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SUPERIOR COURT OF ARIZONA

COUNTY OF MARICOPA

Peter S. Davis, as Receiver of DenSco Investment Corporation, an Arizona corporation, Plaintiff, v. Clark Hill PLC, a Michigan limited liability company; David G. Beauchamp and Jane Doe Beauchamp, husband and wife, Defendants.	No. CV2017-013832 **DEFENDANTS' REPLY IN SUPPORT OF CROSS-MOTION FOR SUMMARY JUDGMENT ON VIABILITY AND APPLICATION OF *IN PARI DELICTO* DEFENSE** (Assigned to the Honorable Daniel Martin)

Defendants Clark Hill PLC and David Beauchamp responded to the Receiver's Motion for Partial Summary Judgment on Defendants' Affirmative Defense of *In Pari Delicto* and cross-moved for summary judgment that the doctrine is viable and bars Plaintiff's Complaint (the "Cross.Mt.") As set forth in this Reply to the Receiver's Response (the "Resp.") to the Cross Motion, (i) *in pari delicto* is a viable, equitable, affirmative defense in Arizona, (ii) it is not precluded by UCATA or the Arizona Constitution, (iii) and it should be applied by this Court as a matter of equity to bar Plaintiff's claims, or at minimum, be the subject of an instruction to the jury for its deliberations.

I. *In pari delicto* is alive, well, and applicable in Arizona courts.

There can be no dispute that *in pari delicto* is a recognized defense under Arizona law. As Judge Warner held in 2016, cases wherein *in pari delicto* "bars fraudfeasors (or, more often, their successors) from suing their attorneys or accountants for facilitating or failing to prevent the fraud" are "consistent with Arizona's articulation of *in pari delicto*, even though no Arizona case has applied it in circumstances like these." *ML Servicing Co. Inc. v. Greenberg Traurig LLP*, 2016 WL 4542927, at *1 (Ariz.Super. Aug. 26, 2016), citing *Brand v.Elledge,* 89 Ariz. 200, 204, 360 P.2d 213, 216 (1961) (a copy of Judge Warner's ruling is attached hereto as **Exh. A**). Although the Receiver argues that *Brand v. Elledge* merely involved an equitable claim on an illegal contract, not a claim for damages, *Brand* nevertheless applied a theory of *in pari delicto* that assessed the parties' relative degrees of fault before dismissing the plaintiff's claim. *Id.*, 89 Ariz. at 216 ("rule applies only where the parties to the wrongful act are equally at fault. It need not apply where one party's wrong is slight in comparison with the other…") That is what Judge Warner recognized, and that is precisely what Defendants request here.

The Receiver also gives short shrift to *Bill Johnson's Restaurant*. 255 F.Supp.3d 927 (D.Ariz. 2017). But that was a 2017 District of Arizona decision involving Arizona parties and applying Arizona law that determined that the doctrine of *in pari delicto* applied to claims against a plaintiff's former legal counsel, and then sent that defense to the jury for consideration. The Receiver's claim that *in pari delicto* has no application in Arizona is wrong.

II. Summary Judgment, or at worst a jury's consideration of the doctrine, is appropriate.

"[T]he in pari delicto doctrine prohibits a plaintiff who has participated in the wrongdoing from recovering when he suffers injury as a result of the wrongdoing." *In re Agribiotech, Inc.*, 2005 WL 4122738, at *5 (D. Nev. Apr. 1, 2005) (citing *First Beverages, Inc. of Las Vegas v. Royal Crown Cola Co.*, 612 F.2d 1164, 1172 (9th Cir. 1980)). This is the archetype of an *in pari delicto* case. Whatever fault the Receiver tries to pin on Defendants

cannot surpass the wrongdoing the Receiver acknowledges Chittick, and thus DenSco, is guilty of. As the court stated in *Agribiotech*, before striking the claims pursuant to *in pari delicto*: "[The plaintiff's] theory essentially is that because KPMG did not stop [plaintiff] from defrauding its own investors and creditors, KPMG owes damages to [plaintiff]." *Id*. The Receiver in this case likewise seeks to hold Defendants liable for not stopping DenSco's sole shareholder, employee, and principal from breaching fiduciary duties owed to DenSco, thereby defrauding DenSco's investors. Yet DenSco's wrongdoing is not disputable, where the Receiver admits that DenSco engaged in fraudulent conduct:

