

738 (Ind. 1895). The receiver is therefore not merely an agent or representative of the corporation exclusively, but is to be regarded as acting for the benefit of both creditors and shareholders. *Id.*

The Indiana Supreme Court has stated:

While the general rule *** is that the receiver of an insolvent corporation has no greater rights than those possessed by the corporation itself, and a defendant in a suit brought by him may take advantage of any defenses that might have been made if the suit had been brought by the corporation before its insolvency, it is equally true that when an act has been done in fraud of the rights of the creditors of the insolvent corporation the receiver may sue for their benefit, even though the defense set up might be valid as against the corporation itself. In such a case he may maintain an action which the corporation itself could not.

Inglehart v. Todd, 178 N.E. 685, 690 (Ind. 1931), (citing, *Lyons v. Benney*, 79 A. 250 (Pa. 1911)).

In this case, the Receiver has alleged acts of fraud which cause injury to Heartland and JMS and derivatively to the investors in Heartland and JMS. (Docket No. 1 – Complaint, ¶ 50-51, 58, 63-64; Appellant’s Appendix, Exhibit B).

Although a receiver is generally in no better position to bring an action than the corporation would have been, he or she may sue or defend in some circumstances where the corporation might have been estopped by its own fraud. 7 I.L.E., *Corporations*, § 181 (2000), (citing, *Iglehart v. Todd*, 178 N.E. 685 (Ind. 1931); *Hammond v. Cline*, 84 N.E. 827 (Ind. 1908); *Franklin Nat. Bank v. Whitehead*, 49 N.E.592 (Ind. 1898); *Vorhees v. Indianapolis Car & Mfg.Co.*, 39 N.E. 738 (Ind. 1895); *Marcovich v. O’Brien*, 114 N.E. 100 (Ind. Ct. App. 1916).

Cases where shareholders are illegally and oppressively pursuing a course in the name of the corporation, and can only be restrained by a court of equity such cases have been described as “exceptional cases” by at least one Indiana court. *Marcovich v. O’Brien*, 114 N.E. 100, 103 (Ind. Ct. App. 1916). The court in the *Marcovich* case examined the powers and duties of a receiver verses the rights of minority shareholders to pursue claims and noted that under Indiana law:

the power and duty of the receiver to collect, protect and preserve all the assets of the insolvent corporation for the benefit of those entitled thereto, including stockholders as well as creditors, and to that end, to maintain and defend all actions for or against such corporation and where the interest of creditors requires, he may maintain and defend certain actions which the corporation itself could not.

Id.

The *Marcovich* court noted that ordinarily a minority shareholder may not pursue a claim on behalf of a corporation but that an exception exists where the corporation is, “under the control of the wrongdoers, ‘in the hands of its enemies.’” *Id.* at 103. The court reasoned that this exception to the general rule governing shareholders bringing actions is even more applicable in a situation where the corporation is insolvent and its affairs are being managed and settled through a receiver appointed by and acting under the direction and orders of the court. The court noted:

When a court has taken possession of the property of an insolvent corporation for administration and appointed a receiver, the property of the corporation is a trust fund for the payment of its debts;...and the receiver in such a case is not the agent or representative of either party to the action, but is uniformly regarded as an officer of the court, exercising his functions for the common benefit of all parties.

Id.

The court further noted that in such “exceptional cases,” the receiver represents both the shareholders and the creditors and is, “to be regarded as their trustee, charged with the duties of collecting, assembling, protecting, and preserving the assets of such corporation for the benefit of those entitled thereto, subject of course to the orders and directions of the court whose officer he is.” *Id.* at 104. Following this reasoning, the court concluded that a receiver is the, “proper party to bring any action which the corporation might have brought and as trustee for the creditors can maintain actions which the corporation could not.” *Id.* Thus, Indiana courts have recognized that receivers are not always to be regarded as standing precisely in the shoes of the corporation for all purposes.

In the *Scholes* case, the Seventh Circuit recognized that the removal of a corporate wrongdoer through appointment of a receiver removes the wrongdoer from the scene and the corporation is no longer bound by his acts. *Scholes*, 56 F.3d at 754-755. Indiana law is identical on this point and recognizes that the appointment of a receiver, “ousts the corporate officers from their authority so that the corporation is no longer bound by their acts....” 7 I.L.E., *Corporations* § 180 (2000), (citing, *Ropp v. Fulton*, 108 N.E. 946 (Ind. 1915)). Thus, not applying the *in pari delicto* defense to a receiver as done by the Seventh Circuit in the *Scholes* case is consistent with the equitable principles of receivership law applied by Indiana courts.

