St. Mary's Journal on Legal Malpractice & Ethics

Volume 4 | Number 1 Article 8

1-1-2014

The Corporate Attorney as "Internal" Gatekeeper and the In Pari Delicto Defense: A Proposed New Standard

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ARTICLE

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The Corporate Attorney as "Internal" Gatekeeper and the *In Pari Delicto* Defense: A Proposed New Standard

Abstract. This Article begins by proposing a distinction between the corporate lawyer's "internal" and "external" gatekeeping role in order to focus on the special challenge posed by the former. As internal gatekeeper, the corporation lawyer is charged with the restraint of the corporation's executives and other employees to prevent harm to the lawyer's corporation client. The external gatekeeper, by contrast, restrains the client to prevent harm to third parties. While each gatekeeping role presents challenges in defining the duties and liability of attorneys, the internal-gatekeeping role is subject to a special defense that can insulate attorneys from liability. Attorneys can interpose an *in pari delicto* defense to corporation claims for malpractice, arguing that knowledge of the executive's wrongdoing should be imputed to the corporation and, as a result, the latter should be barred from recovery because it is "equally or more culpable" than the failed attorney gatekeeper. To date, courts have struggled to determine when executive wrongdoing should be imputed to the corporation, and whether and how to craft exceptions to accommodate the divergent goals of holding corporations accountable for their agents' wrongdoing, while incentivizing lawyers to perform properly as internal gatekeepers.

This Article proposes what it terms the "gatekeeper-imputation" exception to the general rule that knowledge of the executive's wrongdoing should be imputed to the corporation when attorneys seek to interpose an *in pari delicto* defense to allegations of malpractice by a corporate client. When the law firm has expressly or impliedly assumed an obligation to identify or report employee wrongdoing, then information that would have been discovered had the law firm fulfilled that obligation, should not be imputed to the corporation for purposes of the *in pari delicto* defense. Whether the attorney has assumed a gatekeeping role, in turn, should be informed by the express agreements of the corporation and law firm, and in the absence of such agreement, the ethical and statutory gatekeeping duties typically imposed on counsel. The proposed standard will respect the normative basis for imputation, while optimizing the gatekeeping incentives of the corporation and the law firm.

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INTRODUCTION

The vision of the corporation attorney as "gatekeeper" has gained currency in recent years, even if the precise contours of that role remain less than clear. At a minimum, the lawyer-gatekeeper serves as a voice of client restraint in preventing wrongdoing as a part of her commitment to the client, third parties, and the legal order. Although "gatekeeping" often entails restraining the corporation client to protect third parties who might be harmed by the client's wrongdoing,[1] it also includes a lawyer's effort to prevent harm to the corporation client.[2] While we speak in broad strokes about gatekeeping, a single term applied to the lawyer's prevention of wrongdoing obscures a critical distinction: as a result of the *in pari delicto* defense discussed below, the legal standards for recovery against a lawyer for failure in the gatekeeping role vary dramatically, depending on whether the party alleging harm is the corporation client or a third party.

This Article begins by offering a new taxonomy to refine our understanding of the corporate lawyer's gatekeeping role. It distinguishes between "internal" gatekeeping—designed to protect the corporation client from harm—and "external" gatekeeping—in which the lawyer seeks

1. *E.g.*, John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 304 (2004) (describing gatekeepers as "the professionals who serve investors by preparing, verifying, or certifying corporate disclosures to the securities markets").

2. *E.g.*, Rutheford B Campbell, Jr. & Eugene R. Gaetke, *The Ethical Obligation of Transactional Lawyers to Act As Gatekeepers*, 56 RUTGERS L. REV. 9, 9 (2003) (discussing lawyer gatekeeping and focusing on "the lawyer's duty to take action within the corporation to protect the corporate client from harm and restrict the lawyer's participation in the corporate manager's misconduct").

to prevent the corporation or its actors from harming third parties. After distinguishing the internal and external gatekeeping roles, this Article turns to a distinctive challenge posed by the *internal*-gatekeeping role. In certain instances, the lawyer who fails in her duty to protect the client harms the corporation through a breach of the duty of care. If the corporation is to be made whole, and the incentives for internal gatekeeping are to be optimized, the corporation must—in certain circumstances—have the right to recover damages resulting from the lawyer's breach. The corporation's recovery for malpractice for this failed gatekeeping role will be far from straightforward, however. The corporation client that sues its own lawyer for failure in the gatekeeper role will face the centuries-old, equitable defense of *in pari delicto*. *In pari delicto* or "in equal fault" bars a plaintiff from recovering against a tortfeasor when the plaintiff's wrongdoing was equal to or greater than the defendant's.[3]

The defense itself seems sensible in the traditional setting of attorney and client: it is grounded on the equitable notion that courts should not compensate the client for his own intentional or criminal wrongdoing.[4] The defense takes a curious turn, however, when the malpractice plaintiff is a corporation whose executive has committed fraud or other wrongdoing, and the defendant is the lawyer who failed to discover or report this information to the corporation client.[5] Citing agency law principles, courts have imputed knowledge of the wrongful acts of the executive to the corporation.[6] As a result, courts have held that the corporation whose executive committed the crime or fraud is equally or more guilty than the attorney who failed to discover or report the wrongdoing, thereby shielding the attorney from corporate claims for malpractice under the *in pari delicto* defense.[7] Thus understood, the *in*

3. *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985) (defining the common law defense *in pari delicto*); Nisselson v. Lernout, 469 F.3d 143, 151 (1st Cir. 2006) (noting *in pari delicto* bars "plaintiffs from recovering damages resulting from their own wrongdoing"); Am. Trade Partners, LP v. A–1 Int'l Importing Enters., Ltd., 770 F. Supp. 273, 276 (E.D. Pa. 1991) (using *in pari delicto* to determine whether recovery of damages is barred).

4. *See Bateman Eichler*, 472 U.S. at 306 (noting that it is inequitable to "mediat[e] disputes among wrongdoers"); *Am. Trade Partners, LP*, 770 F. Supp. at 276 (explaining *in pari delicto*).

5. *See* Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 453 (7th Cir. 1982) (asking whether the defendant is "entitled to use the wrongdoing of Cenco's managers as a defense against the charges of breach of contract, professional malpractice, and fraud").

6. *See id.* at 456 (noting that the jury was instructed that it could attribute management fraud on behalf of the corporation to the corporations); Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Research Found. v. PriceWaterhouseCoopers, LLP, 989 A.2d 313, 325 (Pa. 2010) (recognizing that many courts impute fraud by management to the corporation).

7. *See Cenco*, 686 F.2d at 456 (holding that Cenco is unable to claim *in pari delicto*); *PriceWaterhouseCoopers*, 989 A.2d at 325 (deciding Cenco is unable to claim *in pari delicto*).

pari delicto defense can insulate counsel from civil accountability for failing to detect or take actions to prevent the intentional or criminal wrongdoing of executives.

Corporations may expect—if not expressly retain counsel to serve in the gatekeeper function—in part to prevent executives from involving the corporation in fraudulent or criminal activities. Should the *in pari delicto* defense categorically eliminate the right of corporations to rely on attorneys in fulfilling their ethical and statutory duties to prevent executive wrongdoing? Is this the price we must pay for a coherent *in pari delicto* defense? And if so, is the corporate attorney really an *internal* gatekeeper by any measure that matters?

Part I will begin by distinguishing the internal and external gatekeeping roles, and ground the discussion by offering examples of the archetypal internal-gatekeeping failure—the corporate attorney who breaches a duty to investigate, discover or report an executive's criminal or fraudulent wrongdoing.[8] Part II will examine the corporation lawyer's ethical duties in these circumstances—since such duties will prove relevant under the proposal that is offered later in this Article. Part II will next ask whether the corporate client could make out a prima facie malpractice case against the lawyer on these facts, exploring the critical relation between ethical breaches by counsel and claims for malpractice.

Part III will examine how the corporation's case against its duty-breaching attorney would fare under the *in pari delicto* defense. It will provide an overview of the defense, its development generally and in connection with claims against gatekeepers—attorneys and others—in the corporate setting. The central question, it turns out, is when the wrongdoing of the executive should be imputed to the corporation, thereby rendering the corporation subject to the *in pari delicto* defense. Part III will provide a sketch of approaches that courts have fashioned on the imputation question, parsing them into three categories for discussion purposes. Part IV will explore the tensions posed by the sometimes conflicting goals of imputation and gatekeeping that are galvanized by the *in pari delicto* defense.

Part V will seek to reconcile those competing goals into a new

8. We will focus on the hypotheticals of this kind because in many ways they are the archetypal gatekeeping failure, and the criminal or fraudulent nature of the wrongdoing directly implicates the *in pari delicto* defense. There are, of course, other scenarios in which the attorney's failures to prevent client wrongdoing could harm the corporation—the failure to prevent breaches of fiduciary duty, for example. Because *in pari delicto* is an equitable defense, and given the delicate distinctions that inform our analysis of when it should and should not apply, the reader should not assume that the analysis here applies without qualification to other attorney internal-gatekeeper failings.

imputation exception focused on whether the lawyer has expressly or impliedly assumed gatekeeping duties. This "gatekeeper-imputation exception" will invite courts to respect any express agreement between the corporation and the law firm with respect to the latter's gatekeeping duties and, in the absence of such agreement, to isolate attorney ethical or statutory gatekeeping failures as those that should not be subject to imputation. Part V will apply the test across the range of hypotheticals introduced in Part I, and explain why the proposed test respects the normative basis for imputation, while optimizing the gatekeeping incentives of the corporation and the law firm.

I. THE PROBLEM: CONTEXT AND CHALLENGES

A. *The Internal and External Gatekeeping Roles*

When corporation employees engage in wrongdoing, the victims are often legion—the corporation itself, the shareholders, and third parties who were harmed by the wrongdoing. In certain instances, the corporation attorney, as gatekeeper, must take action to prevent wrongdoing by the corporation client. When she fails to take such action despite an obligation to do so, those who are harmed may seek recovery against the lawyer.

The challenges posed by claims against lawyers for failings in the gatekeeping role can vary considerably depending on who brings the claim. When those who are not a party to the attorney–client relationship sue the attorney, courts have struggled with whether and when to allow such claims. Claims by non-clients or third parties are challenging in part because they may, if recognized, create obligations that undermine the attorney's duties to her *client*. In earlier works, I have explained the external-gatekeeping challenges at length.[9] When the *client* sues the attorney for failures in the gatekeeping role, the analysis differs radically. Here, we are less concerned with the tensions posed by competing obligations: the duty to the client is readily recognized under basic malpractice principles. Instead, we face a distinctive barrier to analysis of the malpractice claim against the lawyer for failed gatekeeping. If the

9. *See* Kevin H. Michels, *Third-Party Negligence Claims Against Counsel: A Proposed Unified Liability Standard*, 22 GEO. J. LEGAL ETHICS 143, 159–69 (2009) (proposing a test to determine when attorneys should be liable for negligence to nonclients); *see also* Kevin H. Michels, *Lawyer Independence: From Ideal to Viable Legal Standard*, 61 CASE W. RES. L. REV. 85, 111–20 (2010) (arguing that the lawyer's independent requirements of the Rules of Professional Conduct are designed to prevent the client from harming third parties).

wrongdoing is that of a corporate employee, should we ascribe knowledge of the wrongdoing to the corporation? If so, should the corporation's "knowledge" bar it from suing its own attorney?

Given the distinct challenges posed by claims against gatekeepers, we might profitably parse the gatekeeping role into two categories: internal and external. The internal-gatekeeping role concerns protection of the *client* against wrongdoing caused by its employees. Often these corporate employees will harm third parties through criminal or fraudulent behavior, and the third party will sue the corporation for damages resulting from such wrongful behavior. Even though a third party is involved, the corporation may seek recovery against its lawyer for failure to discover or report the executive wrongdoing that lead to its liability to a third party. Because the claim is one of malpractice by the corporation against its *own lawyer* for failure to take action that lead to the corporation's losses, I will characterize this as internal-gatekeeping question. The external-gatekeeping role concerns the lawyer's protection of third parties, i.e., those other than the client, against the wrongdoing of the corporation and its representatives. While there is clearly overlap between the internal and external-gatekeeping roles, they are sharply distinct in terms of who seeks relief against the lawyer—the corporation client or the third party.

In this Article, I propose to examine a central challenge posed by the internal-gatekeeping role—asking when we should ascribe the wrongdoing of the corporate representative to the entity itself, and whether such knowledge should bar corporations from suing their attorneys for failure in the internal-gatekeeping role. To ground our discussion, I will offer some examples of the failed internal-gatekeeping role below.

B. *Internal Gatekeeping Failures: Examples*

The troubling behavior often begins with the rogue executive—the CEO, President, Vice President, or executive below the officer rank who engages in wrongdoing of some kind or another. The gatekeeping problem concerns the corporation lawyer's knowledge, discovery, or reporting of the executive's wrongdoing. In each of the examples that follow, we will assume that the corporation has no actual knowledge of the executive's wrongdoing. The question in each of the examples is whether the law firm should bear liability for its failure to discover or report the executive's wrongdoing to the board of directors of the corporation.

Hypothetical A: The "Knowing" but Silent Attorney

Mary Roberts, outside counsel to Fast Pharma, Inc. ("Fast"), learns that four individuals have suffered strokes during the clinical trials of the company's memory-improvement medicine. Division Vice President Joe Davis instructs Roberts not to list the four "adverse" events in its periodic reporting to the Food and Drug Administration (FDA). Roberts advises Davis that nondisclosure is unlawful, and states that he will handle the filings himself. Roberts does not participate in the periodic company reporting, but takes no other action to prevent the false filings. After additional injuries, an investigation discovers that the company withheld information from the FDA, and a criminal indictment and personal injury actions are lodged against the company. Fast sues Roberts and her firm.

Hypothetical B: The Reckless or Willfully Blind Attorney

In scenario A, assume instead that Davis has told Mary nothing about the adverse events, but that Mary learns of allegations suggesting such wrongdoing. She intentionally chooses not to ask follow-up questions, on the theory that she might turn suspicion into "knowledge" of wrongdoing and therefore be required to report on the executive's wrongful design. She files the FDA report, which lists no adverse events. The corporation later discovers that the company withheld information from the FDA, and a criminal indictment and personal injury actions are lodged against the company. Fast sues Roberts and her firm.

Hypothetical C: The Negligent Attorney

In scenario A, assume instead that Mary has no knowledge of the adverse events, but hears a rumor suggesting such wrongdoing. She negligently (let us assume) fails to ask follow-up questions, and files the reporting document with the FDA, which lists no adverse events. The corporation later discovers that the company withheld information from the FDA, and a criminal indictment and personal injury actions are lodged against the company. Fast sues Roberts and her firm.

Hypothetical D: The Negligent Investigator

In scenario C, assume instead that Mary has no knowledge of the adverse events, and that the corporation, having received an anonymous tip on the employee hotline, suspects that some adverse advents may not have been reported. Fast hires Roberts and her law firm to conduct an internal investigation. Roberts and her firm conduct the investigation negligently and discover no wrongdoing. Fast completes its filing without disclosing any adverse events. Fast later discovers that it withheld information from the FDA, and a criminal indictment and personal injury actions are lodged against the company. Fast sues Roberts and her firm.

While the particulars vary, each hypothetical describes instances in which failings by corporate attorneys are connected with a harm suffered by the company. In each instance, the corporate executive has engaged in intentional wrongdoing, and counsel failed to take action that likely would have prevented the wrongdoing. In the second and third scenarios, the attorney not only failed to prevent the wrongdoing, she engaged in affirmative efforts to further the fraud—witting or otherwise.