- Receiver filed a $45 million claim against Chittick's estate for "aiding and abetting [Menaged] in his torts against DenSco," defrauding DenSco and its investors, and looting millions from DenSco after the First Fraud was revealed against him. (DSOF at Exh. 29)
- Receiver recovered money from investors as Ponzi winners grounded in the theory that Chittick had committed "actual fraud" against them. (DSOF ¶ 55)
- Receiver submitted documents to the Court asserting that "Densco…was operating as a Ponzi investment scheme *while intentionally misleading its investors*…" (DSOF ¶ 54) (emphasis added)

Defendants agree. How can reasonable minds differ on DenSco's and Chittick's fault, when the parties don't differ on the crucial facts?

It is also undisputed that (i) a competing hard money lender, AFG, told Chittick in September 2012 that serious double-liening issues existed with respect to Menaged, and (ii) that Chittick did *nothing* in response to learning about those issues except hand Menaged more than half of DenSco's portfolio over the ensuing year in direct contravention of his own Private Offering Memorandum. (DSOF ¶¶ 19-23) In an attempt create a dispute where none exists, the Receiver makes the incredible assertion that just "because…AFG discovered the double lien issue in September 2012" doesn't mean that "Chittick should have likewise discovered,

investigated, or resolved it." Then, after acknowledging that AFG, in fact, *told Chittick about the double liening issue in 2012*, the Receiver pivots to dispute the inference that "Chittick personally should have taken steps at that time, beyond what he did, which included confronting Menaged." Plaintiff Controverting Statements of Facts ("PCSOF") at ¶¶ 19-20. The Receiver cannot now shrug his shoulders at DenSco's acknowledged years-long dereliction of duty, actions that caused the Receiver to file a $45 million claim against the Chittick estate in the first place. Nor can, the Receiver excuse DenSco's conduct by lamenting that "Chittick was the only employee of a busy operation and therefore relied heavily on his legal counsel, David Beauchamp" who "could have discovered the issue discovered by Gregg Reichman" and apparently stopped DenSco from handing its portfolio over to a con-man (PCSOF ¶ 20-21). Putting aside that *Densco was actually alerted to the issue by AFG*, reasonable minds could not possibly find Defendants more at fault than DenSco for failing to uncover and then prevent an ongoing fraud that DenSco *had actual knowledge of*, *did nothing about, failed to communicate to his lawyers, then exacerbated by knowingly violating DenSco's POM in order to make excessive loans to Menaged without protecting those investments through first position deeds of trust.*

The Receiver also does not materially dispute that Chittick failed to mention *any* of his prior problems with Menaged when he first sought counsel from Beauchamp in January 2014 (which was months after the First Fraud was first revealed to him). Instead, the Receiver disputes the "inference that Chittick knowingly or intentionally omitted relevant information" before asserting, again, that Beauchamp apparently should have figured this all out for himself, notwithstanding his client's lack of disclosure. (PCSOF ¶¶ 33-34) Further, while the Receiver faults Defendants for allegedly failing to advise DenSco as to its disclosure obligations, this argument ignores Defendants history' with Chittick, Chittick's history of disclosure, dozens of written communications, and Chittick owns words in a February 11, 2014 email to Menaged: "I've not taken any new investors, so if I do, I have to disclose a lot to them, which is all about

you." (DSOF ¶ 43)[1] Curiously, in an effort to create a dispute, the Receiver claims that it's not clear in that February 2014 email what time frame Chittick is referring to or whether Chittick was "asking additional people to invest (as opposed to asking for additional investments, or rolling over prior notes, from people who had already invested)." (PCSOF ¶ 43). As the Receiver has repeatedly asserted, however, whether the investors were new or simply rolling over old investments, *is irrelevant* – DenSco had a duty to disclose material information to such investors. The Receiver's attempt to conjure up a dispute as to DenSco's knowledge of its disclosure obligations fails.

Likewise, the Receiver asserts that Forbearance Agreement gives rise to liability against Defendants. Yet the Receiver fails to materially dispute that Chittick and Menaged developed the work-out plan themselves and began implementing it, prior to seeking out Beauchamp, who advised them to document a plan to which they had already agreed. Instead, the Receiver argues that "while working out the forbearance agreement, material terms changed, including the amount and interest rate of additional loans…and the development of a 'confidentiality' provision intended to discourage disclosure to investors." (Resp. at 15) Although the terms of the loans DenSco agreed to provide to Menaged may have changed, there is nothing to suggest that Defendants substituted their own business judgment for Chittick's with respect to those terms. *Id.* And as to the allegedly offensive "confidentiality" provision, Beauchamp's efforts in negotiating that term against Menaged nevertheless resulted in a provision that allowed DenSco to make the required full disclosures to its investors.

