Equity Receivers and the *In Pari Delicto* Defense

*By Steven Rhodes and Kathy Bazoian Phelps**

Federal equity receivers are creations of equity. The in pari delicto *doctrine is similarly a defense based in equity. When equity receivers are called upon to administer the assets of a receivership entity for the benefit of defrauded victims, courts sitting in equity must balance the needs of the victims with the rights of the defendants to assert the* in pari delicto *defense to litigation claims brought by the receiver against them. The competing equities reveal the great discretion that courts can exercise in permitting litigation claims to proceed in the face of the assertion of the* in pari delicto *defense. Courts, however, must also be mindful of a variety of issues and obstacles in deciding whether to allow the* in pari delicto *defense.*

Imagine a suit to recover sufficient funds to fully compensate the innocent victims of a massive fraud. Now imagine that the suit is blocked, not because of the factual or legal merit of the suit, but because of a doctrine of equity unrelated to the conduct of either the plaintiff or the victims.

Such is the plight of an equity receiver when faced with the *in pari delicto* doctrine. In a regulatory enforcement action based on securities fraud, the receiver[1] is charged with preserving and administering the assets of the receivership entity for the benefit of defrauded victims. In fulfilling that responsibility, the receiver often brings claims against the receivership entity's attorneys, accountants, financial institutions, and others for the harm that they allegedly caused to the entity in the course of the fraud that the entity's principals perpetrated upon investors. These claims might include professional negligence, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, and others.[2]

---

* Judge Rhodes is a United States Bankruptcy Judge in the Eastern District of Michigan (Detroit). Ms. Phelps is a partner with Diamond McCarthy LLP in Los Angeles. She may be reached at kphelps@diamondmccarthy.com. They co-authored a book that addresses the legal issues with respect to Ponzi schemes. KATHY BAZOIAN PHELPS & HON. STEVEN RHODES, THE PONZI BOOK: A LEGAL RESOURCE FOR UNRAVELING PONZI SCHEMES (2012), *available at* http://www.theponzibook.com; *id.* §§ 14.01–14.09 (discussing the *in pari delicto* defense).

1. There are many different kinds of receivers appointed in many kinds of cases. This article addresses only the role of an "equity receiver" appointed by a federal district court in an enforcement action filed by the U.S. Securities and Exchange Commission under either section 22(a) of the Securities Act of 1933, 15 U.S.C. § 77v(a) (2012), or section 27(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa(a) (2012). For convenience, this article uses the term "receiver" to refer only to such an equity receiver. Note, however, that equity receivers appointed in actions involving the Commodities Futures Trading Commission, the Federal Trade Commission, or other federal or state agencies face similar, if not identical, issues.

2. *See* PHELPS & RHODES, *supra* note 1, §§ 7.01–7.19 (comprehensively reviewing the potential claims that a receiver may assert against third parties).

When the defendants assert the *in pari delicto* defense to those claims, the legal question becomes whether that defense is available against a receiver's claims. This is an important question because, if the *in pari delicto* defense does bar the receiver's claims, then the receiver loses potentially significant sources of recovery and, consequently, so do the defrauded investors.

I. Inconsistent Application of the *In Pari Delicto* Defense to Receivers

Courts have come to differing views on whether the *in pari delicto* defense applies to a receiver's third-party claims. Some courts simplistically conclude that the receiver only steps into the shoes of the receivership entity in pursuing the entity's claims. These courts then hold that, because the *in pari delicto* doctrine would bar the entity's claims, it bars the receiver's claims.[3]

Other courts conclude, equally simplistically, that a receiver's role is something more—to protect innocent investors. These courts then hold that, because these investors were not complicit in the fraud, the *in pari delicto* doctrine does not bar the receiver's claims.[4] In *FDIC v. O'Melveny & Myers*, the Ninth Circuit noted the following general rule for receivers: "[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."[5] However, the court further explained that "defenses based on a party's unclean hands or inequitable conduct do not generally apply against that party's receiver."[6]

In *Scholes v. Lehmann*, the Seventh Circuit similarly declined to impute the wrongdoer's bad acts to a subsequent independent receiver, commenting as follows:

> [T]he wrongdoer must not be allowed to profit from his wrong . . . [but t]hat reason falls out now that [the wrongdoer] has been ousted from control of and beneficial interest in the corporations. The appointment of the receiver removed the wrongdoer from the scene. The corporations were no more [the wrongdoer's] evil zombies. Freed from his spell, they became entitled to the return of the moneys—for the benefit not of [the wrongdoer] but of innocent investors . . . .[7]