Hypothetical E: The Thieving CEO

Consider a new scenario. Attorney Roberts knows or has reason to know that Division Vice President Joe Davis owns a dummy corporation that, unbeknownst to others at Fast, is receiving payments from Fast. She does not advise the President or the board of the wrongdoing. Upon discovering Davis's theft, Fast sues Roberts and her firm.

In each of the examples, we are focused on whether the corporation can bring a claim against the lawyer for failure to prevent some portion of the losses that would have been prevented by the lawyer's disclosure to officials who were higher up *within* the organization. Our question here is not whether the attorney breached a duty by failing to disclose to parties *beyond* the corporation, such as shareholders who might have prevented the fraud or potential victims who might have avoided the harm with the benefit of notice.[10] By restricting our inquiry to this question, we isolate the central challenge posed by corporate malpractice claims against lawyers who fail in the internal-gatekeeping role: the lawyer's interposition of the *in pari delicto* defense.[11] The defense will assert that the wrongdoing of

10. These are important gatekeeping questions, of course, but they are outside the scope of this Article, which isolates the "internal gatekeeping" questions in order to explore the *in pari delicto* defense.

11. A valuable scholarly treatment of attorney gatekeeper liability is found in George C. Harris, *Taking the Entity Theory Seriously: Lawyer Liability for Failure to Prevent Harm to Organizational Clients Through Disclosure of Constituent Wrongdoing*, 11 GEO. J. LEGAL ETHICS 597 (1998). That piece considers attorney liability not only for failings in what I term the "internal" gatekeeping role, but also for failures to disclose beyond the corporation. The breadth of the article prevents Professor

the executive should be imputed to the corporation, even though the latter is—we shall assume—unaware of the wrongdoing. Before we consider the defense, however, it would be helpful to analyze the propriety of the attorney's behavior in each instance under the ethics rules and legal malpractice standards.

II. THE PRIMA FACIE CASE AGAINST COUNSEL

In this section, we will examine the nature of the attorney's wrongdoing in each of the hypotheticals offered in Part I, and ask whether the corporation can make a prima facie case of malpractice prior to interposition of the *in pari delicto* defense. I will begin by offering a brief overview of the relationship between a breach of the legal ethics rules and malpractice. Thereafter, I will examine the attorney's behavior under the attorney ethics rules. I will then consider the legal malpractice standards in light of the ethics analysis and the more general duties of care imposed on attorneys. Later in this Article, the ethics analysis will return to center stage in explaining how the courts should evaluate the *in pari delicto* defense.[12]

A. *The Ethics Rules*

As a general rule, a breach of the attorney ethics rules is not the basis for a cause of action against counsel for malpractice. The ethics rules can, however, provide evidence of the duty of care owed to the client. Accordingly, a breach of the ethics rules is evidence of a breach of the duty of care in a malpractice matter brought by the client against counsel. Thus, a critical threshold question is whether the attorneys violated the attorney ethics rules in the hypotheticals offered in Part I.

We will begin with Rule 1.13(b) of the *Model Rules of Professional Conduct*,[13] which is worth quoting in its entirety:

Harris from engaging in an extended analysis of the *in pari delicto* question addressed here, which he in passing suggests should be treated as "a matter of duty and causation." *Id.* at 631. In Part V. subsection A., I argue that a duty of care analysis alone is insufficient, and propose a new test by which to determine when imputation is inappropriate, focusing on the importance of the lawyer's gatekeeping role in the corporation's overall monitoring efforts.

12. *See infra* Part V., subsection A.

13. The American Bar Association promulgated the Model Rules of Professional Conduct in 1983, and has amended them frequently thereafter. CTR. FOR PROF'L RESPONSIBILITY AM. BAR ASS'N, ANNOTATED MODEL RULES OF PROF'L CONDUCT (2013). Forty-nine states have adopted some version of the Model Rules, often with amendments. *See* ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT 51:303–04 at 247 (Mar. 31, 2010) (providing an overview of state variations of ABA Model Rules). California is also considering adoption of the Model Rules. *See Proposed Rules of Professional Conduct*, THE ST. BAR OF CAL., http://ethics.calbar.ca.gov/

> If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act[,] or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.[14]

The lawyer in hypothetical A knew that an officer or other employee (Davis) was about to act wrongfully.[15] The question is whether the wrongdoing is of the type identified by Model Rule 1.13 as reason for action by the lawyer.

Under Model Rule 1.13(b), the question is whether the executive intended to (or did) (1) violate "a legal obligation to" the corporation, or (2) violate a "law that reasonably might be imputed" to the corporation, which (3) is likely to result in substantial injury to the corporation.[16] In A, the attorney was about to withhold critical safety information from the FDA, a violation of FDA regulations[17] and a potentially criminal act that would be imputed to the corporation. Moreover, by engaging in fraud, even fraud that is not theft from the corporation, the executive may be violating the fiduciary duty of care owed to the corporation[18] and the implied or express terms of his employment agreement.[19] The Restatement Governing Lawyers provides that an executive "violates a legal obligation to the organization" by an "act or failure to act . . . that, although perhaps intended to serve an interest of the organization, will foreseeably cause injury to the client, such as by exposing the organization

Portals/9/documents/CRRPC/RRC%20Final%20Docs/ProposedRulesofProfessionalConduct011014.pdf (last visited Apr. 20, 2014) ("[T]he State Bar submitted an initial group of proposed Rules of Professional Conduct to the Supreme Court for approval.").

14. MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2013).

15. *Id.* R. 1.0(f).

16. *Id.*

17. 21 C.F.R. § 314(c) (2013).

18. *See* MODEL BUS. CORP. ACT § 8.42(a) (2002) (imposing duty of care on officers); *id.* § 8.42(b)(2) (requiring officer to report "actual probable violation of material law" to superior officer or board).

19. Antioch Litig. Trust v. McDermott Will & Emery LLP, 738 F. Supp. 2d 758, 766 (S.D. Ohio 2010); *In re* Am. Int'l Grp., Inc., 965 A.2d 763, 777 (Del. Ch. 2009).

to criminal or civil liability[,]"[20] a standard clearly satisfied here.

In addition, the executive's wrongdoing in A seems likely to visit substantial harm to the corporation. The nondisclosure could lead to a criminal charge and expose the corporation to substantial civil liability. The fraud on the FDA coupled with the presumed continued sales of the drug made possible by such fraud could lead to massive personal injury liability.

Thus, it is clear that the executive in A triggered an obligation of the attorney to act. The lawyer's obligation is straightforward enough under Model Rule 1.13. She should have "[referred] the matter to higher authority within the organization."[21] This is hardly an extraordinary demand. In A, it would entail advising the Division President or the Board of Directors. The duty is slight and it presents almost no countervailing concern: it does, at least in the first instance, require reporting beyond the corporation, so client confidentiality is not threatened by the reporting. Moreover, the duty reflects the black letter law of entity representation: the lawyer owes his duties to the organization, not the constituents.[22] The duty to report to a higher authority in the organization also aligns with the other ethical duties imposed on counsel.[23] Model Rule of Professional Conduct (RPC) 1.6(b) allows reporting beyond the corporation in order to prevent reasonably certain crime or fraud that will result in substantial injury to another.[24] The lawyer does not perform competently[25] or diligently[26] if she fails to report to others within an organization that a constituent is about to expose the organization to grave harm.[27] The lawyer's silence likewise conflicts with

20. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96 cmt. f (2000). The Restatement comment interprets a standard nearly identical to that contained in Model Rule 1.13(a): requiring action by the lawyer when the executive "violates a legal obligation to the organization." *Id.*; MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2013).

21. MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2013).

22. *See id.* R. 1.13(a) ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."). Moreover, "a lawyer representing only an organization does not owe duties of care, diligence, or confidentiality to constituents of the organization." RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 96 cmt. b (2000) (citations and footnotes omitted).

23. MODEL RULES OF PROF'L CONDUCT R. 1.13 (2013).

24. *Id.* R. 1.6(b).

25. *See id.* R. 1.1 ("Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for representation.").

26. *See id.* R. 1.3 ("A lawyer shall act with reasonable diligence and promptness in representing a client.").

27. *See* RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 96 cmt. e (2000) ("A lawyer is also required to act diligently . . . by taking steps to prevent reasonably foreseeable harm to a

the lawyer's communication as well.[28]

The lawyer's duty in B is complicated by the lawyer's reckless disregard of evidence of the executive's wrongdoing or willful blindness. We will assume that the lawyer was "successful" in her efforts to remain ignorant, and that she does not have "knowledge" as defined by RPC 1.0(f), i.e., "actual knowledge of the fact in question."[29] A critical question is whether this behavior would somehow insulate her from ethical wrongdoing. I have argued elsewhere that an attorney's decision to ignore evidence that arouses reasonable suspicion of client crime or a fraud before furthering a client transaction violates the attorney's duty to exercise independent professional judgment under RPC 2.1.[30] The willful blindness likely violates the duties of competence and diligence as well.

In C and D, the lawyer's mental state falls below that which would trigger either a reporting requirement under RPC 1.13 or a duty of further investigation under RPC 2.1. Although negligent behavior may violate the duties of competence and diligence, we should be slow to cast all acts of negligence as ethical breaches. It is true, however, that the attorney in each of these scenarios has failed her client in a critical gatekeeping sense—by failing to take reasonable actions that likely would have led to discovery and prevention of intentional wrongdoing.

In E, the facts have changed substantially. When the lawyer has knowledge of the executive's thieving from the corporation, her inaction and silence are clearly a breach of that Rule 1.13(b).[31] When the lawyer's mental state falls below knowledge, Rule 1.13(b) would not be triggered, and thus "reason to know" may fall short of such knowledge, as discussed earlier.[32]

B. *Malpractice: The Prima-Facie Claim*

If the attorneys in at least some, if not all, of our hypotheticals are to be internal gatekeepers—that is, if they have some duties to protect the

client.").

28. *See* MODEL RULES OF PROF'L CONDUCT R. 1.4(b) (2013) ("A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.").

29. *Id.* R. 1.0(f) ("A person's knowledge can be inferred from circumstances."); *see also id.* R. 1.0 cmt. 3 ("As defined in Rule 1.0(f), knowledge can be inferred from circumstances, and a lawyer cannot ignore the obvious.").

30. Kevin H. Michels, *Lawyer Independence: From Ideal to Viable Legal Standard*, 61 CASE W. RES. L. REV. 85, 96 (2010).

31. MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2013).

32. *Id.*; *Id.* R. 1.0 (f); T. Leigh Anenson, *The Triumph of Equity: Equitable Estoppel in Modern Litigation*, 27 REV. LITIG. 377, 399–400 (2008).

corporation client from the wrongdoing of its executives in certain instances—then it seems fair to ask whether any financial responsibility will attach for their dereliction of that duty.[33] In this section, we will consider whether the corporation in our hypotheticals can satisfy the basic elements of a malpractice claim against counsel. In Part III, we will explore the *in pari delicto* defense that counsel would likely interpose in response to a malpractice claim.

In order to prevail in a malpractice claim against the attorneys in A and B, the corporations must establish that: (1) the defendant owed the plaintiff a duty of care; (2) the defendant breached this duty; (3) the breach was the cause of plaintiff's harm; and (4) plaintiff suffered damages.[34] The first of these elements is beyond question: the attorney owes a duty of care to the client simply by dint of the attorney–client relationship.[35] The second element of a malpractice claim often takes center stage because of the challenges posed by establishing the contents of the duty owed to the client, and it will be the centerpiece of our discussion here. The corporations in our hypotheticals will require expert testimony to establish the content of the duty of care in a malpractice claim.[36] The third and fourth elements are largely fact questions, although our circumstances pose challenges that warrant mention here.

In the analysis that follows, we will consider both a breach of the ethics rules and a breach of the standard of care. The ethics rules are relevant here for two reasons. First, the corporation's expert can cite the attorney-ethics rules as evidence of the duty of care, provided that the rule was designed to protect the client in the circumstances in question.[37] Second, the ethics analysis will bear on our analysis of whether the *in pari delicto* defense should apply (as discussed in Part IV, subsection A). Of course, an

33. *See* RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 50 (2000) ("The provision of a civil remedy is also important because the lawyer owes special obligations to a client and because the proper functioning of the legal system depends on competent legal representation."). "For purposes of liability . . . a lawyer owes a client the duty to exercise care . . . in pursuing the client's lawful objectives in matters covered by representation." *Id.*

34. W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 30, at 165–66 (5th ed. 1984).

35. RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 50 (2000). In fact, some courts assume a duty once an attorney–client relationship is established. *See, e.g.*, Wachovia Bank, N.A. v. Ferretti, 935 A.2d 565, 570 (Pa. Super. 2007) ("The elements of a legal malpractice action, sounding in negligence, include: (1) employment of the attorney or their basis for a duty . . . .").

36. *See* RONALD MALLEN, JEFFREY SMITH & ALLISON RHODES, LEGAL MALPRACTICE § 37.24 (2014) ("[E]xpert testimony is usually mandatory to prove negligence.").

37. *See* RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 52(2)(c) (2000) (providing that a rule of conduct "may be considered by a trier of fact as an aid in understanding and applying the standard of" care).

attorney can be liable for malpractice even in the absence of an ethics breach, and thus our analysis here will also explore whether the attorney exercised "the competence and diligence normally exercised by lawyers in similar circumstances."[38]

It is clear that the attorney in each of our examples violated the duty of care. The attorney in A has violated RPC 1.13 and a host of other ethical rules. Model Rule 1.13 is undoubtedly designed to protect the client against precisely the harm that eventuated: attorneys are required to report to higher authorities to provide the latter with notice and opportunity to exercise their legal authority to prevent the wrongdoing. Moreover, the attorney in B has arguably violated RPC 2.1 by failing to inquire further before engaging in a transaction with reasonable suspicions of client crime or fraud.

Hypotheticals C and D assume that Roberts failed to act with the care that attorneys would typically exhibit in this setting. Negligence does not require knowledge of the client wrongdoing or even willful or reckless indifference. In C, the attorney can be negligent because of her failure to consider allegations that would have prompted a reasonable attorney to look closer. The rumor concerned criminal or fraudulent activity that would expose the corporation to grave risk. The effort to probe deeper was modest given these risks: if the allegations were valid, substantial harm was not only foreseeable; it is overwhelmingly likely if unchecked.[39] In D, an attorney hired to conduct an internal corporate investigation has a duty to conduct that investigation with reasonable care. Investigations can fail because attorneys do not satisfy what I have termed the truth standards that should guide their investigation.[40] In hypothetical E, it is likewise clear that attorney Roberts has breached the duty of care given that she knew of or should have known of the wrongdoing and took no action.

Causation is typically parsed into two elements—"but for" or factual cause;[41] and "proximate" or legal cause.[42] In A, the attorney's failure to report is clearly a "but for" cause of the loss. Under the Restatement of

38. *Id.* § 52(1).

39. *See id.* § 96 ("[A] lawyer's duty of care to the organization is not limited to avoidance of assisting acts that threaten injury to a client. A lawyer is also required to act diligently and to exercise care by taking steps to prevent reasonably foreseeable harm to a client.").

40. Kevin H. Michels, *Internal Corporate Investigations and the Truth*, 40 SETON HALL L. REV. 83, 111–28 (2010).

41. *See* RESTATEMENT (THIRD) OF TORTS § 26 (2000) ("Conduct is a factual cause of harm when the harm would not have occurred absent the conduct.").