The Receiver's core argument (at 11) is that Defendants' conduct is "extraordinarily blameworthy" because Defendants purportedly advised Chittick to continue breaching securities laws. Defendants met the standard of care and acted appropriately at all times. But even if the Receiver could sustain his claims against Defendants, at its heart, the Receiver's assertion is that Defendants' wrongdoing was not doing enough to stop Chittick's own

[1] *See also* Defendants' Response to Plaintiff's Controverting Statement of Facts at ¶ 96.

wrongdoing—wrongdoing the Receiver has repeatedly acknowledged perpetrated the fraud and caused DenSco's losses.[2] *In pari delicto* applies to bar such claims. *See e.g. Terlecky v. Hurd*, 133 F.3d 377, 379 (6th Cir. 1997) (in case against law firm that allegedly knew about debtor companies illegal activities, "but failed to apprise the business of those illegalities," claims were barred where trustee admitted that "debtors' own actions were instrumental in perpetrating the fraud" rendering debtors "at least as culpable as defendants); *Zazzali v. Hirschler Fleischer, P.C.*, 482 B.R. 495, 512 (D. Del. 2012) (where client "played an essential role in the fraudulent scheme," claims against law firm for preparing offering memorandum barred); *see also Baena v. KPMG LLP*, 453 F.3d 1, 10 (1st Cir. 2006) (negligence claim barred where trustee acknowledged client's management were "the primary wrongdoers."). The Receiver's admissions regarding DenSco's conduct are damning, but at a minimum, the question should be preserved for the jury.

III. The Receiver's attempts to avoid the Court's consideration of *in pari delicto* fail.

A. The doctrine of *in pari delicto* is not barred by the Arizona Constitution.

The Receiver continues to maintain that Article 18, § 5 of the Arizona Constitution bars the application of *in pari delicto*, arguing that the constitutional language addressing "contributory negligence" or "assumption of risk" applies to the equitable doctrine of *in pari delicto*. That distorts the plain language of the constitutional provision to mean something it does not actually say. *In pari delicto* bars a claim brought by a participant in illegal, fraudulent, or inequitable conduct. *In re Bill Johnson's Restaurants, Inc.*, 255 F. Supp. 3d 927, 934 (D. Ariz. 2017). *In pari delicto* does not fit within Article 18, § 5 term of "contributory negligence," unless the parties simply ignore the use of the term "negligence."

To support its expansive reading of the Constitution, the Receiver asserts not only that Defendants disregarded *Sonoran Desert*, but that the case "is decisive." (Resp. at 2) Not so.

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[2] For example, the Receiver asserts that Defendants are liable because they "should have done a 'noisy' withdrawal," alerting investors to DenSco's misconduct. (Resp. at 12)

Sonoran Desert concerned the constitutionality of a statute, in light of Article 18, § 5, that provided a defendant could not be liable for damages a plaintiff incurred "while the plaintiff is attempting to commit or committing a misdemeanor criminal act and the act directly relates to the defendant or the defendant's property." *Sonoran Desert Investigations, Inc. v. Miller*, 213 Ariz. 274, 277 (2006). In other words, under the statute, if a plaintiff committed a crime, he assumed the risk that he would be harmed as a result of actions he took in furtherance of that crime, and would be barred from pursuing claims to redress that harm. *Sonoran Desert* struck down the statute, which essentially codified an application of contributory negligence, holding that the Constitution saves defenses for consideration of a jury only if "the conduct which gives rise to the defense can properly be described as contributory negligence or assumption of risk…" *Sonoran Desert*, 213 Ariz. at 279. Assuming the risk of harm or acting negligently in the commission of a crime, was precisely such conduct. *In pari delicto*, however, is not a defense grounded in negligence or assumption of the risk, and cannot properly be described as such. The Receiver's invocation of the Constitution to avoid DenSco's admitted wrongdoing fails.[3] Although contributory negligence and the defense of *in pari delicto*, both examine the plaintiff's conduct, the policy origins, elements, and applications of the defenses are distinct, and cannot be conflated in the manner the Receiver requests. *See id.*[4]