However, the Seventh Circuit subsequently limited its holding in *Scholes* when faced with claims brought by the receiver against third-party brokerage firms in a

3. *See, e.g.*, Wuliger v. Mfrs. Life Ins. Co., 567 F.3d 787, 792 (6th Cir. 2009); Knauer v. Jonathon Roberts Fin. Grp., Inc., 348 F.3d 230, 238 (7th Cir. 2003); *In re* Wiand, No. 8:05-cv-1856-T-27MSS, 2007 WL 963165, at *6–7 (M.D. Fla. Mar. 27, 2007).

4. *See, e.g.*, Jones v. Wells Fargo Bank, N.A., 666 F.3d 955, 966 (5th Cir. 2012) ("Application of *in pari delicto* would undermine one of the primary purposes of the receivership[—the pursuit of actions to benefit victims of fraud—]and would thus be inconsistent with the purpose of the doctrine."); FDIC v. O'Melveny & Meyers, 61 F.3d 17, 19 (9th Cir. 1995) (per curiam) ("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." (citation omitted)).

5. 61 F.3d at 19 (citation omitted).

6. *Id.* (citation omitted).

7. 56 F.3d 750, 754 (7th Cir. 1995).

Ponzi scheme case for negligence, fraud, and conversion that alleged direct injury to the corporate debtor.[8] Even though the Seventh Circuit agreed with its earlier proposition that an exception to the *in pari delicto* doctrine exists for a receiver in exceptional circumstances involving avoidance of fraudulent conveyances, the court noted that the exception to the general rule may not apply as to other types of claims against third parties.[9]

Courts continue to struggle with the applicability of the *in pari delicto* doctrine to receivers. Some courts follow *Scholes* and *O'Melveny & Myers* and hold that the *in pari delicto* doctrine does not bar the receiver's claims. For example, the Fifth Circuit recently noted:

> In this case, the district court specifically authorized the Receiver to pursue actions for the benefit of "all investors who may be the victims of the fraudulent conduct" of W Financial and to institute actions "as may in his discretion be advisable or proper for the identification, collection, recovery, preservation, liquidation, protection, and maintenance of the Receivership Assets or proceeds therefrom." The Receiver brought this suit on behalf of W Financial to recover funds for defrauded investors and other innocent victims. Application of *in pari delicto* would undermine one of the primary purposes of the receivership established in this case, and would thus be inconsistent with the purposes of the doctrine.[10]

Another court, in declining to apply *in pari delicto* to a receiver, reasoned:

> While the Court recognizes that *O'Melveny & Myers* does not necessarily stand for the broad proposition that equitable defenses may never be asserted against federal receivers, it nonetheless agrees with the Receiver that the same equitable considerations that guided the Ninth Circuit in *O'Melveny & Myers* compel the same conclusion in this case. Like the receiver in *O'Melveny & Myers*, the Receiver in this case was not a party to any of the alleged misconduct in which the [wrongdoers] engaged. Rather, he was appointed by the Court "to take such action as is necessary and appropriate to preserve and take control of and to prevent the dissipation, concealment, or disposition of any assets . . . ." The Court finds persuasive the Receiver's assertion that allowing [the wrongdoers' auditor] to invoke the defense of *in pari delicto* would frustrate the Court's plan by "diminishing the value of the asset pool held," thereby hurting innocent third-party creditors, while benefitting . . . an alleged wrongdoer.[11]

8. *See Knauer*, 348 F.3d at 231–33.

9. *Id.* at 236.

10. Jones v. Wells Fargo Bank, N.A., 666 F.3d 955, 966 (5th Cir. 2012) (citation omitted); *see also* Reneker v. Offill, No. 3:08-CV-1394-D, 2012 U.S. Dist. LEXIS 83017, at *92–93 (N.D. Tex. June 14, 2012); Wiand v. EFG Bank, No. 8:10-CV-241-T-17MAP, 2012 U.S. Dist. LEXIS 30323, at *20–22 (M.D. Fla. Feb. 8, 2012); Perlman v. Wells Fargo Bank, N.A., 830 F. Supp. 2d 1308, 1320 (S.D. Fla. 2011) ("Under Florida law, a receiver does not always inherit the sins of his or her predecessors." (citation and internal quotation marks omitted)); Kirschner v. Wachovia Capital Mkts., LLC (*In re* Le-Nature's Inc.), No. 08-1518, 2009 U.S. Dist. LEXIS 98700, at *8–13 (W.D. Pa. Oct. 23, 2009) (holding that the appointment of a receiver days before the filing of a bankruptcy case left nothing to impute from the debtor to the trustee); Pearlman v. Alexis, No. 09-20865, 2009 U.S. Dist. LEXIS 88546, at *6–10 (S.D. Fla. Sept. 25, 2009); Harmelin v. Man Fin., Inc., No. 06-1944, 2007 U.S. Dist. LEXIS 73851, at *20–22 (E.D. Pa. Oct. 2, 2007).