42. *See id.* § 29 ("An actor's liability is limited to those harms that result from the risks that made the actor's conduct tortious.").

Torts test of proximate causation, it would appear that the very risks that made the conduct a breach of the duty of care, i.e., that failure to advise a higher-up would allow the executive to further the harm, have eventuated. Under a closely related foreseeability test, the harm was again best understood as a proximate cause: it was highly likely that inaction by the attorney would result in the harm that eventuated. The wrongdoing was not some surprise that befell the attorney, but the fulfillment of the executive's avowed plans. In B and C, crime or fraud that harms the corporation is the foreseeable result of failure to inquire more deeply before furthering a transaction when an attorney suspects a client of crime or fraud, whether willfully blind, reckless or unreasonable. Likewise, in D, it is hard to imagine a more direct consequence of negligent failure to descry ongoing wrongdoing then the harms resulting from the undiscovered wrongdoing.

As implied by the causation analysis above, the corporation will also be able to satisfy the damages element of a prima facie malpractice claim. In Part V, subsection C below, we will ask whether comparative negligence principles should reduce the corporation's recovery.

Thus, it appears that the plaintiff corporation (in hypotheticals A through D) has a strong prima facie claim against its own attorney for malpractice. The analysis, however, is complicated by the fact that the corporation's own executive engaged in the wrongdoing. Should that fact affect the corporation's right of recovery against its attorney? We turn to that question next.

III. THE *IN PARI DELICTO* DEFENSE

A. *The Defense and Its Rationale*

As its Latin name implies, the *in pari delicto* defense addresses the concern that a plaintiff who seeks recovery engaged in wrongdoing of his own. Although the doctrine can be characterized in a variety of ways, it generally provides that the plaintiff cannot recover from a defendant if the plaintiff bears equal or greater fault for the wrongdoing that lead to the claim.[43] Some courts have characterized the wrongdoing that would invalidate the plaintiff's claim more narrowly, allowing the *in pari delicto*

43. *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985) ("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.").

defense, for example, when the plaintiff's losses "are substantially caused by activities the law forbade him to engage in."[44] The doctrine is an equitable one, and its equitable strains can be heard in centuries-old formulations: "no court will lend its aid to a man who grounds his action upon an immoral or illegal act."[45] The defense has been embraced by both state and federal courts.[46] Although the defense was originally an equitable one, it is now widely accepted as "a defense in actions at law."[47] While courts have spoken generally of wrongdoing, it appears that most have confined the doctrine's application to criminal or fraudulent behavior.[48]

One challenge posed by the *in pari delicto* doctrine is whether the defense should apply when the degree of fault between plaintiff and defendant differs. Justice Story's famous description bears quotation here:

> And indeed in cases where both parties are *in delicto*, concurring in an illegal act, it does not always follow that they stand *in pari delicto*; for there may be, and often are, very different degrees in their guilt. One party may act under circumstances of oppression, imposition, hardship, undue influence, or great inequality of condition or age; so that his guilt may be far less in degree than that of his associate in the offen[s]e. And besides, there may be on the part of the court itself a necessity of supporting the public interests or public policy in many cases, however reprehensible the acts of the parties may be.[49]

Thus, courts traditionally assessed the relative culpability of parties, limiting the defense to those instances in which the plaintiff was an equal or greater wrongdoer. In addition, the defense could, in certain instances, be abrogated to serve the public interest.[50]

In time, however, these limitations have eroded and the defense, in turn, has expanded. As the United States Supreme Court has noted, "[n]otwithstanding these traditional limitations, many courts have given the *in pari delicto* defense a broad application to bar actions where

44. Am. Trade Partners, LP v. A–1 Int'l Imp. Enters., Ltd., 770 F. Supp. 273, 276 (E.D. Pa. 1991).

45. Fowler v. Scully, 72 Pa. 456, 467 (1872) (quoting sources originating with *Holman v. Johnson*, 98 Eng. Rep. 1120 (1775)).

46. *See* Nisselson v. Lernout, 469 F.3d 143, 151–52 (1st Cir. 2006) (noting that "[t]he *in pari delicto* defense has long been woven into the fabric of federal law. . . . [Massachusetts has] warmly embraced [the doctrine]").

47. Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Research Found. v. PriceWaterhouseCoopers, LLP, 989 A.2d 313, 328 (Pa. 2010).

48. *Id.*

49. 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE AS ADMINISTERED IN ENGLAND AND AMERICA § 423 (W.H. Lyon, Jr. ed., 14th ed 1918) (emphasis added).

50. *Id.*

plaintiffs simply have been involved generally in 'the same sort of wrongdoing' as defendants."[51] With respect to federal actions, the Supreme Court has returned the defense to its original moorings, holding that the defense will prevail only if "the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress."[52] The Court also left room for an exception if enforcement of the securities laws would be undermined by the defense.[53] The latter exception might be framed generally as a "public-interest" exception, asking whether "preclusion of the suit would not interfere with the purposes of the underlying law or otherwise contravene the public interest."[54]

The rationale for the doctrine is that courts should "not lend aid to parties who base their cause of action on their own immoral or illegal acts."[55] In one memorable formulation, the court declared that it should not be forced to serve as "referee between thieves."[56] There is also concern that the wrongdoer will, in a sense, profit from his own wrongdoing if allowed to recover damages.[57] Courts bar the plaintiff's claim not because the defendant's actions were justified in any sense, "but rather because the plaintiff, being equally wrong, has forfeited any claim to the aid of the court."[58] Another basis for the defense is deterrence: "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality."[59]

B. *The Defense and Legal Malpractice*

The courts have applied the *in pari delicto* defense to dismiss claims of clients against their attorneys in a variety of settings. For example, in

51. *Id.*; Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 307 (1985) (citing Perma Life Mufflers, Inc. v. Int'l Parts Corp., 392 U.S. 134, 138 (1968)); *see also Nisselson*, 469 F.3d at 152 ("Over time, however, courts expanded the doctrine's sweep, deploying it as a basis not dismissing suits whenever a plaintiff had played any role—no matter how modest—in the harm-producing activity.").

52. *Bateman Eichler*, 472 U.S. at 310–11.

53. *See id.* (stating that the holding of the Court "would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public").

54. *See Nisselson*, 469 F.3d at 152 (characterizing the public-interest exception more generally).

55. Choquette v. Isacoff, 836 N.E.2d 329, 332 (Mass. App. Ct. 2005).

56. Stone v. Freeman, 82 N.E.2d 571, 572 (N.Y. 1948).

57. *See* Robins v. Lasky, 462 N.E.2d 774, 779 (Ill. App. Ct. 1984) (describing the court's history in refraining from using its judicial power to aid fraudulent practices).

58. Pantely v. Garris, Garris & Garris, PC, 447 N.W.2d 864, 867 (Mich. Ct. App. 1989) ("In the familiar economic language of the Chicago School, among wrongdoers equally at fault the law ought not to redistribute losses caused by the wrong itself, but rather should leave the parties where it finds them.").

59. Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985).

Pantely v. Garris, Garris & Garris, PC,[60] the client committed perjury in testifying about her residency status, allegedly on the advice of counsel.[61] The court barred the client from recovery against her attorney under the *in pari delicto* defense noting that, despite her emotional stress during her divorce proceeding, the court "cannot adopt her view that this renders her conduct less wrong than that of her lawyers. If stress provided an excuse for perjury, we would do well to abolish the oath and the hypocrisy it would foster."[62] The court concluded that the parties were therefore *in pari delicto*.[63] The court also rejected the client's argument that public policy warranted an exception to the doctrine, noting that perjury rules were not the type of complex ethical dilemmas where the client "could follow an attorney's advice, do wrong[,] and still maintain suit on the basis of not being equally at fault."[64]

Likewise, the Wisconsin Supreme Court rejected a claim against counsel by a client who suffered damages and possible prosecution for perjuring himself, again under the alleged advice of counsel.[65] In dismissing the complaint under the *in pari delicto* defense, the court reasoned that the public interest did not warrant an exception: "Although the public interest is served by discouraging attorney misconduct, it would be inappropriate to promote that interest by removing the damage to those who deliberately and willfully lie under oath in bankruptcy proceedings."[66] The court reasoned that an attorney disciplinary action is the appropriate means to address the attorney's wrongdoing, not an action that will reward the client for his own wrongdoing.[67] Relying on that reasoning, a Massachusetts appellate court reached a similar result in dismissing a client's claim against an attorney who allegedly advised him to commit perjury regarding his income and assets in a bankruptcy hearing.[68]

The client's wrongdoing that leads to dismissal of his malpractice claim can take a variety of turns, as an Illinois appellate decision makes clear.[69]

60. Pantely v. Garris, Garris & Garris, PC, 447 N.W.2d 864 (Mich. Ct. App. 1989).

61. *Id.* at 868.

62. *Id.*

63. *Id.*

64. *See id.* (noting that "a law degree does not add to one's awareness that perjury is immoral").

65. Evans v. Cameron, 360 N.W.2d 25, 26–27 (Wis. 1985).

66. *Id.* at 29.

67. *Id.*

68. *See* Choquette v. Isacoff, 836 N.E.2d 329, 335 (Mass. App. Ct. 2005) ("An 'attorney's misconduct of advising clients to perform illegal acts should be discouraged by the threat of attorney disciplinary action,' as opposed to clients filing suit against the attorney to recover damages incurred due to being caught." (quoting *Evans*, 360 N.W.2d at 29)).

69. Robins v. Lasky, 462 N.E.2d 774, 775–76 (Ill. App. Ct. 1984).

The plaintiff alleged that, on the advice of his attorney, he moved to Florida to escape service of process in Illinois, at great financial and emotional cost.[70] The plan proved unavailing, the advice negligent, and the client was served in the action. The court dismissed the client's claims, describing the client's decision as an "admitted attempt to evade the law" and thus "wrongful conduct."[71]

Our next question is how the *in pari delicto* should fare in the situation presented here—the failed internal gatekeeper. On the one hand, there is obvious similarity between the instances cited above and the internal-gatekeeping role: both involve attorney wrongdoing and the wrongdoing of another actor. The executive wrongdoer in our gatekeeping scenario is not the party seeking redress for the attorney's malpractice, however. Should this change the analysis? We turn to this next.

C. *The Defense and the Corporate Client*

As discussed, in the legal practice setting, the *in pari delicto* defense asks whether the *client's* wrong should bar her recovery against the attorney. The attorney in our gatekeeping scenarios represents the *corporation*, not the executive who directed and facilitated the wrongful acts.[72] Moreover, in our scenarios, the corporation or its successors, not the executive, seeks recovery against the attorney in the malpractice action. Thus, a critical question in the internal-gatekeeping scenario is whether the actions of the executive should be imputed to the *corporation*.[73] The practical upshot of such imputation is that the corporation, as the wrongful actor, would be barred from recovery against the attorney under the *in pari delicto* defense. In this section, we will consider the approaches of courts that have imputed the executive behavior to the corporation and those that deemed imputation inappropriate. The discussion that follows seeks to sketch some of the main approaches; it is intended to be more illustrative than exhaustive.[74]

70. *Id.* at 775–79.

71. *See id.* at 779 (describing the behavior as "unclean hands").

72. *See* MODEL RULES OF PROF'L CONDUCT R. 1.13(a) (2013) (noting that the attorney represents the organization and not its constituents).

73. *See* Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Research Found. v. PriceWaterhouseCoopers, LLP, 989 A.2d 313, 333 (Pa. 2010) ("[A]s is often the case, agency law plays a pivotal role in the defense's practical availability.").

74. For example, in order to focus the inquiry, this section will not consider the sole-actor doctrine, which imputes knowledge of the agent to the company, even when the agent acts adversely to the corporation when the agent dominates the entity or is the sole person who can act on its behalf. *E.g.*, *In re* Amerco Derivative Litig., 252 P.3d 681, 695 (Nev. 2011) (distinguishing between an agent acting either on his own behalf or on the corporation's).

Courts are often called to consider the *in pari delicto* defense in connection with corporation claims against auditors. We will consider these cases in tandem with those against law firms for two reasons. First, many of the leading decisions on the *in pari delicto* defense involve auditors rather than attorneys, as the following discussion will make clear. Second, courts have readily applied the analysis developed in the auditor setting to claims against attorneys as well. Although courts have not emphasized the distinction between the attorney and auditor roles, Part V will draw on the distinctive obligations of attorneys in assessing the applicability of the defense corporate claims against counsel.

1. Imputation Absent an "Adverse Interest"

Cenco Inc. v. Seidman & Seidman[75] is an early and seminal case[76] on the question of whether a defendant professional could "use the wrongdoing of plaintiff's managers" as a defense against charges of breach of contract, malpractice, and fraud.[77] Employees of Cenco had engaged in a massive fraud that involved its senior management, including the chairman and president, along with vice-presidents and other top managers.[78] The fraud, which was not discovered by its independent auditors, involved the inflation of inventories in Cenco's Medical/Health Division far above their actual value.[79] This greatly increased the market price of Cenco's stock, allowing Cenco to purchase other companies less expensively, borrow money at lower rates, and receive inflated inventory values from its insurers for claims for inventory that was lost or destroyed.[80] When the fraud was discovered, purchasers of Cenco's inflated stock and the corporation itself brought claims against a variety of defendants, including the auditors.[81]

In determining whether the trial judge gave an erroneous instruction to the jury about whether the auditor could use the wrongdoing of Cenco's managers as a defense against the charges of breach of contract, professional malpractice and fraud, Judge Posner first rejected what it

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

76. *See PriceWaterhouseCoopers*, 989 A.2d at 331 (characterizing the decision in *Cenco* as "pioneering" and describing its influence).

77. *Cenco*, 686 F.2d at 453.

78. *Id.* at 451.

79. *Id.*

80. *Id.*

81. *Id.* For the purposes of this Article, we are concerned with the corporation's claim against the auditors, and the auditors' invocation of a defense grounded on the wrongdoing of the corporation's executives.

characterized as "one extreme position on this question"—that the employee's fraud is always attributed to the corporation by the principle of respondeat superior.[82] With no controlling precedent, the court looked to the "underlying objectives of tort liability" and determined that the beneficiaries of a judgment against the auditors would be the stockholders of Cenco.[83] The court characterized this outcome as "perverse" because the stockholders included the corrupt officers, those who elected the board of directors who oversaw Cenco during the fraud, and the plaintiff class to whom the auditors had already paid $3.5 million to as part of the settlement.[84]

The court drew a sharp distinction between "fraud on behalf of a corporation" and "fraud against it." As the court explained:

> Fraud against the corporation usually hurts just the corporation; the stockholders are the principal if not only victims; their equities vis-à-vis a careless or reckless auditor are therefore strong. But the stockholders of a corporation whose officers commit fraud for the benefit of the corporation are beneficiaries of the fraud. Maybe not net beneficiaries, after the fraud is unmasked and the corporation is sued—that is a question of damages, and is not before us. But the primary costs of a fraud on the corporation's behalf are borne not by the stockholders but by outsiders to the corporation, and the stockholders should not be allowed to escape all responsibility for such a fraud, as they are trying to do in this case.[85]

If the executives were engaged in fraud against the *corporation*, then *Cenco* would not have imputed their wrongdoing to the corporation, and the corporation would have a valid claim against the auditors who failed to discover the fraud.[86] The court concluded, however, that the managers were engaged in fraud against third parties, not the corporation itself, and

82. *Id.* at 454.