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[3] Similarly unavailing is the Receiver's reliance on *Fahringer* for the proposition "Arizona's courts have made clear that the protections of Article 18, § 5" apply "in all cases" where the defense is based on the injured party's conduct. (Resp. at 3) In *Fahringer*, the court considered only whether the statute at issue impermissibly barred a passenger in a vehicle driven by a drunk driver from asserting a claim against a government entity in the event of an accident. *See Fahringer*, 164 Ariz. at 602. In other words, the question was whether the passenger's negligence in accepting transportation from a drunk driver could serve as a bar to that passenger's claim. The Court found the statute impermissibly abrogated that passenger's claim in violation of the constitutional provision regarding contributory negligence.

[4] The Receiver also selectively quotes from various cases to overbroadly suggest that any doctrine that bars a plaintiff's claim based on the "conduct of a particularly category of persons" is supplanted by the Constitution. (Resp. at 3) That is clearly not the case. For example, the doctrines of laches, estoppel, and unclean hands, as well the various statutes of

B. The doctrine of *in pari delicto* is not barred by Arizona's comparative fault scheme.

In pari delicto is not a comparative fault doctrine. (Cross.Mot. at 12-14) Rather, it bars a claim as a matter of public policy where a party can demonstrate that plaintiff wrongfully participated in its own harm. As Judge Warner concluded in a legal malpractice case brought by the successor to Mortgages Limited against Mortgages Limited's former law firm,

> *In pari delicto is not, as ML argues, a matter of comparative fault*. It does not bar a claim because the plaintiff is at fault for its own injury. It bars a claim because, as a matter of equity, the court will not get involved in disputes between wrongdoers.

ML Servicing, 2016 WL 4542927, at *2 (emphasis added).[5] Thus, the better reasoned analysis, like that of Judge Warner, is not to conflate the distinct doctrine of *in pari delicto*, with the comparative fault and negligence doctrines in A.R.S. §12-2506. Doing so would "contradict[] the public policy purposes at the heart of in pari delicto—deterrence and the unseemliness of the judiciary serv[ing] as paymaster of the wages of crime." *Kirschner v. KPMG LLP*, 938 N.E.2d 941, 957 (N.Y. 2010) ("there is no reason to suppose that the [comparative fault] statute did away with common-law defenses based on intentional conduct, such as *in pari delicto* . . .") (internal quotations omitted).[6] The comparative fault statute has not displaced the common law defense of *in pari delicto*.

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limitations, all turn, in one fashion or another, on the "conduct of a particular category of persons." None of them are barred by the Constitution.

[5] Receiver's citation to opinions from Massachusetts and West Virginia fail because those cases rely on inapposite law. *Chelsea Hous. Auth. V. Mclaughlin*, for example, concerns a purported comparative fault statute specifically aimed at actions involving the "practice of public accountancy" where the defendant "is held liable for damages…in which action a claim or defense of fraud is raised against the plaintiff…and the fraud was related to the performance of the duties of the [accountant]…" Resp. at 6, n.1, citing 125 N.E.3d 711, 714 (Mass. 2019) (construing Mass. Gen. Laws Ann. ch. 112, § 87A 3/4). In *Tug Valley Pharmacy, LLC v. All Plaintiffs Below in Mingo Cty.*, West Virginia essentially adopted the *in pari delicto doctrine*, holding that "a plaintiff may recover unless his fault 'equals or exceeds' the negligence of all other parties." *Id.*, citing 773 S.E.2d 627, 635 (W.Va. 2015).

[6] New York's comparative fault statute, NY CPLR § 1411, applies to both negligent and intentional conduct, just as Arizona's does. *Kirchner*'s analysis is persuasive.

C. The doctrine of in pari delicto applies to the Receiver's claims.

The Receiver argues that *in pari delicto* does not apply to claims brought by a receiver, citing *F.D.I.C. v. O'Melveny & Myers*, 61 F.3d 17 (9th Cir. 1995) in support of its argument. Although the Receiver repeatedly objects to Defendants' citation to out-of-state and federal cases, *O'Melveny* was a federal decision (i) applying California, not Arizona, law, and (ii) involving the FDIC, an "intricate regulatory scheme designed to protect the interests of third parties," and is thus not controlling or persuasive authority. *Id.*, citing *Camerer v. California Sav. & Commercial Bank,* 4 Cal.2d 159, 170–71, 48 P.2d 39 (1935). The Receiver's demand that this Court adopt such law here rests on a flawed foundation.

