

# Third Circuit Certifies Questions Regarding the *In Pari Delicto* Defense to the Pennsylvania Supreme Court

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The United States Court of Appeals for the Third Circuit has certified two questions to the Pennsylvania Supreme Court regarding the scope and availability of the *in pari delicto* defense to claims against a corporation's auditors for professional negligence, breach of contract and aiding and abetting a breach of fiduciary duty. *Official Committee of Unsecured Creditors of Allegheny Health, Education & Research Foundation v. PricewaterhouseCoopers, LLP*, No. 07-1397 (3d Cir. July 1, 2008). Specifically, the Third Circuit has asked the Pennsylvania Supreme Court to determine:

- What is the proper test under Pennsylvania law for determining whether an agent's fraud should be imputed to the principal when it is an allegedly non-innocent third party that seeks to invoke the law of imputation in order to shield itself from liability?
- Does the doctrine of *in pari delicto* prevent a corporation from recovering against its accountants for breach of contract, professional negligence or aiding and abetting a breach of fiduciary duty, if those accountants conspired with officers of the corporation to misstate the corporation's finances to the corporation's ultimate detriment?

Allegheny Health, Education & Research Foundation (AHERF) was a health care provider that pursued an aggressive strategy of acquisition and became the largest provider in Pennsylvania. Ultimately, AHERF's strategy failed, and the company suffered substantial operation losses in 1996 and 1997. Faced with these losses, AHERF's senior management admitted to knowingly misstating the company's finances and to providing those false financial figures to the company's auditor. In 1998, AHERF's board of directors learned of the company's true financial condition and filed for bankruptcy protection.

Thereafter, AHERF's Official Committee of Unsecured Creditors sued AHERF's former auditor, asserting claims for professional negligence, breach of contract and aiding and abetting a breach of fiduciary duty. The auditor filed a motion for summary judgment on all three claims based on the *in pari delicto* defense, which

precludes courts from becoming involved in disputes between two parties that are equally at fault. The district court granted summary judgment in favor of the auditor, finding that AHERF senior management's fraud could be imputed to the company and because the committee stands in the shoes of the company, the *in pari delicto* defense prevents the creditors committee from recovering from the auditor.

On appeal, the creditors committee first asserted that the fraudulent acts of senior management could not be imputed to AHERF because they acted for their own benefit and not with the intent to serve the company's interests. In contrast, the auditor argued, and the district court found, the relevant test should not focus on the subjective intent of senior management but rather whether the company received any benefit from management's conduct. After discussing the disagreement regarding the operative imputation test, the Third Circuit found that the case presented a novel factual scenario in which an alleged "joint fraudfeasor" (rather than an innocent third party) is asserting the imputation arguments. Prior Pennsylvania cases concerning imputation were premised on the public policy "that it is more reasonable that when one of two innocent persons must suffer from the wrongful act of a third person, that the principal who has placed the agent in the position of trust and confidence should suffer, rather than an innocent stranger." The Third Circuit, therefore, certified to the Pennsylvania Supreme Court the question regarding the appropriate imputation test to apply in this case.

The creditors committee also argued that even if senior management's conduct is imputable to AHERF, as a matter of equity, the doctrine of *in pari delicto* should not shield the auditor from liability because AHERF did not personally engage in any inequitable conduct. As such, the committee maintained that the company and its auditor do not stand in a position of equal fault. The auditor responded that the Third Circuit, in *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 347 (3d Cir. 2001), had rejected a similar argument and applied the defense to bar claims of a creditors committee. The Third Circuit agreed that *Lafferty* appears to have foreclosed the creditors committee's argument, but observed that *Lafferty's* view of the *in pari delicto* defense is a minority one, and that there is an absence of law regarding whether the defense would apply to the aiding and abetting breach of duty claim and very little guiding precedent from Pennsylvania courts. Given the uncertainty concerning the *in pari delicto* doctrine, the court certified to the Pennsylvania Supreme Court the question regarding the application of the *in pari delicto* defense against a corporation asserting the causes of action at issue in this case.