83. *Id.* at 455.

84. *Id.*

85. *Id.* at 456.

86. Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 456 (7th Cir. 1982). In a later case, the Seventh Circuit construed the "fraud against the corporation" standard broadly, refusing to impute knowledge to the corporation and deprive it of a claim against an auditor in a case where the insiders operated an insurance company while insolvent, although elements of "looting" were also arguably present. In rejecting the auditor's argument, the court noted, "More colloquially put, if defendants' position were accepted, the possession of such 'friends' as Reserve had would certainly obviate the need for enemies." Schacht v. Brown, 711 F.2d 1343, 1348 (7th Cir. 1983). The court also offered a narrow reading of *Cenco*, suggesting that, even if the fraud were directed at third parties, Cenco would impute knowledge to the corporation only if the plaintiff corporation would properly compensate the victims of the wrongdoing, and such recovery would deter future wrongdoing. *Id.*

that imputation was not justified.[87] The court noted that the board of directors was comprised of some members who were dishonest and others who were careless, which made their failure to detect to fraud both "hard to condone[,]" and that coupled with the scale of the fraud and number of high ranking managers involved, warranted imposition of responsibility on the corporation for the fraud that the auditor failed to detect.[88] The court also noted that allowing the corporation to recover against the auditor would reduce the "incentives to hire honest managers and monitor their behavior."[89]

Although *Cenco's* imputation of knowledge from the executives to the corporation appears to have been influenced at least in part by the unique circumstance that shareholders who were involved in the fraud might benefit by allowing a claim against a failed auditor,[90] its holding has persuaded courts to impute knowledge more categorically.[91] Relying on *Cenco*, the Second Circuit reached a more sweeping result in *Kirschner v. KPMG LLP*.[92] In that case, a corporation eventually discovered and disclosed that the President and CEO had, over a period of years, arranged for hundreds of millions of dollars in loans that camouflaged the company's uncollectable debt and created a false picture of the company's finances, eventually leading to its bankruptcy.[93] The trustee appointed to advance the corporation's claims arising prior to bankruptcy filed an action against the attorneys and auditors for malpractice in failure to discover the wrongdoing.[94] The defendants interposed an *in pari delicto* defense.[95]

A central question in the case was whether the wrongdoing of the

87. *Schact*, 711 F.2d at 1348–49.

88. *Cenco*, 686 F.2d at 456.

89. *Id.*

90. *Id.* at 455–56.

91. *See In re* Am. Int'l Grp., Inc., 965 A.2d 763, 826 (Del. Ch. 2009) (characterizing *Cenco* as "based on the notion that immunizing auditors from malpractice claims, even in situations where the auditor's compliance with professional standards might have helped catch the fraud and limit the harm to the corporation, is good policy because it incentivizes independent directors and even stockholders to be effective monitors of managerial behavior"). *American International* is especially interesting because, in applying New York law, it was constrained to dismiss the malpractice claims of the corporation against its auditor under the categorical imputation approach of *KPMG* and its progeny, which it noted "does not necessarily reflect the outcome that would be reached if Delaware [law] applied." *Id.* at 828; *see also* Kirschner v. KPMG LLP., 938 N.E.2d 941, 951 (N.Y. 2010) (noting that the New York court has "held for over a century that all corporate acts—including fraudulent ones—are subject to the presumption of imputation . . . [a]nd, as with pari delicto, there are strong considerations of public policy underlying this precedent . . . .").

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

93. *Id.* at 945.

94. *Id.* at 946.

95. *Id.* at 949.

executive should be imputed to the corporation.[96] If so, the court reasoned, then the corporation would be *in pari delicto* with the professional defendants, and its claim should be barred.[97] The court cited a central principal of agency law, that "the acts of agents, and the knowledge they acquire while acting within the scope of their authority are presumptively imputed to their principals."[98] Because corporations can act only through their agents, it should "be responsible for the acts of its authorized agents even if particular acts were unauthorized."[99] Agency law presumes, moreover, "that agents communicate information to their principals," regardless of whether such communication in fact takes place.[100] The corporation selects the agent, and therefore should bear the risk of loss from the dishonest behavior of the agent, even when the agent commits fraud.[101]

The *KPMG* court acknowledged a narrow exception to the general rule of imputation—the "adverse-interest" exception.[102] When the agent "totally abandons" the corporation's interests and acts "entirely for his own or another's purposes," then his behavior will not be imputed to the corporation.[103] The court embraced *Cenco*'s narrow reading of the exception,[104] which applies when the executive steals, embezzles from, or loots the corporation for his own interests, not when he commits fraud in his role as an executive.[105] The presumption that an agent will communicate with a principal, the court reasoned, loses its force when the agent is stealing from his principal.[106] Because the executive's fraud did not victimize the corporation, the adverse-interest exception did not apply

96. *Id.* at 947 (describing the adverse-interest exception and its application to corporate officers).

97. *Id.* at 949.

98. *Id.* at 950.

99. *Id.*

100. *Id.* at 951.

101. *Id.*

102. Kirschner v. KPMG LLP, 938 N.E.2d 941, 952 (N.Y. 2010).

103. *Id.*

104. *See id.* (highlighting the requirement of adversity between the defrauder's interests and the interests of the corporation).

105. *See id.* ("A fraud that by its nature will benefit the corporation is not 'adverse' to the corporation's interests, even if it was actually motivated by the agent's desire for personal gain . . . . Thus, '[s]hould the 'agent act[] both for himself and the principal,' . . . application of the exception would be precluded." (quoting Capital Wireless Corp. v. Deloitte & Touche, 216 A.D.2d 663, 666 (1995))).

106. *See id.* at 951 ("[T]he presumption that agents communicate information to their principals . . . governs in every case, except where the corporation is actually the agent's intended victim.").

here.[107] The *KPMG* court dismissed the claims against the professional defendants, holding that the acts of the executive were imputed to the corporation under agency law, and therefore the corporation's claims were barred by the *in pari delicto* defense.[108] The holding, the court noted, was consistent with the centuries-old precedent of imputing the acts of agents to the principal, and it incentivized corporations to exercise care in the selection of their agents.[109]

The sweep of the *KPMG* decision is indeed striking. With the exception of an executive's theft from the corporation, the court's holding would effectively insulate attorneys from all liability for failure to report an executive's wrongdoing to higher-ups in the organization. The organization is irrefutably presumed to "know" of such wrongdoing, and therefore is deemed responsible for the act regardless of its actual knowledge. With the exception of hypothetical E, none of the wrongdoing falls within the adverse-interest exception, since the executives were not stealing from the corporation or otherwise advancing only their personal interests.[110] In each of these hypotheticals, the attorneys would be immune from liability for their failings, even if their failings breached an ethical obligation to investigate or report the information and even if they were expressly retained to investigate alleged wrongdoing. If attorneys have an internal-gatekeeping duty, then, under *KPMG*, it is one without a civil remedy for its breach.[111]

For an example of the categorical imputation approach in the law firm setting, consider *In re Greater Southeast Community Hospital Corp. I*.[112] There, a law firm was alleged to have committed malpractice in connection with opinion letters it issued that enabled the corporation to obtain

107. *Id.* at 953.

108. *Id.* at 959.

109. *Id.* at 951–52.

110. In theory, the categorical imputation approach would also apply to hypothetical D, where the attorney was negligent in conducting an internal investigation into whether the executive was engaged in wrongdoing against a third party, since the executive's wrongdoing was not adverse to the corporation. The outcome is so perverse (the imputation would eliminate the law firm's liability under the *in pari delicto* defense) that courts have chosen not to apply the imputation rule in these circumstances, albeit without explaining why the principles that justify imputation absent an adverse interest do not warrant imputation here. *See* Kirschner v. K & L Gates, 46 A.3d 737, 745 (Pa. Super. Ct. 2012) ("By negligently conducting is investigation, K&L Gates affirmatively caused harm to Le-Nature's . . . [which] negate[s] the defense of imputation.").

111. The attorneys would remain accountable in a disciplinary forum for those ethical breaches, provided that the client (or other party with standing) chose to file an ethical grievance.

112. *In re* Greater Se. Cmty. Hosp. Corp. I, 353 B.R. 324, 333–34 (Bankr. D.C. 2006).

additional financing.[113] The corporation trustee alleged that the law firm knew or should have known that the statements in the opinion were false, and that the corporation relied on those statements in obtaining additional financing that deepened its insolvency.[114] The court dismissed the malpractice claims against the attorney because the fraud of the executives was committed on behalf of, rather than against the corporation, and therefore the adverse-interest exception did not apply.[115]

In the subsections that follow, we will consider two other categories of approaches to the *in pari delicto* defense. In considering these distinctive approaches, it is important to keep in mind that courts generally agree that imputation of knowledge of executive wrongdoing to the corporation is inappropriate when the executive steals from the corporation for the reasons cited in *Cenco* and *KPMG*. The disagreement concerns whether to impute knowledge of the executive's wrongdoing in cases in which the executive furthers a crime or a fraud by the corporation *against* a third party in claims by the corporation against those who may have breached some duty to discover or report the wrongdoing to the corporation. Despite the fact that the fraud was conducted "on behalf" of the corporation on a third party,[116] the corporation itself can suffer grave harms that early gatekeeper discovery could have prevented or reduced. *KPMG* exemplifies the most sweeping or "categorical" approach to the imputation question.[117] Below we consider two other approaches.

2. An Additional Exception to Imputation: Bad Faith

Our question is when the wrongdoing of a rogue executive will be imputed to the corporation, thereby providing the failed gatekeeper an *in pari delicto* defense against the corporation's claim for malpractice. Here

113. *Id.*

114. *Id.*

115. *See id.* at 369 (emphasizing that although the company was "harmed by the artificial prolongation of its existence," it "benefit[ed] to some degree by that same prolongation at the expense of innocent third parties"). Of course, even courts that purport to impute knowledge absent an adverse interest, struggle to define the exception. In *BCCI Holdings (Luxembourg), S.A. v. Clifford*, the law firm allegedly advised senior officials of a bank to engage in an unlawful transaction. BCCI Holdings (Luxembourg), S.A. v. Clifford, 964 F. Supp. 468, 472–73 (D.D.C. 1997). Although defendants offered arguments to suggest that the officials were acting on behalf of rather than against the corporation, the court found the allegations sufficient to deny the law firm's motion to dismiss. *Id.* at 479–80.

116. Thus, the question is whether to impute knowledge of executive wrongdoing to others when the executives are, in Judge Posner's memorable phrase, "turning the company into an engine of theft against outsiders." *Cenco*, 686 F.2d at 454.

117. *Kirschner*, 938 N.E.2d at 941.

we consider an additional exception to imputation where the gatekeeper was alleged to be in collusion with the executive.

In *Official Committee of Unsecured Creditors of Allegheny Health Education & Research Foundation v. PriceWaterhouseCoopers, LLP*,[118] the auditor was alleged to have colluded with the officers of the corporation to misstate the financial condition of the entity, "concealing the corporation's deepening insolvency and facilitating management's continuation of a ruinous business strategy while thwarting essential, remedial intervention by the board of trustees."[119] The Pennsylvania Supreme Court acknowledged that, in some instances, the *in pari delicto* defense could be validly interposed by an auditor in a claim by the corporation for malpractice.[120] The court stated that, as a general matter, the executive's wrongdoing should be imputed to the corporation, and the *in pari delicto* defense should therefore apply, when the auditor is negligent.[121] The court reasoned that imputation in this instance "gives appropriate recognition to the fact that it is the principal who has empowered the agent."[122] The court also noted that the "outrageous" behavior of the executives "should have a legitimate place in the negligence case" against the auditor.[123]

The court concluded, however, that imputation would not be appropriate when the auditor and the corporation collude.[124] The corporation should not be charged with knowledge of its executives' wrongdoing against a third party that "actively and intentionally" prevented those in the corporation's "governing structure who were non-participants in the fraud from acquiring such knowledge."[125] The court also noted that the assumption that agents will share information with the principal does not apply when the executive and third party work actively to conceal information from the principal.[126] Thus, when the auditor engages in secretive, collusive behavior with the executive, it will not receive the benefit of the *in pari delicto* defense.[127]

118. Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Research Found. v. PriceWaterhouseCoopers, LLP, 989 A.2d 313 (Pa. 2010).

119. *Id.* at 315.

120. *Id.* at 331.

121. *Id.* at 335.

122. *Id.*

123. *Id.*

124. *Id.* at 336.

125. *Id.*

126. *Id.* at 337.

127. *See* BCCI Holdings (Luxembourg), S.A. v. Clifford, 964 F. Supp. 468, 480 (D.D.C. 1997) (refusing to apply the imputation doctrine to shield defendants from liability where plaintiffs

In *BCCI Holdings (Luxembourg), S.A. v. Clifford*,[128] the court relied on a bad-faith analysis in refusing to impute knowledge of executive's criminal wrongdoing to the corporation when the law firm was alleged to be complicit in the wrongdoing.[129] The court reasoned that imputation "may not be invoked where third persons use the agent to further their own frauds upon the principal"[130] because imputation would in that instance "shield" the law firm from the consequences of its own fraud.[131]

In *Kirschner v. K & L Gates*,[132] the district court considered a complaint against a law firm that was retained by a special committee of the board of directors to investigate allegations by three senior managers who resigned.[133] The managers alleged that the CEO had and continued to engage in fraud in connection with the company's financial statements.[134] The law firm found no evidence of malfeasance by the CEO, a report relied on by the special committee.[135] The complaint alleged that the law firm "failed to uncover the massive fraud being perpetrated by [the CEO,]" and that the CEO and others were able to continue to "loot" the corporation, "incurring further corporate debt and wasting corporate funds on avoidable transactions."[136] Among other failings, the law firm allegedly allowed the CEO, the alleged wrongdoer, to "dictate and limit the manner in which the investigation was conducted."[137] After more expenditure by the CEO, the company eventually sought relief in bankruptcy court, and the trustee sought relief on behalf of the corporation contending, inter alia, claims of malpractice, breach of fiduciary duty, and negligent misrepresentation against the firm.[138]

The court acknowledged that *Alleghany* would require imputation of the executive's wrongdoing to the corporation in cases of negligence.[139] It

alleged that corporate officials' and attorneys' collusion lead to the corporation's demise).

128. BCCI Holdings (Luxembourg), S.A. v. Clifford, 964 F. Supp. 468 (D.D.C. 1997).

129. *Id.* at 479–80.

130. *Id.*

131. *Id.*

132. Kirschner v. K & L Gates LLP, 46 A.3d 737 (Pa. Super. Ct. 2012).

133. *Id.* at 742.

134. *Id.* at 741.

135. *Id.* at 744–45.

136. *Id.* at 745.

137. *Id.* at 756; *see also* Kevin H. Michels, *Internal Corporate Investigations and the Truth*, 40 SETON HALL L. REV. 83, 103–04 (2010) (discussing the duties of investigative counsel to develop an accurate account, and the means by which such account should be pursued by investigative counsel).

138. *Kirschner*, 46 A.3d at 746–47.