First, the Receiver asserts, based on nothing more than a law review article, that the purportedly "better and more prevalent view" rejects the volume of authority Defendants cite. (Resp. at 7) As set forth in the Motion, however, numerous jurisdictions, including the 6th and 7th Circuits, hold that a Receiver is subject to equitable defenses like *in pari delicto* or unclean hands. (Cross.Mot. at 11) The equitable principles that would have applied had DenSco itself filed the instant suit, do not disappear merely because DenSco's own complicit conduct resulted in the appointment of a receiver. As the 7th Circuit explained, where the receiver is not seeking to recover diverted funds under a fraudulent transfer or conveyance theory, but is instead claiming tort damages against those that "were allegedly partly to blame for their occurrence," the "equitable balancing" requires the court to maintain "that the receiver stands precisely in the shoes of the corporations for which he has been appointed" and subject to the defense of *in pari delicto*. *Knauer v. Jonthan Roberts Financial Group,* 348 F.3d 230, 236-37 (7th Cir.2003).

The Receiver argues that in parsing the equities, the court should consider the impact on DenSco creditors. The *in pari delicto* doctrine, however, does nothing to abrogate those investors' potential claims. The investors, who placed their trust in a friend and family member who appears to have abused it, would still have the right to bring claims against DenSco, the

Chittick estate, and various third parties. The purported expedience of allowing a Receiver to bring claims *that belong to the wrongdoer—DenSco--not the investors*, is no reason to create an exception to the general rule that a receiver is subject to the same defenses as the entity it represents. (Cross.Mot. at 11-12)[7]

D. The doctrine of *in pari delicto* may be applied to a claim for aiding and abetting breach of fiduciary duty.

The Defendants have cited numerous cases where *in pari delicto* has been applied to claims for aiding and abetting breach of fiduciary duty. (Cross.Mot. at 16-17) In response, the Receiver asserts that a Delaware Court has adopted a "fiduciary duty exception" that precludes application of the doctrine against a corporations fiduciaries, and complains that the various cases cited by Defendants do not "directly address the exception." (Resp. at 9 n.3) But the fact that many jurisdictions have not adopted the so called "fiduciary duty exception," and therefore do not apply it, does not suggest that it should apply in this case. To the contrary, it demonstrates that the Court should be wary of adopting such an exception to the general rule when many persuasive authorities apply the *in pari delicto* doctrine in factual circumstances analogous to this case.[8]

Further, as set forth in the Motion, in cases of "full corporate complicity," i.e., where there is no innocent shareholder or director, it makes no sense to apply the exception, because everyone at the corporate level was complicit. No one could have been duped by the fiduciary's alleged participation in the company's misconduct. *See* Mot. at 16-17, citing *In re National Century Financial Enterprises*, 783 F.Supp.2d 1003 (S.D. Ohio 2011); *see also*

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[7] For the same reason, applying *in pari delicto* would not "frustrate the purposes of the law the receiver seeks to invoke," because investors remain free to assert whatever claims they may have a right to.

[8] Even the case cited by the Receiver, *Stewart v. Wilmington Trust SP Services, Inc.*, for example, refused to find that a fiduciary duty exception extended to cover claims for negligence. 112 A.3d 271 (Del. Ch. 2015) ("in this case, the claims against Wilmington Trust and the Auditor Defendants for…negligence will be barred by *in pari delicto*, but the claims…for aiding and abetting breaches of fiduciary duty will not").

Peterson v. McGladrey & Pullen, LLP, 676 F.3d 594, 596 (7th Cir. 2012) (entities had no claim against defendant for failing to detect and warn the entities about a fraud that their owner, and thus the entities, already understood).

The Receiver does not distinguish *National Century*, except to argue that litigants should not be able to escape liability "by pointing at other wrongdoers and saying they did it too." (Resp. at 9) That misconstrues the doctrine of *in pari delicto*, which is based on the policy that the court will not come to the aid of an acknowledged wrongdoer (in this case, DenSco) who is merely pointing the finger at another. In such circumstances, the doctrine serves to uphold *in pari delicto*'s public policy of deterring illegal action and leaving the loss where it lies without it being "weakened by exceptions." *Kirschner*, 938 N.E.2d at 950. For these reasons, even if the Court were to conclude that Arizona would adopt the so-called "fiduciary duty exception," it should not apply in these circumstances.