Although a receiver is ordinarily in the same position as the corporation he represents when bringing a claim, this is not the case where a corporate wrongdoer has been removed and the Receiver must respond to a claim of *in pari delicto* based on the actions of a deposed corporate officer. At the time the Receiver was appointed on August 21, 2000, Payne and Danker were “ousted” from their positions of authority and thereafter no longer controlled Heartland and JMS. Therefore, the Receiver in this case is not subject to the *in pari delicto* defense based on Payne and Danker’s prior actions.

2. Principles of Equity

With the merger of law and equity, the doctrine of *in pari delicto* is a “counterpart” of the equitable defense of unclean hands, which “forbade a plaintiff to recover damages if his fault was equal to the defendant’s.” *Byron v. Clay*, 867 F.2d 1049, 1052 (7th Cir. 1989). The *in pari delicto* maxim is closely related and considered a corollary of the unclean hands maxim. 27A Am.Jur.2d, *Equity* § 132, (citing, *Morrissey v. Bologna*, 123 So.2d 537 (Miss. 1960)).³

“[I]f a person guilty of unconscionable or wrongful conduct purges himself or herself by adequate and effective renunciation and repudiation, the right to relief will be restored.” 27A Am. Jur.2d, *Equity*, § 135, (citing, *Stewart v. Jackson*, 635

³“A court of equity may avail itself of the precedents to be found in the reported opinions of the courts of other lands that have had occasion to consider a particular problem before the Indiana court.” 12 I.L.E., *Equity*, §3, (citing, *Sclamberg v. Sclamberg*, 41 N.E.2d 801 (Ind. 1942)).

N.E.2d 186 (Ind. Ct. App. 1994); *Dickerson v. Murfield*, 147 P.2d 194 (Or. 1944).

“Equity will not suffer a wrong to be without a remedy.” *State ex rel McGonigle v. Madison Circuit Court for Fiftieth Judicial Dist.*, 193 N.E.2d 242 (Ind. 1963); *King v. City of Bloomington*, 159 N.E.2d 563 (Ind. 1959). “Equity looks beneath rigid rules to find substantial justice and has the power to prevent strict rules from working an injustice.” 12 I.L.E., *Equity* §3 (2001), (citing, *Doe v. Shults-Lewis Child and Family Services, Inc.*, 718 N.E.2d 738 (Ind. 1999); *Murphy v. Murphy*, 698 N.E.2d 877 (Ind. Ct. App. 1998).

“Once having acquired jurisdiction of a cause, an equity court may go on to complete adjudication, even to the extent of establishing rights and creating legal remedies. This rule has been said to rest on the fundamental concepts that ‘equity will not suffer a wrong to be without a remedy’ and that ‘equity delights to do justice and not by halves’.” 12 I.L.E., *Equity* §4 (2001) (citing, *Haas v. Holder*, 32 N.E.2d 590 (Ind. 1941); *F.W. Means & Co. v. Carstens*, 428 N.E.2d 251 (Ind. Ct. App. 1981).

One who comes into equity must do so with clean hands. *Lake County Trust Co. v. Wine*, 704 N.E.2d 1035 (Ind. Ct. App. 1998). Under this maxim, equity will refuse to lend its aid in any matter to one seeking its active interposition, who has been guilty of unlawful or inequitable conduct in the matter with relation to which he or she seeks relief. *Kroeger v. Kastner*, 10 N.E.2d 902 (Ind. 1937); *Lake County Trust Co. v. Wine*, 704 N.E.2d 1035 (Ind. Ct. App. 1998).

Because the District Court found state law claims against the Defendants to belong to the Receiver, permitting them to rely upon the *in pari delicto* defense would allow a defendant who has committed a serious wrong to go unpunished. In light of foregoing equitable principles adopted by Indiana Courts, the District Court should have refused to apply an equitable defense to shield the wrongdoing Defendants from responsibility for their conduct.

C. The *Scholes v. Lehman and Troelstrup* Cases Support Not Applying the *In Pari Delicto* Doctrine in Corporate Receivership Cases.

The term *in pari delicto* refers to “equal fault or guilt”. *Black’s Law Dictionary*, 5th Ed. (West 1979) pg. 711. See *Theyes v. Bates*, 337 N.E.2d 837, 844 (Ind. Ct. App. 1975). In cases where it applies, the *in pari delicto* doctrine prevents a plaintiff whose fault is equal to or greater than the defendants from pursuing those claims. *Cenco, Inc. v. Seidman*, 686 F.2d 449, 453-454 (7th Cir. 1982). In *Scholes v. Lehman*, 56 F.3d 750 (7th Cir. 1995), the third-party defendants raised the *in pari delicto* defense in response to the receiver’s efforts to recover assets fraudulently conveyed, arguing the receiver’s claims were barred. However, this Court concluded that the *in pari delicto* defense was unavailable as against a receiver for a corporate entity since the wrongdoer who had previously controlled the receivership entity had been removed. *Id.* at 754-755.