11. Mosier v. Stonefield Josephson, Inc., No. CV-11-2666 (PSG), 2011 U.S. Dist. LEXIS 124058, at *16–17 (C.D. Cal. Oct. 25, 2011) (citations omitted).

A few other decisions have extended this rationale even further in finding that the appointment of a receiver actually cleanses a claim of the *in pari delicto* defense, leaving the claims free of the defense for a subsequently appointed bankruptcy trustee.[12]

Despite the majority of cases that decline to apply the *in pari delicto* doctrine to a receiver and bar the receiver's claims, other courts still bar receivers' claims on this basis unless any exceptions apply.[13]

II. The *In Pari Delicto* Defense: An Equitable Doctrine

This article suggests a more nuanced analysis of whether a receiver's claims are subject to the *in pari delicto* defense and explores the equities involved in carrying out the responsibilities of the court and the receiver. Analyzing the application of an equitable doctrine to an equity receiver is not without some obstacles, however. The article concludes with a frank review of some necessary considerations in this process.

The *in pari delicto* doctrine is an equitable one.[14] In a regulatory enforcement action, a district court appoints an equity receiver in its exercise of a statutory grant of equity jurisdiction.[15] The receiver's role is simply to assist the court in achieving an equitable result by whatever means the court determines in its discretion.[16] When a receiver appointed under the court's equity powers sues a third-party defendant for allegedly participating in the receivership entity's fraud and that defendant asserts an equitable defense such as the *in pari delicto* defense, the court must evaluate all of the equities.

Such an evaluation strongly suggests that a receiver's claims should not be subject to the *in pari delicto* defense. Additionally, under its equity power, the district court could also choose to include in the order appointing the receiver a provision preemptively barring the defense, provided that the court also puts in place appropriate due process procedures.[17] In its most basic form, the *in pari delicto* defense bars a wrongdoer's claim against a third party when the two were complicit in the wrongdoing.[18] As the Third Circuit stated, "The doctrine of *in pari delicto* provides that a plaintiff may not assert a claim against a defendant if the plaintiff bears fault for the claim."[19]

---

12. *See, e.g.*, *In re* NJ Affordable Homes Corp., No. 05-60442 (DHS), 2013 Bankr. LEXIS 4798, at *109–11 (Bankr. D.N.J. Nov. 8, 2013); *Kirschner*, 2009 U.S. Dist. LEXIS 98700, at *8–13.

13. *See, e.g.*, Wuliger v. Mfrs. Life Ins. Co., 567 F.3d 787 (6th Cir. 2009); Hays v. Pearlman, No. 2:10-CV-1135-DCN, 2010 U.S. Dist. LEXIS 116803, at *16–21 (D.S.C. Nov. 2, 2010); Marwil v. Cluff, No. 1:03-cv-0787-DFH-JMS, 2007 U.S. Dist. LEXIS 65996, at *23–27 (S.D. Ind. Sept. 5, 2007); Wiand v. Mitchell, No. 8:06-CV-1085-T-27MSS, 2007 U.S. Dist. LEXIS 24069, at *24 (M.D. Fla. Mar. 27, 2007); Myatt v. RHBT Fin. Corp., 635 S.E.2d 545, 548 (S.C. Ct. App. 2006).

14. Phelps & Rhodes, *supra* note 1, § 14.01.

15. *See* 15 U.S.C. §§ 77v, 78aa (2012).

16. *See id.*; Jones v. Wells Fargo Bank, N.A., 666 F.3d 955, 966 (5th Cir. 2012).

17. *See infra* Part V.

18. *See* Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 306 (1985); Phelps & Rhodes, *supra* note 1, §§ 14.01–14.09.

19. Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 354 (3d Cir. 2001).