139. *Id.* at 764.

concluded, however, that the allegations satisfied the two instances in which *Alleghany* nonetheless allows liability—bad faith and executive acts that were not designed to benefit the corporation.[140] With respect to the former, the court offers scant analysis of why the law firm's failings amount to bad faith rather than negligence, other than to cite plaintiff's averments to that effect.[141] With respect to the second, the court offers little explanation of why and when the alleged wrongdoing of the executive would satisfy the seemingly narrow exception for adverse-interest offered by *Cenco* and *KPMG* and seemingly embraced by *Alleghany*.[142] The court stated simply that, "we cannot conclude that a material misstatement of corporate financial information, so as to hide [the CEO's] looting of the company, provided any benefit to [the corporation]."[143] Given Alleghany's statement that benefit to the corporation would, as in *Cenco*, be construed "liberally," the *K & L Gates* decision seems to strain application of the rule. Perhaps *K & L Gates* reflects the court's discomfort with the straightjacket of an imputation rule that would immunize negligent gatekeepers whose failings prevent boards from performing their oversight role. As we will discuss in Part V, the *K & L Gates* court might have considered the significance of the fact that the law firm was expressly retained to investigate the wrongdoing in question.

The Restatement Third of Agency has spawned some controversy over its handling of the imputation question as applied to gatekeepers. Section 5.03 restates the longstanding principle that notice of the agent's acts are imputed to the principal, and Section 5.04 restates the adverse-interest exception, requiring—again, as long understood—that the agent act "solely" for his (or another's) benefit in order to trigger the exception. Section 5.04 adds a new exception "to protect the rights of a third party who dealt with the principal in good faith."[144] The Section provides

140. *Id.*

141. *Id.*

142. *See* Kirschner v. K & L Gates LLP, 46 A.3d 737, 764 (Pa. Super. Ct. 2012) (relying on *Allegheny* without directly addressing the narrow exception for adverse interest).

143. *Id.*

144. Section 5.04 of the Restatement Third Agency provides:

> 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 not imputed to the principal if the 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. Nevertheless, notice is imputed (a) when necessary to protect the rights of a third party who dealt with the principal in good faith; or (b) when the principal has ratified or knowingly retained a benefit from the agent's action. A third party who deals with a principal through an agent, knowing or having reason to know that the agent acts adversely to the principal, does not deal in good faith for this purpose.

further that a third party "knowing or having reason to know that the agent acts adversely to the principal, does not deal in good faith."[145] As Mark Loewenstein observes, the provision's context suggests that we read the good faith exception as "an exception to an exception," meaning that the presence or absence of good faith by a third party matters only when the agent is acting solely to benefit himself (or another).[146] The adverse-interest exception is rarely satisfied because corporate wrongdoers seldom act "solely" for their own interests. As a result, this interpretation would rarely change the analysis in gatekeeper failure cases.[147]

Were it only that simple. The Restatement Third offers a curious interpretation of Section 5.04 in Illustration 5. In the Illustration, A, an agent of the corporation (CFO), withholds material information from auditor T who certifies incorrect financial statements even though he "knows or has reason to know" that the information was withheld. In a claim by the corporation against T for losses resulting from the faulty financial statements, knowledge of A's fraud will not be imputed to the corporation because T did not act in good faith. The Illustration is confusing because nowhere does it state that A was acting "solely in his interest" in withholding information from T, thus calling into question the limited reading of the good faith exception offered in the paragraph above. Does Illustration 5 propose a *new* exception to imputation, applicable generally and not only when the agent has an adverse interest? If so, why would such a profoundly new doctrine be offered as an illustration rather than in the statement of the rule set forth in Section 5.04, which by its terms addresses only the adverse interest exception? Loewenstein considers these and other anomalies posed by Illustration 5, concluding that the drafters of the Third Restatement intended to create a new exception to imputation and used the good faith exception and Illustration 5 to do so after failed attempts to broaden the adverse-interest exception.[148] After a careful study of the ALI's deliberations and the language proposed and adopted, Loewenstein characterized the change as "a stealth attempt to significantly alter the imputation doctrine as it existed for many, many

RESTATEMENT (THIRD) OF AGENCY § 5.04 (2006).

145. *Id.*

146. Mark J. Loewenstein, *Imputation, The Adverse Interest Exception, and the Curious Case of the Restatement (Third) of Agency*, 84 U. COLO. L. REV. 305, 341–42 (2013).

147. *Id.*

148. *Id.* at 340–47. Professor Loewenstein traces the American Law Institute discussions that lead to adoption of this change, citing concerns about the interests, albeit disclosed, of those who encouraged the change. *Id.* at 330–40.

years with no acknowledgment that such an alteration was taking place or why."[149]

If Section 5.04 and Illustration 5 intended to create a new imputation exception, then the next question is how to interpret its "know or reason to know" standard. Does this suggest that imputation would be inappropriate when a gatekeeper is *negligent*, or is something akin to recklessness on the part of the gatekeeper required to trigger exception? The Restatement comments offer no elaboration.[150]

3. No Imputation for Negligence

Other courts, evaluating the culpability of professionals alleged to have failed in their gatekeeping role, have rejected the traditional imputation analysis in determining whether the executive's culpability should be ascribed to the corporate client for purposes of the *in pari delicto* defense. In *NCP Litigation Trust v. KPMG LLP*,[151] two executives intentionally provided false information to the company's auditors, who did not discover the misstatements for "several years."[152] When subsequent audits uncovered the fraud and tens of millions of dollars in losses, the corporation reported the misstatements and declared bankruptcy.[153] A trustee, appointed to pursue the interests of the corporation—as its successor interest—and shareholders, brought a negligence claim against the auditors, which raised the *in pari delicto* defense.[154] The trial court applied a standard agency analysis, imputing the wrongdoing of the executives to the corporation, and holding therefore that the corporation and the auditors were *in pari delicto*, dismissing the case against the auditors.[155]

The New Jersey Supreme Court held that knowledge of the wrongdoing of the executives should not be imputed to the corporation for purposes of the *in pari delicto* defense.[156] The court began by acknowledging that, under agency law, the knowledge of the agent—in this case, the executives—is imputed to the principals—here, the corporation.[157] The

149. *Id.* at 346.

150. *See id.* at 344–45 (noting the absence of any explanation in the Restatement comments on the elements of the "good faith" standard).

151. NCP Litig. Trust v. KPMG LLP, 901 A.2d 871 (N.J. 2006).

152. *Id.* at 873.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.* at 879.

court discussed three rationales for the imputation rule.[158] First, as discussed earlier, the rule creates incentives for principals to select agents carefully.[159] Second, the rule "encourages a principal to develop effective procedures for the transmission of material facts, while discouraging practices that isolate the principal or co-agents from facts known to an agent."[160] Third, the rule encourages third parties to do business with agents, because the principal remains ultimately accountable to the third party for the agent's acts and representations.[161] At the heart of the doctrine is a compelling rationale: principals should not benefit "through their agents while avoiding the consequences of agent misdeeds."[162]

The court found those rationales less compelling in considering the liability of an auditor who negligently fails to discover the agent's fraud.[163] The imputation rule, it noted, "operates on an all-or-nothing basis," either allowing or eliminating liability and is insensitive to the demands of particular cases.[164] Imputation, the court noted, understandably protects innocent third parties who are defrauded by the actions of the corporation's executive, by allowing the third party to recover from the corporation.[165] Here, by contrast, imputation would insulate an auditor alleged to have failed to detect the executives' fraud in breach of its contract with, and duty of care to, the corporation.[166] The court also noted that by rejecting immunity and thereby allowing claims against auditors, it was maintaining incentives for the *auditors* to perform

158. *Id.*

159. *See id.* ("[T]he imputation doctrine 'creates incentives for a principal to choose agents carefully and to use care in delegating functions to them.'" (quoting RESTATEMENT (THIRD) OF AGENCY § 5.03 cmt. b (2006))).

160. *Id.* at 871 (quoting RESTATEMENT (THIRD) OF AGENCY, § 5.03 cmt. b (2006)).

161. NCP Litig. Trust v. KPMG LLP, 901 A.2d 871, 879 (N.J. 2006) ("[T]hird parties who are aware that the principal is ultimately accountable for its agent's actions and representations are more likely to conduct business through an agent.").

162. *Id.* at 879 (quoting Andrew J. Morris, *Clarifying the Imputation Doctrine: Charging Audit Clients with Responsibility for Unauthorized Audit Interference*, 2001 COLUM. BUS. L. REV. 339, 350 (2001)).

163. *See NCP*, 901 A.2d at 879 (reaching the same conclusion as the Appellate Division, but refusing to adopt the same equitable fraud rationale).

164. *See id.* at 880 (stating that "[imputation] is unforgivably binary" (quoting Andrew J. Morris, *Clarifying the Imputation Doctrine: Charging Audit Clients with Responsibility for Unauthorized Audit Interference*, 2001 COLUM. BUS. L. REV. 339, 353 (2001))).

165. *See id.* at 882 (responding to the dissent's statement that, as a result of the holding, the imputation defense will cease to exist).

165. *See id.* at 879–80 (reasoning that the imputation defense "in a simple principal–agent relationship begins to break down" when applied to a more complex fact scenario involving a corporate audit).

166. *Id.*

properly.[167] Thus, the New Jersey Supreme Court's decision appears to eliminate the *in pari delicto* defense for the negligent auditor.[168]

Some courts have refused to impute the executives' wrongdoing to the corporation in negligence for other reasons. One approach is the "innocent insiders" theory, which does not impute the wrongdoing of the executives to the corporation if there was at least one member of corporate management without knowledge of the fraud who could have prevented it.[169] The innocent-insider approach would eliminate imputation in the vast majority of claims against failed gatekeepers. Of course, knowledge of the wrongdoing, if sufficiently widespread among management can eliminate the need for imputation, since the *actual* knowledge of the corporation would preclude a claim against the failed gatekeeper under an *in pari delicto* defense.

For example, in an Ohio case, the trustee for the corporation alleged malpractice against a law firm for a variety of alleged failings in a transaction between the corporate client and an Employee Stock Ownership Program (ESOP) to purchase one hundred percent of the corporation's outstanding stock.[170] The law firm allegedly failed to advise the board that the transaction involved self-dealing, and instead facilitated the conflicted transaction.[171] The court held that, "[c]orporate counsel has a duty to act as gatekeeper, to take appropriate action to advise the directors, and to help them avoid wrongdoing that could seriously harm its

167. *See id.* at 883 (noting that a holding making auditors liable for their negligence would encourage them to be more sincere and conscientious in the future). The court later elaborated on this argument in its analysis of the shareholder claims against the corporation, claims that present different concerns although none that are central to the analysis here. *Id.* at 886–87.

168. *See, e.g.*, Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Research Found. v. PriceWaterhouseCoopers, LLP, 989 A.2d 313, 335 (Pa. 2010) ("[W]e read the rationale for the New Jersey Supreme Court's decision in NCP as effectively negating imputation (and thus barring the *in pari delicto* defense) . . . .").

169. *See* Smith *ex rel.* Estate of Boston Chicken, Inc. v. Arthur Andersen, LLP, 175 F. Supp. 2d 1180, 1199 (D. Ariz. 2001) (noting that the wrongful act of a corporate actor would not be imputed to a corporation if it could allege the existence of one corporate actor who would have prevented the fraud if he had been aware of it (citing Wechsler v. Squadron, Ellenoff, Plesent & Sheinfeld, 212 B.R. 34, 44–45 (S.D.N.Y. 1997))); Sec. Investor Prot. Corp. v. BDO Seidman, 49 F. Supp. 2d 644, 650–51 (S.D.N.Y. 1999) (discussing two cases where the courts refused to impute the wrongful conduct on the corporation unless all of the managers were involved in the defrauding); *see also* 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, 50 (2006) (arguing that the exception is inconsistent with agency law, bad policy and not likely to be widely adopted by courts).

170. Antioch Litig. Trust v. McDermott Will & Emery LLP, 738 F. Supp. 2d 758, 770–71 (S.D. Ohio 2010).

171. *Id.* at 771.

corporate client."[172] The court rejected the law firm's *in pari delicto* defense partly on the grounds that it was not clear from the pleadings that the self-interested directors dominated the board, therefore warranting imputation of their action to the entity.[173] The court also noted that the pleadings did not allege that the corporation had equal or greater culpability than the law firm.[174]

IV. IMPUTATION AND GATEKEEPING: COMPETING RATIONALES

A. *Introduction*

The question, let us recall, is when should law firms that fail in the internal-gatekeeper role be allowed to interpose an *in pari delicto* defense to a corporate client claim for malpractice. For many courts, the question quickly devolves into an analysis of whether to "impute" the wrongdoing or its knowledge to the corporation under agency principles. If the corporation is deemed the wrongdoer or is deemed to be aware of the wrongdoing—i.e., if the wrongdoing is imputed to the corporation—then the corporation is equal or more culpable than the lawyer and therefore the lawyer should have the benefit of the *in pari delicto* defense. It is difficult to imagine more varied and inconsonant judicial approaches to the problem than those we have considered—imputation in the absence of an adverse interest, bad-faith imputation, and the rejection of imputation in cases of negligence. In this Part, the goal is not to assess the relative merits of these approaches, but to take a closer look at the reasons for imputing executive wrongdoing and its knowledge to the corporation, as well as the tensions posed by these goals and the gatekeeping role of the attorney. This will set the stage for my attempt to reconcile these divergent goals into a new imputation exception in Part V.

At first blush, agency law certainly seems relevant to an *in pari delicto* defense: it explores the bases for attributing "the legal consequences of one person's [action] to . . . another person."[175] Because the *in pari delicto* defense asks us to compare culpability between the corporation and the failed gatekeeper, it is tempting to look to the attribution principles of agency law to determine whether the corporation should be attributed blame. We will begin by examining agency's law attribution of *liability*

172. *Id.*
173. *Id.* at 772–73.
174. *Id.* at 773.
175. RESTATEMENT (THIRD) OF AGENCY intro note (2006).

from agent to principal, asking whether it bears on the imputation question posed by the *in pari delicto* defense in our examples. Next, we will examine agency law's imputation of *knowledge* from agent to principal, again exploring its relevance for our question.

B. *Imputation of Liability*

The Restatement Third of Agency distinguishes between the "direct" and "vicarious" liability of a principal for the actions of an agent.[176] Direct liability can be imposed on the principal who grants "actual authority" to an agent to engage in the wrongful behavior.[177] The imputation questions posed by our scenarios do not implicate actual authority because the board of directors had no knowledge of the executive's plans, and therefore did not manifest to the agent that it desired the agent to undertake the wrongful acts.[178] Vicarious liability, however, turns not on the principal's authorization of the wrongdoing but on the nature of the agent's role.[179] Thus, a principal is vicariously liable for the torts of its agents who act on apparent authority[180] and for the torts of employees acting within the scope of their employment.[181] In our scenarios, if a third party, such as the patient in Scenario A, who ingested the medication and suffered a stroke, brought a claim against the corporation, clearly the wrongdoing of the executives would and should be attributed to the company under one or both of these vicarious liability principles.

One quite literal objection is that *in pari delicto* is not concerned with whether the principal is liable for the agent's act, but whether the principal should be deemed the criminal or intentional wrongdoer for purposes of

176. *See id.* § 7.07 cmt. b (2006) (stating that respondeat superior subjects the employer to vicarious liability, which is distinct from direct liability).

177. *See id.* (recognizing that an employer can be subject to direct liability for the "harm caused by the employee's tortious conduct").

178. *See id.* § 2.01 ("An agent acts with actual authority when, at the time of taking action that has legal consequences for the principal, the agent reasonably believes, in accordance with the principal's manifestations to the agent, that the principal wishes the agent so to act.").

179. *See id.* § 7.08 cmt. b (holding the principal accountable when the third party reasonably believes that the agent is acting on behalf of the principal and such belief is traceable to the principal's manifestations).