The appointment of a receiver removes the wrongdoer from the scene. *Id.* The corporation ceases to be the wrongdoer’s lackey and become entitled, via the receiver, to pursue claims against those who have injured it. *Id.*

This Court has also drawn a distinction between receivers for individual wrongdoers or sole proprietorships and receivers for corporations and recognized that corporations, as opposed to sole proprietorships, have a distinct legal identity apart from the wrongdoer. *Troelstrup v. Index Futures Group, Inc*, 130 F.3d 1274, 1277 (7th Cir. 1997). Appellant submits that a correct application of the reasoning in *Scholes* and *Troelstrup* cases should have resulted in the rejection of the *in pari delicto* defense in this case where the wrongdoers were removed from the corporate scene through appointment of a receiver.

D. The *Schacht v. Brown* Case Supports Not Applying the *In Pari Delicto* Doctrine in Receivership Cases.

A receiver cannot be estopped from pursuing claims against outside defendants on the basis of imputing to the corporation the wrongdoer's knowledge of fraud where:

- (1) the corporation on whose behalf the receiver brings claims received no benefit but rather was injured by a scheme involving its managers, directors, and outside defendants;
- (2) any recovery in the suit will inure to the benefit of innocent parties and not wrongdoers;
- (3) defendants can assert any prior satisfaction of creditor's claims as an off-set to prevent double recovery; and
- (4) such a lawsuit will deter future misconduct without sending signals to wrongdoers that their misconduct will be indemnified by third parties.

Schacht v. Brown, 711 F.2d 1343, 1347-1348 (7th Cir. 1983).

In *Schacht*, the Court determined that a receiver was not estopped from pursuing federal R.I.C.O. claims against an outside accounting firm on behalf of a

corporation that was fraudulently continued in business past its point of insolvency and systematically looted by directors and shareholders. The defendant accounting firm relied upon this Court's two-prong analysis in *Cenco, Inc. v. Seidman*, 686 F.2d 449 (7th Cir. 1982) for determining whether to impute knowledge to the corporation. Much like the Defendants in this case, the defendants in the *Schacht* case contended that the Receiver under Illinois receivership law could not bring the claims because the knowledge of the wrongdoers should have been imputed to the corporation in receivership.

In *Cenco*, this Court had undertaken a two-pronged analysis to determine whether imputation of knowledge of corporate officers should occur. The court considered: (1) whether a judgment in favor of the plaintiff corporation would properly compensate the victims of the wrongdoing and (2) whether recovery would deter future wrongdoing. *Id.* at 455. However, this Court in the *Schacht* case reasoned that since the claims were federal R.I.C.O. claims rather than Illinois common law claims that the Court could bring to bear "federal policies" in deciding the estoppel question and that the *Cenco* analysis was not applicable. *Schacht* at 1347.

However, more importantly this Court concluded that even if state law claims had been brought and the *Cenco* analysis was applicable an important prerequisite for invoking the two-prong analysis was still lacking. *Id.* This Court explained that in *Cenco*, the corporation benefitted from the fraudulent inflation of the

corporation's inventories and stock prices to the detriment of outside creditors making the case, "ripe for an analysis of whether the director's knowledge of the fraud should be imputed to the benefitted corporation." *Id.* In contrast, in the *Schacht* case the corporation was injured when it was fraudulently continued in business past its point of insolvency and systematically looted. *Id.* at 1347-1348. Therefore, this Court concluded that the *Cenco* two-prong analysis for determining whether to impute knowledge to the corporation was not triggered. *Id.* at 1348. The difference between the cases was that in the *Cenco* case the corporation benefitted from the wrongdoing, while in the *Schacht* case the corporation was injured by the wrongdoing.

In this case, the District Court has found that the Receiver has properly alleged injury to the entities in receivership. Thus, this case is most like the *Schacht* case where the receiver was permitted to pursue claims against outside wrongdoers and was not estopped by the actions of former corporate officers.