The Supreme Court explained the dual premises of the *in pari delicto* doctrine: "first, . . . courts should not lend their good offices to mediating disputes among wrongdoers; and second, . . . denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality."[20] The doctrine has no statutory basis in either federal or state law; it is based entirely in equity.[21] Accordingly the application of the *in pari delicto* defense is in the discretion of the court.[22]

Under this doctrine, it is abundantly clear that an entity that had perpetrated a securities fraud could not recover on a claim that its bank, attorney, or accountant aided and abetted that entity's own fraud.[23] This article does not assert otherwise in such a case.

However, when that entity is subject to a court-supervised regulatory receivership due to its securities fraud, the question becomes whether the same result should apply if the receiver brings that claim.

Standing alone, the *in pari delicto* doctrine says nothing about its application to a successor, such as a receiver. Rather, the issue turns on whether the entity's fraud should be imputed to the receiver. Resolving the question of imputation, and therefore the viability of the *in pari delicto* defense to a receiver's claim, requires analysis of the receiver's role when applying the securities laws in a regulatory enforcement action.

20. *Bateman Eichler*, 472 U.S. at 306 (footnotes omitted).

21. *R.F. Lafferty & Co.*, 267 F.3d at 354 ("[*I*]*n pari delicto* is a doctrine of equity."); Harris v. Honein (*In re* Honein), No. NV-10-1494, 2012 WL 2428916, at *5 (B.A.P. 9th Cir. June 27, 2012) ("A trial court's authority to deny relief on the basis of the doctrine of *in pari delicto* is a well-known equitable concept applicable under both federal and Nevada state law."); Kipperman v. Onex Corp., 411 B.R. 805, 882 (N.D. Ga. 2009) ("*In pari delicto* is ultimately a doctrine of equity . . . ."); Buchwald v. The Renco Grp., Inc. (*In re* Magnesium Corp. of Am.), 399 B.R. 722, 765 (Bankr. S.D.N.Y. 2009) ("[T]he Pennsylvania Supreme Court, in *Universal Builders*, has ruled that *in pari delicto* is properly regarded as an equitable defense . . . ." (citing Universal Builders, Inc. v. Moon Motor Lodge, Inc., 244 A.2d 10, 13–14 (Pa. 1968))); Cohen v. Morgan Schiff & Co. (*In re* Friedman's Inc.), 394 B.R. 623, 631 (S.D. Ga. 2008) ("In Georgia, *in pari delicto* is an equitable doctrine." (citation omitted)); Stanziale v. Pepper Hamilton LLP (*In re* Student Fin. Corp.), 335 B.R. 539, 547 (D. Del. 2005) ("*In pari delicto* is an equitable doctrine . . . .").

22. Acme Am. Repairs, Inc. v. Katzenberg, No. 03-CV-4740 (RRM) (SMG), 2011 WL 3876971, at *2 (E.D.N.Y. Aug. 31, 2011) ("[*I*]*n pari delicto* is an equitable defense; thus courts have discretion whether to apply the defense in any particular case." (citation and internal quotation marks omitted)); Couldock & Bohan, Inc. v. Société Generale Sec. Corp., 93 F. Supp. 2d 220, 233 (D. Conn. 2000) ("The application of the *in pari delicto* doctrine rests upon the sound discretion of the court."); Collins v. Ryckman (*In re* Ryckman), 468 B.R. 754, 761 (Bankr. W.D. Pa. 2012) ("[A]pplication of [*in pari delicto*] is within the discretion of the Court."); Adelphia Commc'ns Corp. v. Bank of Am., N.A. (*In re* Adelphia Commc'ns Corp.), 365 B.R. 24, 48 (Bankr. S.D.N.Y. 2007) ("[*I*]*n pari delicto* is not a mechanical application of the law of agency, but rather involves discretionary attention to the fairness of applying it to the facts in a given case."), *aff'd in part sub nom.* Adelphia Recovery Trust v. Bank of Am., N.A., 390 B.R. 64 (S.D.N.Y. 2008); Christians v. Grant Thornton, LLP, 733 N.W.2d 803, 815 (Minn. Ct. App. 2007) ("Bearing in mind that equitable decisions are discretionary, we find no basis on which to conclude that the district court abused its discretion . . . .").

23. *See, e.g.*, Peterson v. McGladrey & Pullen, LLP, 676 F.3d 594, 599 (7th Cir. 2012); Mosier v. Callister, Nebeker & McCullough, 546 F.3d 1271, 1276–78 (10th Cir. 2008); *R.F. Lafferty & Co.*, 267 F.3d at 360.