180. *See id.* § 7.08 ("A principal is subject to vicarious liability for a tort committed by an agent in dealing or communicating with a third party on or purportedly on behalf of the principal when actions taken by the agent with apparent authority constitute the tort or enable the agent to conceal its commission.").

181. *See id.* § 7.07 (imposing vicarious liability on an employer for an employee's torts committed "within the scope of employment").

the *in pari delicto* defense.[182] We will explore this form of imputation, nonetheless, because *KPMG* imputes the "act" to the principal on grounds similar to those that warrant imputation of liability.[183] If the executive's wrongful "act" should be imputed to the corporation for roughly the same reasons as liability for the act, then the analysis bears directly on the *in pari delicto* defense because the corporation would, in such instance, be more culpable than the law firm.

The question, however, is whether the justifications for vicarious liability hold any force in the *in pari delicto* scenarios at issue here despite the *KPMG* court's allusion to this theory in support of imputation. First, both forms of vicarious liability presume that the agent has committed a tort against the third party. While the executive in our scenario no doubt harmed those who consumed the medication, the *attorney* in our hypotheticals is a victim and is not seeking to impose liability on the corporation for the wrong committed against him by the agent. In fact, the claim here runs the other way, from principal to attorney. Thus, it may simply be a category error to suggest that the vicarious liability theories of agency law should inform our analysis of the *in pari delicto* defense.

Vicarious liability under the apparent-authority doctrine derives from the behavior of the principal in creating the manifestation of apparent authority: if the principal creates a reasonable belief in a third party that the agent is authorized to act on behalf of the principal, then the principal should be liable for the agent's actions.[184] Liability is extended to the principal regardless of the agent's motivations or whether the agent's acts are "beneficial" to the principal—in large part because the principal is responsible for creating a reasonable belief in the third party that the agent is acting with the principal's authorization.[185] The rationale sheds no light on the *in pari delicto* question posed by our scenario: unlike the arms-length third party, the lawyer has not relied on or taken action because of the agent's apparent authority.[186]

182. *See* Antioch Litig. Trust v. McDermott Will & Emery LLP, 738 F. Supp. 2d 758, 772–73 (S.D. Ohio 2010) (explaining the applicability of the *in pari delicto* doctrine).

183. *See* Kirschner v. KPMG LLP, 938 N.E.2d 941, 950 (N.Y. 2010) ("A corporation must, therefore, be responsible for the acts of its authorized agents even if particular acts were unauthorized.").

184. *See* RESTATEMENT (THIRD) OF AGENCY § 7.08 cmt. b (2006) (basing liability on a principal's manifestations towards a third party).

185. *See id.* (reasoning that a principal's control over a third party's perception justifies the imposition of liability).

186. *See id.* § 2.03 cmt. d ("Some transactions by their nature should strike a dissonant chord

Respondeat superior is premised in part on the notion that the "employer's ability to exercise control over its employees' work-related conduct enables the employer to take measures to reduce the incidence of tortious conduct."[187] Thus, one goal is to create employer incentives for supervision beyond those already provided by the direct action against an employer. The rationale has force in our *in pari delicto* scenarios, provided that we are mindful of the countervailing concern: one important method of control that the employer exercises over the executive is the corporate attorney who fulfills her gatekeeping role by discovering and reporting executive wrongdoing. Another justification for respondeat superior is the simple fairness of holding an employer accountable for the harm caused to third parties by an employee, whose actions—by definition—the employer could control.[188] This relates closely to the equitable notion that other authorities have cited in support of the respondeat superior rule: if the employer can benefit through the actions of its employees, it ought also be responsible for their wrongful actions.[189] The rationale does strike a strong normative chord: those who empower others to act on their behalf should bear the benefits and burdens of that choice. While this rationale appears most compelling when an executive harms a third party in the corporation's name, it retains at least some force in the *in pari delicto* setting as well.

C. *Imputation of Knowledge Under Agency Law*

Agency law is not concerned only with the imposition of liability on the principal. It also imputes the agent's *knowledge* to the principal on matters material to the agent's role.[190] The imputation of knowledge would

for a reasonable third party, given the situation in which an agent has been placed, the nature of the principal or its activities, or what the third party knows of the agent's position within an organization. A basic circumstance is whether the transaction is itself legal.").

187. *Id.* § 7.07 cmt. b (2006).

188. *See id.* (differentiating acts that are subject to the principal's control from those that are not).

189. One traditional rationale for these attributions of liability is that the corporation can act only through its agents, and therefore the corporation should be deemed responsible for these actions even if they are not authorized. *See, e.g.*, Lee v. Pittsburgh Coal & Min. Co., 56 How. Prac. 373, 375 (Super. Ct.1877), *aff'd* 75 N.Y. 601 (1878) (holding a company liable for a contract and sale made through its "agents of natural persons . . . deemed to be clothed with all the powers and authority necessary or proper to effectuate the purposes of their creation").

190. RESTATEMENT (THIRD) OF AGENCY § 5.03 (2006) ("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 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.").

appear to be more closely akin to the issues implicated by the *in pari delicto* defense: if the corporation *should* be ascribed knowledge of the executive's wrongdoing in our scenarios, then clearly the attorney is less culpable than the corporation, whose executive engaged in fraudulent or criminal behavior. As discussed earlier, courts that have imputed knowledge from the executive to corporation for purposes of the *in pari delicto* defense have relied, at least in part, on the knowledge-imputation principle.

A critical threshold question is whether the imputation standard under agency law applies to the *in pari delicto* scenarios addressed in the hypotheticals. The Restatement imputes knowledge from agent to principal "[f]or purposes of determining a principal's legal relations with a third party" except when the agent "acts adversely to the principal."[191] This would appear to justify imputation in all of the hypotheticals in Part I other than when the executive steals from the corporation,[192] as some courts have found.[193] We must proceed with caution, however. The lawyer is not the archetypical "third party" contemplated by the imputation doctrine—for example, the consumer of the medicine described in our example. Unlike the traditional third party, the lawyer has not been harmed by the corporation or its agent. The distinction between the "third party" contemplated by the Restatement and the lawyer becomes more pronounced when we examine one important rationale for the knowledge imputation rule in the *in pari delicto* setting. We impute knowledge from the agent to the principal in part *because* the agent has a duty to keep the principal informed.[194] The lawyer in our examples is not only a "third party," she is an additional *agent* of the corporation with reporting duties of her own.[195]

Another rationale for knowledge imputation stems from the simple

191. *Id.*

192. *See* Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 456 (7th Cir. 1982) (considering circumstances where the executives engaged in fraud against the corporation).

193. See the previous discussion of imputation absent an adverse interest in Part III subsection C.1.

194. *See* RESTATEMENT (THIRD) OF AGENCY § 5.03 cmt. b (2006) (noting that one reason to impute knowledge to principal is that "[a]n agent . . . has a duty, unless otherwise agreed, to use reasonable effort to transmit material facts to the principal or to coagents designated by the principal").

195. *See id.* § 1.01 cmt. c. (stating that a lawyer-client relationship is an agency relationship). The attorney, just like the corporation's other agents, must "act on the principal's behalf and subject to the principal's control," according to the Restatement's definition of agency. *See id.* § 1.01 (defining agency relationship as "the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act.").

justice of holding a principal responsible for the information on which its agent acts. At the Restatement reasons:

> A principal's agents link the principal to the external world for purposes of taking action, including the acquisition of facts material to their work for the principal. An agent undertakes to act on behalf of a principal; at the time the agent determines how to act, facts known to the agent at the time should guide the agent's determination of what action to take, if any.[196]

This rationale parallels the rationale for imputing liability to the principal discussed earlier.[197] The justification hints at a strong normative intuition: the principal who seeks to benefit from the agent's information gathering (and actions based on that information) cannot insulate himself from the burden of that knowledge.[198] For convenience, I will call this the "benefit–burden" rationale of imputation. To the extent we visualize the lawyer as a "third party" to the corporation-executive relationship, the benefit-burden rationale does appear to justify imputation of executive wrongdoing to the corporation in its claims against counsel.

Courts have also favored imputation of knowledge in gatekeeper settings in order to encourage principals to select and monitor agents effectively.[199] The premise is uncontroversial: as the Restatement reasons, imputation incentivizes principals to choose effective agent-monitoring techniques, and discourages principals from adopting policies that will "isolate the principal[s] . . . from facts known [by] agents."[200] Although the rationale holds force generally, we cannot ignore the irony of allowing this rationale to justify the wholesale rejection of a corporation's claims against their failed lawyer gatekeeper. The law firm is not only an agent, as described above, but also one who in certain instances is ethically and statutorily obligated to report information to the principal about the behavior of the principal's executives. If the corporation's gatekeeper agents are categorically immunized from liability for failure to provide information to the corporation, one wonders how effectively the corporation could monitor its affairs through its agents—a concern that goes well beyond incentive.

Consider, by way of simple analogy, an executive who does not advise

196. *Id.* § 5.03 cmt. b.

197. *See supra* Part IV. subsection B. n.190–91.

198. *See* RESTATEMENT (THIRD) OF AGENCY § 5.03 cmt. b (2006) (noting, with respect to transaction example, that imputation precludes principal from using agent as a "shield").

199. *See* Kirschner v. KPMG LLP, 938 N.E.2d 941, 951–52 (N.Y. 2010) (emphasizing that "imputation fosters an incentive for a principal to select honest agents and delegate duties with care").

200. RESTATEMENT (THIRD) OF AGENCY § 5.03 cmt. b (2006).

the board of critical information about the operations of the company. In a claim against the executive for wrongdoing, the executive, although an agent, could not interpose a defense based on imputation of knowledge from agent to principal. If knowledge imputation protected the agent from liability to the principal for nondisclosure, the agent's underlying duty to disclose information would be eviscerated. Corporations hire law firms, also agents, with the expectation that the latter will fulfill their ethical and statutory duties to report the wrongdoing of their employees, often an important part of the corporation's monitoring mechanism.

The Restatement acknowledges that in certain instances, imputation should not defeat gatekeeper reporting duties:

> A principal may retain a service provider on terms or for tasks that make imputation of agents' knowledge irrelevant to subsequent claims that the principal may assert against the service provider. For example, a principal may retain a service provider to assess the accuracy of its financial reporting or the adequacy of its internal financial controls or other internal processes, such as its processes for reporting and investigating complaints of harassment in the workplace. If the service provider fails to detect or report deficiencies, the principal's claim against the service provider should not be defeated by imputing to the principal its agents' knowledge of deficiencies in the processes under scrutiny.[201]

The Restatement's example is helpful, although it stops shy of identifying the reason why imputation would not apply here, other than to deem it "irrelevant."[202]

The Restatement correctly refuses to impute knowledge when a service provider fails to detect or report wrongdoing not because imputation is "irrelevant," but presumably for a more basic, unstated reason. In a claim between the corporation and the failed service provider, imputation may be inconsistent with the very reason for which the service provider was retained: to descry and report the information in question.[203] In a critical

201. *Id.*

202. Perhaps a better term would be "inappropriate," since a principal's imputed knowledge would be quite "relevant" in a subsequent claim against one hired to identify and report such knowledge, although we should nonetheless resist such imputation.

203. Auditors are routinely hired for the purpose of detecting fraud, and *Cenco's* imputation of knowledge to the corporation when its auditors fail in their express calling is thus especially troubling. *See In re* Am. Int'l Grp., Inc., 965 A.2d 763, 829 n.246 (Del. Ch. 2009) ("[I]f auditors are employed, as I think is true, in material part because there is the potential that corporate officials may misuse their powers and commit acts of financial wrongdoing, immunizing auditors in situations when, but for the auditor's professional negligence, wrongful managerial behavior may have been stopped before it resulted in grievous harm relieves the audit firm of any responsibility in one of the circumstances when the auditor's compliance with its professional standard of care is most critical.").

sense, the service provider may have been hired, in part, *because* the corporation will be imputed knowledge of its agent's wrongdoing in claims by *third parties*. The service provider's monitoring role is an important means of preventing such wrongdoing and the corporation's attendant liability to third parties associated with such claims. Even if the attorney was not hired expressly to engage in monitoring efforts, 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. Thus, imputation of facts that the attorney was obligated to report may well be inappropriate in circumstances in which he was expressly or impliedly retained for the purpose of finding and reporting such information.[204]

Some important distinctions are beginning to emerge from the confusion that has enshrouded the *in pari delicto* defense in the attorney-gatekeeper setting. While it is generally sensible to impute knowledge from an executive to the corporation when the corporation is sued by a third party for wrongdoing furthered by the executive in the corporation's name, the rationales that support such general imputation are less compelling in claims between the corporation and an attorney who failed in the internal-gatekeeping role. As discussed, the attorney is not the archetypical "third party" harmed by the corporation through its executive's wrongdoing, but an additional agent of the corporation, in many circumstances charged with helping to prevent the very wrong in question.

V. A PROPOSED NEW APPROACH: THE GATEKEEPER-IMPUTATION EXCEPTION

A. *The Gatekeeper-Imputation Exception*

As Part IV demonstrates, agency law's imputation principles offer confusing and at times inconsistent guidance for determining when

204. There is an important instance in which imputation of knowledge would be appropriate to ground an *in pari delicto* defense. As the Restatement notes, "If a principal's agents fail to disclose or misstate material information to a third party who provides services to the principal, the agents' conduct may result in flawed work by the service provider." RESTATEMENT (THIRD) OF AGENCY § 5.03 cmt. b (2006). Of course, the service provider may or may not be justified in relying on the information provided by the agent, especially when circumstances suggest that the agent's statements are less than trustworthy. If reliance is justified, and the information proves incorrect, it seems fair to impute knowledge of the misstatement to the corporation. This imputed knowledge, in turn, may ground the attorney's *in pari delicto* defense. On the other hand, if the reliance is justified, the attorney presumably has not committed malpractice in the first place.

lawyers who have failed in the internal-gatekeeping role should be entitled to interpose an *in pari delicto* defense. In this Part, we will search for a standard that more closely captures the core concerns implicated by the defense in the failed attorney gatekeeper setting. Two caveats before we begin: First, while the approach offered below may offer insight on the imputation question regardless of the type of gatekeeper, the inquiry that follows is directed at the unique concerns implicated by the attorney's gatekeeper role.[205] As I will discuss, the standard proposed here derives at least in part from the unique role of the attorney, and the reader should therefore not assume complete correspondence with non-attorney gatekeeping or monitoring roles. Second, the proposal that follows is designed to address the challenges posed by claims for attorney failings in the internal-gatekeeping role, and not all corporation malpractice claims against counsel in which the *in pari delicto* defense might apply.

A threshold question that must be addressed by any proposal for reform is whether agency law and its imputation principles should bear at all on the *in pari delicto* defense in the corporate setting. It is tempting to dismiss imputation as inapposite here, on the grounds that imputation is designed to hold the corporation responsible for the harms its agents inflict on others.[206] The corporation or its agents have not harmed the attorneys in our scenerios; on the contrary, the attorneys are *defendants* in corporation claims for malpractice. The attorney, moreover, is an agent of the corporation, and "imputation does not furnish a basis on which an agent may defend against a claim by the principal."[207] This general notion is certainly sensible in the typical claim between principal and agent. If, for example, the attorney fails to advise the client that the client does not have to testify in a criminal matter, we would not impute to the client knowledge of what the attorney knew or should have known to support a defense by the attorney to the client's malpractice claim. Thus, why not eliminate imputation entirely when corporations sue their attorneys for malpractice in failing to discover or report executive wrongdoing?