The *Schacht* Court stated further that even if the *Cenco* two-prong analysis was applied it would still not yield the result of estopping the Receiver from bringing the claims. *Id.* This Court concluded that recovery by the receiver would in fact satisfy both prongs of the *Cenco* analysis, reasoning that first, any recovery by the receiver will inure to the estate and that the claims of entirely innocent parties would be satisfied in full before the corporations shareholders receive anything. This Court also noted that the defendants did not claim that the wrongdoers held equity

positions entitling them to recover from the instant suit. Secondly, the Court in *Cenco* case was concerned about double recovery by creditors of the corporation whereas in the *Schacht* case the Court noted that if the receiver recovered successfully that defendants could assert the previous satisfaction of the claims of the creditors as an off-set or bar to subsequently recovery. Thirdly, the *Schacht* court, noted that, unlike the corporation in the *Cenco* case, there were no wrongdoers who stood to gain as shareholders directly from the suit and had been no other corporate shareholders in a position to police the wrongdoer's or conduct an independent audit. Therefore, permitting recovery would not, "send unqualified signals to shareholders that they need not be alert to managerial fraud since they may later recover full indemnification for that fraud from third party participants." *Id.*

In this case, any recovery by the Receiver would inure to the receivership estate and ultimately to the innocent investors. Payne and Danker who are incarcerated would not receive anything since the amount of damages being claimed corresponds to the total amount of claims asserted by the creditors of Heartland and JMS. Also, in order to avoid double recovery by the creditors, if the Receiver's claims were successful, defendants would be entitled to off-set any amounts recovered by the Receiver and distributed to the creditors.

Further, recovery in this case by the Receiver may help to deter future misconduct of these or other brokerage firms who would fail to supervise or monitor their agents. Also, the shareholders of Heartland and JMS were the wrongdoers,

and no wrongdoing shareholders now remain in a position to benefit from any recovery by the Receiver. Therefore, this Court's analysis in *Schact v. Brown* supports not applying the *in pari delicto* doctrine in this receivership case.

E. The Ninth Circuit's Decision in *FDIC v. O'Melveny & Myers* Supports Not Applying the *In Pari Delicto* Doctrine in Receivership Cases.

The Ninth Circuit has held that defenses based on a party's unclean hands do not apply against a receiver. *FDIC v. O'Melveny & Myers*, 61 F.3d 17 (9th Cir. 1995). In the *O'Melveny* case, the Federal Deposit Insurance Corporation (the "FDIC") as receiver for a failed savings and loan sued the former counsel of the S&L for legal malpractice and breach of fiduciary duty. The former counsel raised the equitable defense of *in pari delicto* and argued that the receiver was barred from bringing claims against third parties due to the entity's unclean hands.

The Ninth Circuit held that the Receiver was not barred by the *in pari delicto* doctrine from bringing claims against third parties. *Id.* at 19. The Ninth Circuit recognized the general rule that, "a receiver occupies no better position than that which was occupied by the person or party for whom he acts ... and any defense good against the original party is good against the receiver." *Id.* The Ninth Circuit went on to state however, that this general rule is subject to exceptions including, "defenses based on a party's unclean hands or inequitable conduct do not generally apply against that party's receiver." *Id.* The Ninth Circuit further noted that, while a party may itself be denied a right or defense on account of its misdeeds, there is little reason to impose the same punishment on a receiver that steps into the party's

shoes pursuant to a court order. *Id.* The Court explained:

A receiver, like a bankruptcy trustee and unlike a normal successor in interest, does not voluntarily step into the shoes of the [entity]; it is thrust into those shoes. It was neither a party to the original inequitable conduct nor is it in position to take action prior to assuming the [entity's] assets to cure any associated defects or force the [entity] to pay for incurable defects.

Id.

Moreover, the Ninth Circuit reasoned that to hold otherwise would allow the opposing party to enjoy a windfall, which might be justifiable as against the wrongdoer but not as to innocent creditors. *Id.* The Ninth Circuit concluded:

In light of these considerations, we conclude that the equities between a party asserting an equitable defense and a[n entity not in receivership] are at such variance with the equities between the party and a receiver of the [entity] that equitable defenses good against the [entity] should not be available against the receiver. To hold otherwise would be to elevate form over substance—something courts sitting in equity traditionally will not do. *See Drexel [v. Berney]*, 122 U.S. [241], 254, 7 S.Ct. [1200,] 1205, [30 L.Ed. 1219 (1887)].

Id.

Likewise, the Appellant submits that in this case the application of the equitable defense of *in pari delicto* would elevate form over substance and permit the defendants s windfall. It is inequitable to permit the Defendants to escape any liability whatsoever for their wrongful conduct merely because the wrongful conduct of the Defendants coincided with the wrongful conduct of certain other wrongdoers who have now been removed from the corporate scene.

F. District and Circuit Courts Recognize the Distinction Between Bankruptcy Cases and Receivership Cases in Deciding Whether to Permit the Equitable Defense of *In Pari Delicto*.

