluded that neither element existed here. The court held that the adverse interest exception applied and was not subject to the "sole actor" exception because the debtor not only was obligated to "inform herself" but also the court, the creditors and the U.S. trustee of her misconduct; instead she filed false statements under penalty of perjury.

Significance of Opinion

Although the Maryland bankruptcy court recognized that the *in pari delicto* doctrine has been applied to bar claims by a bankruptcy trustee based on a debtor's pre-petition activities, it refused to apply the doctrine to preclude a Chapter 7 bankruptcy trustee from pursuing claims against third parties who participate in fraud or other misconduct post-petition.

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