205. As noted earlier, we have considered cases involving auditors and attorneys to sketch the various approaches to imputation in large part because courts have not seen fit to distinguish the auditor and attorney roles in evaluating the *in pari delicto* defense.

206. For a recent proposal to this effect, *see* Christine M. Shepard, *Corporate Wrongdoing and the* In Pari Delicto *Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275, 337–38 (2012) ("Imputation functions properly to allow third parties to rely on their dealings with a principal's agent. It is not proper for the task of assigning fault to a corporation when the corporation, as a plaintiff, seeks to recover from a third party who harmed it.").

207. RESTATEMENT (THIRD) OF AGENCY § 5.04 cmt. b (2006).

First, we should be clear about the implications of "no imputation" approach: it would effectively eliminate the *in pari delicto* defense in the internal-gatekeeper setting unless the company has actual knowledge of its agent's wrongdoing.[208] The *in pari delicto* defense asks whether the plaintiff is guilty of intentional or criminal wrongdoing,[209] and absent imputation of the wrongful acts or knowledge of the executive (or other employee)[210] to the corporation, the corporation does not have the requisite culpability to trigger an *in pari delicto* defense in our scenarios. The *in pari delicto* defense is not designed to compare degrees of *negligence* between the plaintiff and the defendant: comparative negligence does that already, and if the goal is to provide grounds for dismissal of a case when the plaintiff is "equal to more" *negligent* than the defendant, then modified comparative negligence will accomplish precisely that.[211] While the corporation may itself have engaged in negligence in failing to conduct its own monitoring efforts,[212] that negligence cannot ground a law firm's *in pari delicto* defense. Because the "no imputation" approach would (absent actual knowledge by the corporation) eliminate the *in pari delicto* defense when attorneys are sued for failure to detect or report executive wrongdoing, we should be confident that imputation serves no valid purpose before categorically eliminating it in corporate malpractice claims.

As discussed earlier, we can distill three reasons for imputing the acts and knowledge of executive wrongdoing to the corporation. First, under what I have termed the "benefit–burden" rationale,[213] the corporation acts and gathers information through its agents, and thus it *should* be

208. We need not address the delicate questions surrounding when the corporation has "actual" knowledge of its executive's wrongdoing because our concern is with when and whether to impute knowledge to the corporation. For example, while the board of directors' knowledge of the wrongdoing would no doubt constitute "actual" corporation knowledge of the wrongdoing, it is less clear whether the knowledge of only one or a few members would suffice for such a finding.

209. *E.g.*, Gen. Car & Truck Leasing Sys., Inc. v. Lane & Waterman, 557 N.W.2d 274, 279 (Iowa 1996) ("The culpability element of the {*in pari delicto*} doctrine requires that the plaintiff has been guilty of illegal or fraudulent conduct." (citing 27A Am.Jur.2d Equity § 132, at 611)).

210. I will use the terms "executive" and "employee" interchangeably throughout this discussion since my proposed standard would apply to both.

211. *See, e.g.*, 14 MAINE REV. STAT. § 156 (barring plaintiff from recovery if the plaintiff's negligence is equal to or greater than defendant's).

212. Christine Shepard attempts to overcome this concern by arguing that "[i]f the corporation's reporting systems are inadequate to the goal of detecting and deterring insider fraud, the corporation can fairly be deemed a 'knowing and substantial participant' in the fraud." Christine M. Shepard, *Corporate Wrongdoing and the* In Pari Delicto *Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275, 328–29 (2012). With the arguable exception of willful blindness, however, a corporation's negligent monitoring is not tantamount to knowledge of an executive's wrongful act.

213. *See supra* Part IV. subsection B. n.199.

accountable for its agents' actions and knowledge with respect to claims concerning a third party.[214] The converse of this rationale also explains the adverse-interest exception to imputation: "[I]t makes no sense to charge a person with the actions or knowledge of someone purporting to act as the person's agent if the purported agent was not acting at all on that person's behalf."[215] Second, the corporation's agents have a duty to communicate with the principal, and thus we have reason to believe that the principal will be informed when the agent is furthering wrongdoing in the corporation's name.[216] Again, when the agent is stealing from the corporation, we expect the agent not to fulfill this communication duty, thus providing a second rationale for the adverse-interest exception. Third, imputation will incentivize the corporation to select and monitor its employees carefully.[217] The question is whether any of these rationales warrant imputation in our scenarios.

Although the first of these reasons for imputation is most compelling when the corporation is sued by a third party for the wrongdoing of its agents, it retains force in claims between the corporation and the attorney for the latter's failure to discover employee wrongdoing. As a general matter, the corporation, which connects to the world through its agents, *ought* to be attributed to the acts and knowledge of its agents.[218] Although the attorney is an agent of the corporation, her failure concerns information about the acts and knowledge of *another* corporation agent—in our examples an executive who was hired and controlled by the corporation and who benefits the corporation in his agency role. Thus, imputation in this case is categorically distinct from imputation of knowledge that is unique to the attorney in the self-incrimination example offered above.

The second reason, which emphasizes that agents have duties to communicate with their principals, applies not only to corporations but also to attorneys, who also have duties to communicate with the principal under the attorney-ethics rules[219] and agency law.[220] Thus, if there is

214. Christine M. Shepard, *Corporate Wrongdoing and the* In Pari Delicto *Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275, 328–29 (2012).

215. Mark J. Loewenstein *Imputation, The Adverse Interest Exception, and the Curious Case of the Restatement (Third) of Agency*, 84 U. COLO. L. REV. 305, 317 (2013).

216. *Id.*

217. *Id.*

218. *Id.*

219. MODEL RULES OF PROF'L CONDUCT R. 1.4 (2013).

220. RESTATEMENT (THIRD) OF AGENCY § 8.11 (2006).

reason to assume that executives are communicating with the corporation, *ipso facto*, these reasons also apply to the attorney.

The third rationale creates dissonance as well. If we impute information from agents to principals to incentivize the corporation's monitoring efforts, then we cannot ignore the often critical role that attorneys play in helping the corporation monitor its affairs. A board of directors has a duty to keep reasonably informed about corporate affairs and to implement systems to monitor legal compliance.[221] The board of directors is not charged with day-to-day involvement in the operation of the corporation. In order to satisfy its monitoring duties, a board must establish systems and intermediates through which it can monitor corporate affairs. By way of example, the board may conduct ethics seminars, deploy anonymous tip lines, impose internal corporation reporting rules for suspected wrongdoing, and retain investigative counsel to explore allegations of wrongdoing. As a structural matter, the board—distanced from day-to-day operations—can and, in fact, must rely on the fulfillment by others of duties to discover and report executive or other employee wrongdoing.[222] The gatekeeping efforts of lawyers are an important means by which the corporation fulfills this monitoring role. Thus, even if we are persuaded that the benefit–burden rationale justifies imputation in the scenario offered above, we can begin to see the wisdom in crafting an exception that acknowledges the gatekeeping role of lawyers. The challenge is to frame an imputation rule that recognizes that both the corporation and the law firm have responsibilities for preventing executive wrongdoing, and that these duties are often intertwined.

When the attorney expressly or impliedly assumes corporation monitoring responsibilities, there are at least two reasons to question the propriety of imputation to the corporation of the knowledge of executive wrongdoing. First, such imputation will essentially eliminate the attorney's liability for failing to fulfill her express or implied duty. As a result, the corporation will not be able to rely on a critical intermediary necessary to fulfill its duty of care to monitor the corporation. Thus, the "public-interest" exception[223] to the *in pari delicto* defense warrants an

221. *See* 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 4.01(a)(1) (2008) (noting that the duty of care "includes the obligation to make, or cause to be made, an inquiry when, but only when, the circumstances would alert a reasonable director or officer to the need therefor").

222. *See* ROBERT CHARLES CLARK, CORPORATE LAW, § 3.4 at 129–30 (1986) (describing the "monitoring" model).

223. *See* Nisselson v. Lernout, 469 F.3d 143, 152 (1st Cir. 2006) (explaining the public-interest exception).

exception when gatekeepers fail in their monitoring role. Second, basic notions of equitable estoppel militate against imputation. Although the "elements" of equitable estoppel are fluid, "hypocrisy related to factual matters from words, conduct, or even silence may result in an equitable ban."[224] When a law firm has expressly or impliedly assumed a gatekeeping role with respect to a matter, and the corporation reasonably relies on counsel's performance of that role, there is certainly irony if not hypocrisy in its seeking to impute knowledge to the corporation of the very information the law firm failed to discover or report. The doctrine of equitable estoppel is especially apt here because *in pari delicto* is itself an equitable doctrine.

The reasoning leads to the proposed standard, which I will term the "gatekeeper imputation" exception. In malpractice claims by corporations against their law firms for failures to discover or report executive wrongdoing, courts should impute the acts and knowledge of the executive to the corporation subject to the traditional adverse-interest exception and a gatekeeper-imputation exception. *The gatekeeper imputation exception provides that when the law firm has expressly or impliedly assumed an obligation to identify or report employee wrongdoing, then information that would have been discovered had the law firm fulfilled that obligation should not be imputed to the corporation for purposes of the* in pari delicto *defense.* If *either* the adverse-interest or the gatekeeper-imputation exception applies, then courts should not impute knowledge of executive wrongdoing to the corporation for purposes of the defense.

A lawyer *expressly* assumes a gatekeeping role when she agrees to undertake an investigation or monitoring role. The more challenging question is when a law firm *impliedly* takes on such a role. Given our rationales for the gatekeeping exception, it seems that something more than the duty of care alone should be required to imply such a duty.[225] Drawing on the estoppel rationale, the law firm must have a strong enough obligation to identify and report the wrongdoing, would it amount to "hypocrisy" for it to seek to impute knowledge to the corporation of the

224. T. Leigh Anenson, *The Triumph of Equity: Equitable Estoppel in Modern Litigation*, 27 REV. LITIG. 377, 389 (2008).

225. By way of reminder, our question is not whether a breach of the duty of care would be sufficient to ground a malpractice claim, which—of course—it would be if coupled with causation and damages. Our question is whether counsel can interpose an *in pari delicto* defense to such a malpractice claim. The *in pari delicto* defense, in turn, will depend on whether the executive's wrongdoing (or knowledge thereof) will be imputed to the corporation, rendering the latter equally or more culpable, and therefore warranting dismissal of the malpractice claim. The gatekeeper exception identifies a category of instances in which such imputation would be inappropriate.

information it failed to report. Valid reasons to imply such a duty can be derived from certain ethics rules, such as RPC 1.13 or, on my interpretation, RPC 2.1, and statutory provisions, (such as the Sarbanes Oxley reporting requirements) which require the attorney to undertake specific investigation or reporting efforts in carefully delimited instances. Conversely, ethics rules that are roughly analogous to the duty of care that attaches to all representations, such as the competence and communication requirements of RPC 1.1 and RPC 1.4, respectively, should not, standing alone, trigger the gatekeeper imputation exception. Of course, the proposed standard does not change the legal theory that grounds the corporation's claim against the law firm, which remains malpractice. Instead, the proposal looks to the express or implied commitments of the law firm (the latter measured by the law firm's ethical and statutory reporting duties) to determine when to impute knowledge of the executive's wrongdoing to the corporation.

The gatekeeper-imputation exception steers a principled path between competing goals. It optimizes the corporation and lawyer's monitoring roles, without abandoning the normative claim that executive acts and knowledge should presumptively be imputed to the corporation. It acknowledges that corporations rely on gatekeepers to monitor their own executives, and lawyers who undertake such duties, whether expressly or by implication, must have incentives to perform properly. Corporations, in turn, should be encouraged to use a variety of monitoring mechanisms to prevent executive fraud, and if lawyers are categorically insulated from liability for their gatekeeping efforts, then one valuable tool in the corporation's monitoring arsenal is eliminated.[226] Even when the lawyer is a part the corporation's monitoring efforts, the corporation retains incentives to pursue additional monitoring paths to reduce the risk of liability to third parties, and the possible reduction of its claims against the attorney on comparative negligence grounds.[227]

In addition, the gatekeeper-imputation exception eliminates the anomalies of the current judicial approaches. While intuitively appealing, the bad faith exception for imputation, adopted by some courts[228] and arguably embraced by the Third Restatement,[229] calls for a deeper

226. While attorneys would remain disciplinarily accountable for such ethics breaches, as David Luban notes, "aggrieved clients are more interested in obtaining malpractice damages than in filing grievances." DAVID LUBAN, LEGAL ETHICS AND HUMAN DIGNITY 155 (2007).

227. *See infra* Part V subsection C.

228. *See supra* Part III subsection C.2.

229. *See supra* Part III subsection C. n.144–49.

explanation of why the *in pari delicto* defense should no longer apply in these circumstances. When an attorney represents an individual client, the bad faith of the lawyer would not eliminate the *in pari delicto* defense, which allows the defense when both plaintiff and defendant are engaged in wrongdoing.[230] So why should the attorney's bad faith eliminate the defense in the corporate setting? The answer is that when the attorney engages in bad faith with an executive to commit fraud, the attorney is—by definition—in possession of knowledge of executive wrongdoing that should be disclosed to the corporation under Model 1.3(b) and other rules. In other words, the attorney in this instance has failed in her implied gatekeeping role. The attorney should not, in such instance, be the beneficiary of imputation for the reasons that support the gatekeeper-imputation standard proposed herein.

The gatekeeper-imputation exception also resolves the challenges posed by the rejection of imputation in cases of negligence. As noted above, the categorical rejection of imputation disregards the notion that corporations should, absent a particularized exception, be charged with knowledge of the wrongdoing of the executives they empower to act on their behalf. Moreover, the abandonment of imputation in cases of attorney negligence, without a special justification, would undermine the equitable notion that grounds the *in pari delicto* defense in the first place. The archetypal *in pari delicto* defense involves an individual client who commits intentional wrongdoing and a negligent attorney. Thus the question is why should we reject the defense categorically when the attorney is negligent in working with a *corporate* agent who committed intentional wrongdoing? The gatekeeper test offers a cabined answer: individuals do not expressly or impliedly hire attorneys to monitor themselves; corporations do. Thus, the proposed standard does not categorically reject imputation for all instances of attorney negligence; instead, the proposed imputation exception attaches when an attorney undertakes an express or implied gatekeeping obligation.

By directing our inquiry toward the relation of an attorney's gatekeeping role to the corporation's overall monitoring efforts, the gatekeeper-imputation test invites courts to examine the attorney's failings with a discriminating eye. It distinguishes between *types* of attorney failings in ways that until now have been overlooked. While negligence alone should not be sufficient to eliminate imputation and, as a result, the

230. As noted earlier, one rationale for the defense is that courts do not wish to referee between wrongdoers. *See supra* Part III. subsection A. n.58.

in pari delicto defense, negligence in an express or implied gatekeeping role should be. By looking to the attorney's ethical and statutory gatekeeping roles to determine when an attorney has an implied gatekeeping obligation, the proposed test brings nuance to an area of the law that has long been characterized by categorical and inconsistent approaches. The next section will consider how these distinctions would play out in practice under the proposed test.

B. *The Exception Applied*

To gain some understanding of how the gatekeeper-imputation test might apply in concrete circumstances, we will return to the hypotheticals set forth in Part I. The examples will allow us to consider when an attorney has expressly or impliedly agreed to a gatekeeping role, and how the gatekeeping exception relates to the adverse-interest exception.