E. The equities favor application of the doctrine of *in pari delicto*.

The Receiver argues, citing a Massachusetts District Court case applying Massachusetts law (Resp. at 17), that Defendants have not met various factors that a court is purportedly required to evaluate before applying the equitable doctrine of *in pari delicto*. Such an evaluation, however, is not necessary, given the Receiver's acknowledgment of DenSco's wrongdoing. *See Knauer*, 348 F.3d at 237-38 (the "basic equity" is that the defendant was not as culpable as the entity he advised, notwithstanding receiver's argument that he was "separated" from that entities "past crimes"). In any event, even those alleged factors do not lead to a different result.

First, the Receiver argues that equity demands rejection of the doctrine in this case because the wrongdoer would not benefit from the funds sought. (Resp. at 17). That merely restates the Receiver's argument that the doctrine should not apply to receivers at all. As set forth above, courts routinely reject that rationale where the receiver is seeking tort damages against those purportedly helped cause them, as the Receiver is here. *See id.*

Next, the Receiver argues that the defense should not apply because Defendants benefitted from DenSco's wrongful conduct by receiving legal fees. *Id.* That argument would bar any professional from invoking the defense merely by virtue of having provided services to the fraudulent actor, thereby undoing one of the primary bases for the doctrine in the first place. *See* Section II, *supra; see also ML Servicing Co. Inc.*, 2016 WL 4542927, at *1 (Ariz.Super. Aug. 26, 2016) (*in pari delicto* "bars fraudfeasors (or, more often, their successors) from suing their attorneys or accountants for facilitating or failing to prevent the fraud"). Instead, the court must assess whether Defendants obtained a benefit *from the breaches themselves*. *See Knauer,* 348 F.3d at 236 (allowing defendants to invoke *in pari delicto* against receiver where claims were "for tort damages from entities *that derived no benefit from the embezzlements*, but that were allegedly partly to blame for their occurrence") (emphasis added). Defendants did not, and there is no allegation otherwise.

Finally, the Receiver asserts that applying the doctrine would frustrate the "purposes of the law the receiver seeks to invoke." (Resp. at 17) That is nothing more than an argument against the doctrine itself, which bars legal claims based on the plaintiff's wrongful conduct or unclean hands. Arizona, and courts around the country, however, have assessed the competing policies inherent in the *in pari delicto* doctrine, and permit that affirmative defense, notwithstanding that the doctrine could bar what a plaintiff believes might otherwise be valid claims.

IV. CONCLUSION

Pursuant to the argument and facts set forth above and in the Defendants' Supporting Statement of Facts, Defendants respectfully request that the Court dismiss Plaintiff's Count 1 for Breach of the Standard of Care and Count 2 for Aiding and Abetting Breach of Fiduciary Duty on the grounds that DenSco was *in pari delicto* with the Defendants. Alternatively, Defendants request that the Court deny the Receiver's Motion and preserve the defense for a jury to consider.

DATED this 22nd day of November, 2019.

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Exhibit A

2016 WL 4542927 (Ariz.Super.) (Trial Order)
Superior Court of Arizona.
Maricopa County

M L SERVICING CO INC, et al.,
v.
GREENBERG TRAURIG LLP, et al.

No. CV 2011-005803.
August 26, 2016.

Under Advisement Ruling

Michael C Manning.

Michaile Janae Berg.

Randall H. Warner, Judge.

***1** Two motions are under advisement following oral argument. Both are denied.

1. *Greenberg Traurig's January 25, 2016 Motion For Summary Judgment On In Pari Delicto Grounds.*

This is a legal malpractice action. Plaintiffs are the post-bankruptcy successors of Mortgages Limited, and they assert their claim against attorney Robert Kant and his firm, Greenberg Traurig (together, "GT"). Plaintiffs allege that Kant committed malpractice in preparing private placement memoranda and advising Mortgages Limited regarding securities matters. There is no dispute that Plaintiffs stand in Mortgages Limited's shoes, so the court will refer to both as "ML."

GT argues that the common law doctrine of *in pari delicto* bars the malpractice action. ML engaged in a scheme to defraud its investors, GT argues, and it cannot sue its lawyer for aiding or failing to prevent the fraud.