The most obvious instance in which corporations retain lawyers to play an important role in monitoring efforts is when they do so expressly. Consider Hypothetical D, in which the corporation hired the attorney to conduct an internal corporate investigation of alleged, ongoing malfeasance by certain of the corporation's executives. If the law firm fails to uncover such wrongdoing, and such failing is the result of malpractice or some greater failing, then we would not impute the knowledge of the wrongdoing to the corporation in a claim between the corporation and the law firm for such failing. The law firm was hired expressly for the gatekeeping function, and for reasons described earlier, the law firm's negligence in furthering an expressly undertaken gatekeeping role should deprive it of the *in pari delicto* defense. While this is an instance in which it would strain credulity to insulate the law firm from liability, the traditional imputation standards—imputation absent an adverse interest—provide no conceptual room for an exception and would dictate an untenable outcome.

Of course, a corporation could expressly retain a law firm to perform an internal-gatekeeping role even in the absence of reasons to initiate an internal investigation. Thus, while uncommon, the retention agreement between the attorney and the law firm *could* state that the firm is being retained to monitor corporate affairs, whether generally or with respect to a particular division or certain specified aspects or transactions of the business. In such instance, a law firm that was negligent in its monitoring role should not be allowed to interpose the *in pari delicto* defense for failings related to such express undertaking.

Conversely, the parties could *limit* the law firm's liability for breaches of gatekeeping duties by express agreement.[231] An advantage of the proposed standard is that it encourages corporations and law firms to address in advance whether and to what extent the law firm is expected to perform a gatekeeping role. When the parties agree on this role, there is rarely reason for courts not to respect their allocation of responsibility by and between themselves. Essentially, the advance agreement allows the corporation to deploy the law firm in furtherance of the corporation's monitoring duties as much or as little as it wishes, provided the retained law firm agrees to it. An agreement to limit the gatekeeping role of the law firm should be ratified by the board of directors to lessen the risk that an executive bent on wrongdoing might jettison the lawyer's gatekeeper role as a part of his wrongdoing scheme.

When the corporation retains a law firm for roles other than internal investigations, it often does not direct the law firm to engage in a discovery and reporting role in the engagement letter. For example, a law firm might be engaged to handle a transaction or provide counseling services on a specific issue or an array of issues. Given the parties' silence on the issue, courts should, as noted above, look to the source and nature of the attorney's duties to determine whether the attorney has an implied gatekeeping function, thereby eliminating the *in pari delicto* defense. For example, in Hypothetical A, the law firm knew of the executive's planned criminal or fraudulent scheme but did not report this fact to the board of directors of the corporation. Here, the lawyer has breached RPC 1.13(b), which expressly obligates the attorney to undertake the internal-gatekeeping role in this circumstance.[232] In addition, under section 307 of the Sarbanes-Oxley Act of 2002,[233] an attorney who discovers evidence of the company's "material violation of securities law or breach of fiduciary duty or similar violation" must report it to the company's chief legal counsel or the chief executive officer and, failing an adequate response, to an audit or independent committee of the board of directors or the entire board.[234] If the reporting attorney fails to receive an "appropriate

231. MODEL RULES OF PROF'L CONDUCT R. 1.8(h)(1) (2013). The argument would not release the attorney from her ethical and statutory reporting obligations; it would extend only to liability for malpractice, which can be adjusted in advance by agreement subject to the conditions set forth in RPC 1.8(h)(1). *Id.*

232. *See supra* Part I.

233. 15 U.S.C. § 7245 (2006) (setting forth rules of professional responsibility for attorneys).

234. Sarbanes-Oxley Act of 2002 § 307, 15 U.S.C. § 7245 (2006); *see also* 17 C.F.R. § 205.2(e) (2010) (defining "evidence of material violation").

response," he must report higher within the client organization.[235] Given the ethical and/or statutory reporting obligations on these facts, it is fair to conclude that the lawyer had an implied duty to serve as a gatekeeper on these facts, and imputation would not be appropriate.

Hypothetical B presents a closer question, given the interpretative challenges posed by ethics and statutory standards in question. In B, the attorney had reason for suspicion of executive criminal or fraudulent wrongdoing but intentionally choose not to ask follow-up questions. The attorney turned a blind eye to the allegations to avoid converting suspicion into "knowledge" of wrongdoing and therefore being required to report on the executive's wrongful design. In this instance, it is clear that the attorney did not have the requisite knowledge to trigger a duty to report the executive's wrongdoing to the board of directors under RPC 1.13. The attorney's obligations under Sarbanes-Oxley are triggered when counsel "becomes aware of evidence of a material violation" of the client.[236] If "awareness" under Sarbanes-Oxley is akin to "knowledge"[237] then the attorney's reporting obligation would not be trigged under the statute on these facts. As discussed earlier, however, the law firm on my proposed interpretation has breached the duty of investigation implied by RPC 2.1.[238] An attorney, on this view, does not exercise independent, professional judgment when she willfully ignores information suggesting that a transaction she is about to further is criminal or fraudulent. Once again, the ethical breach signals the gatekeeper-imputation exception of the

235. If the attorney does not believe that the response is appropriate, the attorney must then report the material violation to the audit committee of the board of directors, to a committee of independent directors, or to the entire board of directors. *See* 17 C.F.R. § 205.3(b)(3) (specifying when a lawyer shall report to if "an appropriate response within a reasonable time" is not provided). The attorney is permitted to, but need not, report beyond the corporation in certain instances. *See generally* William H. Volz & Vahe Tazian, *The Role of Attorneys Under Sarbanes–Oxley: The Qualified Legal Compliance Committee as Facilitator of Corporate Integrity*, 43 AM. BUS. L.J. 439, 443 (2006) (devising a structure and procedure for monitoring corporations).

236. *See* 17 C.F.R. § 205.3(c) (specifying the procedure for reporting illegality when the attorney is "aware of evidence of a material violation"); *see also id.* § 205.2(e) ("Evidence of a material violation means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.").

237. Sarbanes-Oxley is implicated when the attorney becomes "aware" that what has or is about to occur is evidently wrongful. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,727 n.105 (Aug. 24, 2000) (codified at 17 C.F.R. pts. 240, 243, and 249) ("'Aware' is a commonly used and well-defined English word, meaning 'having knowledge; conscious; cognizant.'").

238. *See supra* Part II. subsection A. n.29–30.

lawyer's failing in the gatekeeping role in the corporation's arsenal of monitoring efforts.

Contrast the ethical breaches in hypotheticals A and B with the more limited failings in C. In the latter scenario, the attorney unintentionally but unreasonably overlooked signals that, if noticed, would have led her to discover executive wrongdoing. Although the unreasonable failing could, as noted earlier, ground a prima facie malpractice case by the corporation against the attorney, the question is whether knowledge of the executive's wrongdoing should be imputed to the corporation under these circumstances. The absence of an express undertaking to serve as a gatekeeper coupled with the absence of a special ethical or statutory obligation to discover and report on the ethical wrongdoing suggests that the attorney's reporting duties, in these circumstances, would not satisfy the gatekeeper imputation exception.[239] Thus, in this instance, the attorney could successfully interpose an *in pari delicto* defense.

Let us turn finally to Hypothetical E, in which the employee's wrongdoing is directed at the corporation, whether in the form of theft from the company or some variation on that theme. Here, the adverse-interest exception applies, and knowledge of the executive's wrongdoing would not be imputed to the corporation. As a result, the attorney would not be able to interpose an *in pari delicto* defense. There is no reason to invoke the gatekeeper exception in this scenario although it too might be satisfied,[240] since the adverse-interest exception eliminates imputation.

C. *Gatekeeping and Comparative Negligence.*

In those instances in which the gatekeeper imputation or adverse-interest exception applies and the law firm cannot invoke an *in pari delicto* defense to a malpractice claim for its failure to discover an executive's wrongdoing, the remaining question is how the corporation's failings, if any, should bear on its malpractice claim against counsel. The simple answer is that the corporation's recovery should be reduced by its own negligence under principles of comparative negligence.[241] In this section, we will examine how comparative negligence would play out in a failed

239. As noted earlier, only ethics rules that impose specific gatekeeping duties should ground such implied duties, and not the general competence or communication requirements of RPC 1.1 and 1.4, respectively. *See supra* Part V. subsection A.

240. *See* discussion of Hypothetical E in Part I. subsection B.

241. *See* RONALD MALLEN, JEFFREY SMITH & ALLISON RHODES, LEGAL MALPRACTICE § 22.2 n.7 (2014) (listing jurisdictions that allow attorneys to seek to reduce malpractice recovery based on the comparative negligence of the client).

gatekeeper malpractice claim. Thus, the challenge here is what would constitute evidence of negligence on the part of the board of directors in the absence of actual or implied knowledge of the executive's planned wrongdoing.[242]

The corporation's failings to monitor could take a variety of forms. For example, the board might have failed to install other monitoring procedures or systems that would enable it to learn of wrongdoing. It may have created an environment where wrongful behavior was either ignored or tacitly rewarded by emphasizing profit and disregarding legal and ethical boundaries. It may have refused to create channels for others to report on the executive's behavior or punished those who took such action in the past. The particulars notwithstanding, a corporation can share the blame for the failure to discover its own executive's intentional or criminal wrongdoing—and comparative negligence would, in such case, reduce its recovery against counsel.

The relative negligence of the corporation and the law firm may also vary with the reasonable expectations of the parties regarding their monitoring roles. For example, when a corporation has expressly identified a problem for investigation by counsel, it may be reasonable for the corporation to substantially reduce its own investigative efforts on the question. In such instance, its own failings to investigate the matter should not reduce its recovery. On the other hand, when the law firm is only impliedly a gatekeeper, a jury could reduce the corporation's recovery against counsel for the corporation's failure to undertake its own, independent monitoring efforts. The judgment would be fact sensitive.

Courts frequently justify the imputation to the corporation of knowledge of executive wrongdoing on the grounds that it will incentivize the corporation to monitor its agents. As noted earlier, however, the imputation of such knowledge can eliminate the incentive of law firms to perform *their* role properly, since imputation can insulate the law firm from liability under an *in pari delicto* defense. The gatekeeper imputation exception therefore eliminates imputation in those situations in which the attorney has expressly or impliedly undertaken a gatekeeping role, preserving the strong incentive for law firms to perform their assumed gatekeeping duties properly. The gatekeeper-imputation exception does not eliminate the incentives of *corporations* to engage in monitoring,

242. The Hypotheticals assumed that the corporation who is suing for malpractice had no actual knowledge of the executive's criminal or fraudulent design. If it had, of course, then the *in pari delecto* defense would apply without the need for imputation, and plaintiff's claims would likely be barred under the *in pari delicto* defense.

however. Corporations will continue to be accountable to third parties who are harmed by the executive wrongdoing, providing a strong incentive to maintain controls and monitoring efforts rather than relying solely on a contribution claim against counsel in defending such third-party claims. Second, boards of directors have duties of care that require monitoring regardless of imputation, which, in many instances will require a variety of controls in addition to counsel reporting, especially when the law firm has not expressly assumed a monitoring role. Thus, even when the gatekeeper-imputation exception applies, the corporation's recovery for malpractice against its attorney will be subject to a comparative negligence defense, which will direct jury inquiries into the nature and extent of the *corporation's* monitoring efforts.

CONCLUSION

I have proposed that we distinguish "external" gatekeeping, which protects third parties from harm by the corporation client, from "internal" gatekeeping, which protects the corporation from harm resulting from the wrongdoing of its own executives or other employees. The distinction allows us to isolate the challenges that are unique to the latter role, which arise when corporations sue their lawyer for malpractice in failing to prevent executives from engaging in crimes for fraud, often against third parties, that ultimately result in substantial losses to the corporation. When we impute knowledge of the executive's wrongdoing to the corporation, the *in pari delicto* defense essentially eliminates lawyer liability for internal-gatekeeper failings. If the lawyer is categorically protected from liability to the corporation for failures to report executive wrongdoing, one can question whether the lawyer is an internal gatekeeper by any measure that matters. Thus, the central question addressed by this Article: when *should* the *in pari delicto* defense bar claims by corporations against law firms for malpractice in their role as internal gatekeeper? A review of the caselaw suggests that courts have not developed a clear or coherent answer to this question.[243]

As a general matter, imputation and its adverse-interest exception seem sensible. The corporation benefits from the acts of its agents, and should suffer the burden of the wrongdoing that agents effect on its behalf. Conversely, when the agent acts adversely to the corporation, we should

243. *See supra* Part III. Subsection C.; *see also* Christine M. Shepard, *Corporate Wrongdoing and the* In Pari Delicto *Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275, 316–18 (2012) (noting that the correct application of the *in pari delicto* defense remains unclear).

not impute knowledge of such wrongdoing to the corporation. These principles, though generally correct, fail to capture another concern, however: attorneys are often a critical part of the corporation's means of monitoring its own agents. Thus, the imputation rule and adverse-interest exception are a good start, but, standing alone, they fail to engage and reconcile the competing reasons to impute and reject imputation in the attorney gatekeeper setting.

This Article proposes a second exception to the imputation rule. In addition to adverse-interest exception, attorneys should also be subject to a "gatekeeper-imputation" exception. *When the law firm has expressly or impliedly assumed an obligation to identify or report employee wrongdoing, then information that would have been discovered had the law firm fulfilled that obligation should not be imputed to the corporation for purposes of the in pari delicto defense.* A law firm expressly assumes a gatekeeping role when it agrees to undertake an investigation or monitoring role. Gatekeeping duties are implied when required by the attorney's ethical or statutory obligations.

In each of the hypotheticals discussed in Part I, the attorney's failings to investigate, discover, or report information are breaches of the duty of care. The failings, however, differ on closer examination. They differ in whether the investigative role was express or implied, and whether the failings involved ethical or statutory obligations to investigate and report. These distinctions have been overlooked by courts, which have tended to disregard the type of lawyer failing in their imputation analysis. The proposed standard invites courts to consider these distinctions in assessing when to allow lawyers to interpose an *in pari delicto* defense.

The gatekeeper-imputation test allows the corporation and the client to adjust their rights and responsibilities by advance agreement. In the absence of an express understanding or undertaking, courts can find an implied gatekeeping duty in certain, carefully delimited circumstances. The attorney's negligence, standing alone, is not sufficient to invoke the gatekeeper-imputation exception. When lawyers breach their ethical and statutory duties to investigate, discover and/or report employee crimes and fraud, the exception would apply, and imputation would not be appropriate in corporation claims against the attorney for malpractice in failing to discover or report the wrongdoing in question. When the attorney's information discovery and reporting roles, though negligent, are *not* breaches of attorney's ethical or statutory gatekeeping requirements, lawyers should be allowed to interpose an *in pari delicto* defense. When imputation is not appropriate, the corporation's recovery for malpractice will be reduced by a comparative negligence defense, which will direct jury inquiries into the nature and extent of the *corporation's* monitoring efforts beyond counsel.

Courts frequently justify imputation to the corporation of knowledge of executive wrongdoing on the grounds that it will incentivize the corporation to monitor its agents.[244] As noted earlier, however, the imputation of such knowledge can reduce the incentive of law firms to perform *their* internal-gatekeeping role, since imputation can insulate the law firm from liability under an *in pari delicto* defense. The gatekeeper-imputation exception respects the normative basis for imputation, while incentivizing corporation boards of directors to maintain internal controls and lawyers to satisfy their ethical and statutory internal-gatekeeping duties.

244. *See In re* Am. Int'l Grp., Inc., 965 A.2d 763, 826 (Del. Ch. 2009) (discussing imputation and how it "incentivizes independent directors and even stockholders to be effective monitors of managerial behavior").