In pari delicto is an equitable defense that prevents a deliberate wrongdoer from recovering against a co-conspirator or accomplice. *Baena v. KPMG, LLP*, 453 F.3d 1, 6 (1st Cir. 2006). It is based on the idea that the court will not lend aid to one whose claim is founded on its own illegal act. *In re Dublin Securities, Inc.*, 133 F.3d 377, 380 (6th Cir. 1997); *see also MF Global Holdings Ltd. v. PricewaterhouseCoopers LLP*, 57 F. Supp. 3d 206, 209 (S.D.N.Y. 2014) (*in pari delicto* mandates that courts will not intercede in disputes between wrongdoers). As the Arizona Supreme Court explained, *in pari delicto* "is founded upon the equitable doctrine of he who comes into court must come with 'clean hands'." *Brand v. Elledge*, 89 Ariz. 200, 204, 360 P.2d 213, 216 (1961).

A body of case law has developed in which the doctrine bars fraudfeasors (or, more often, their successors) from suing their attorneys or accountants for facilitating or failing to prevent the fraud. *In pari delicto*, those cases hold, precludes such claims when the plaintiff engages in intentional misconduct. *See, e.g., In re Dublin Securities*, 133 F.3d at 380 (claim barred where complaint alleged that plaintiffs intentionally defrauded investors); *Zazzali v. Hirschler Fleischer, P.C.*, 482 B.R. 495, 513 (D. Del. 2012) (claim barred where complaint alleged Ponzi scheme). Conversely, the doctrine does not apply if the plaintiff did not commit intentional wrongdoing. *See MF Global Holdings*, 57 F. Supp. 3d. at 211 (denying motion to dismiss where complaint did not show plaintiff was a "willing participant" in the unlawful conduct).

These cases are consistent with Arizona's articulation of *in pari delicto*, even though no Arizona case has applied it in

circumstances like these. *Brand* notes that the doctrine only applies where parties to a wrongful act are equally at fault, or where the plaintiff is more guilty than the defendant. 89 Ariz. at 204-05, 360 P.2d at 216-17. Thus, if ML engaged in an intentional scheme to defraud investors, it cannot recover against GT for failing to prevent the fraud.

ML argues that GT did more than just fail to prevent it from making misstatements and material omissions. Rather, it argues, anything ML did wrong was the result of GT's malpractice. But if ML engaged in intentional fraud - that is, if it knowingly made false and misleading statements to investors for the purpose of inducing investment - such conduct would not result from an attorney's advice or omission. It would result from ML's own intent to deceive. Even if GT also intended to deceive (something the evidence does not support) or knowingly aided ML in perpetrating a fraud, *in pari delicto* would bar the claim. *Brand*, 89 Ariz. at 204-05, 360 P.2d at 216-17

***2** *In pari delicto* is not, as ML argues, a matter of comparative fault. It does not bar a claim because the plaintiff is at fault for its own injury. It bars a claim because, as a matter of equity, the court will not get involved in disputes between wrongdoers. Thus, if ML engaged in intentional wrongdoing, the doctrine of *in pari delicto* bars recovery completely. To hold otherwise would allow ML to profit from its own wrongdoing, which is exactly what *in pari delicto* prevents.

Thus, the dispositive question on summary judgment is whether ML engaged in an intentional scheme to defraud its investors. GT argues that ML's Complaint, and the Securities and Exchange Commission order it references, constitute admissions that ML committed intentional fraud. It relies heavily on the proposition that ML has "adopted" the SEC order issued against its affiliate, Mortgages Limited Securities, LLC. It has not. Although ML references the SEC order in the Complaint and in other papers, it has been careful not to allege or concede that it committed fraud. And while the evidence otherwise supports a finding that ML engaged in a scheme to defraud, it does not compel that finding. For this reason, summary judgment must be denied.

IT IS ORDERED denying the Motion.

2. *Plaintiffs' Motion For An Order Establishing That Plaintiffs Have Made A Prima Facie Showing In Support Of Their Claim For Punitive Damages.*

Plaintiffs seek a determination that they have made a *prima facie* showing on their claim for punitive damages so they may commence discovery regarding Defendant's financial condition. They have not. The evidence in this case does not support a finding that GT acted with the kind of "evil mind," as defined by Arizona case law, that is necessary for a punitive damages claim.

IT IS ORDERED denying the Motion.

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