III. The Equitable Role of a Receiver in a Securities Regulatory Enforcement Action

Unfortunately, the cases that address the foundational question of the role of a receiver in a regulatory enforcement action often only parrot tired and inconsistent generalities:

- "The general rule is that a receiver acquires no greater rights in property than the debtor had . . . ."[24]
- In a case involving a Ponzi scheme, "the interests of the Receiver are very broad and include not only protection of the receivership *res*, but also protection of defrauded investors and considerations of judicial economy."[25]
- "[W]hen the receiver acts to protect innocent creditors, . . . he can maintain and defend actions done in fraud of creditors even though the corporation would not be permitted to do so."[26]
- A receiver is appointed "to promote orderly and efficient administration of the estate . . . for the benefit of creditors."[27]
- "Federal equity receivers are appointed to take control, custody, and/or management of property involved in litigation."[28]
- "The Receiver's primary role initially was to marshal the assets . . . ."[29]
- "The role of the Receiver in this case, and similar cases, is 'to bring suits under UFTA against ponzi scheme investors to the extent that investors have received payments in excess of the amounts invested and those payments are avoidable as fraudulent transfers.'"[30]
- "Receivers appointed at the SEC's request are equipped with a variety of tools 'to help preserve the status quo while the various transactions [are] unraveled . . . to obtain an accurate picture of what transpired.'"[31]

24. Javitch v. First Union Sec., Inc., 315 F.3d 619, 625 (6th Cir. 2003); *see also* Eberhard v. Marcu, 530 F.3d 122, 132 (2d Cir. 2008) (noting that the receiver "stands in the shoes" of the corporation); Armstrong v. McAlpin, 699 F.2d 79, 89 (2d Cir. 1983) (same); Lank v. N.Y. Stock Exch., 548 F.2d 61, 67 (2d Cir. 1977) (same); Wuliger v. Anstaett, 363 F. Supp. 2d 917, 923 (N.D. Ohio 2005) (same).

25. SEC v. Universal Fin., 760 F.2d 1034, 1038 (9th Cir. 1985) (citation omitted); *see also* SEC v. Malek, 397 F. App'x 711, 714 (2d Cir. 2010) (noting that the "[r]eceiver is charged with protecting the interests of all investors").

26. Jones v. Wells Fargo Bank, N.A., 666 F.3d 955, 966 (5th Cir. 2012) (citations omitted).

27. SEC v. Hardy, 803 F.2d 1034, 1038 (9th Cir. 1986); *see also Wuliger*, 363 F. Supp. 2d at 919–20 ("the ultimate goal of maximizing the estates for the benefit of the investors" (citation and internal quotations omitted)).

28. *Wuliger*, 363 F. Supp. 2d at 923.

29. SEC v. Cross (*In re* Cross), 218 B.R. 76, 79 (B.A.P. 9th Cir. 1998).

30. Wiand v. Morgan, 919 F. Supp. 2d 1342, 1348 (M.D. Fla. Jan. 23, 2013) (quoting Donell v. Kowell, 533 F.3d 762, 770 (9th Cir. 2008)).

31. Eberhard v. Marcu, 530 F.3d 122, 131 (2d Cir. 2008) (quoting SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1105 (2d Cir. 1972)).

- "'A primary purpose of appointing a receiver is to conserve the existing estate.'"[32]
- "Receivers are directed to 'marshal the assets' of the defendant, . . . and 'prevent the dissipation of [the] defendant's assets pending further action by the court.'"[33]
- "This authority necessarily includes the power to investigate the defendant's transactions."[34]

However, none of these statements fully or adequately describes either the role of a receiver or the purpose of the court's appointment of a receiver. To do that properly, the analysis must begin with an understanding of the court's own mandate and role in a regulatory enforcement action.

A federal district court's jurisdiction in an SEC enforcement action is founded in either section 22(a) of the Securities Act of 1933[35] or section 27(a) of the Securities Exchange Act of 1934.[36] These statutes contain nearly identical language. Section 22(a) of the Securities Act of 1933 states:

> The district courts of the United States and the United States courts of any Territory shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, except as provided in section [16] of this title with respect to covered class actions, of all suits *in equity* and actions at law brought to enforce any liability or duty created by this subchapter.[37]

By these statutes, federal district courts are granted jurisdiction over suits *in equity* brought to enforce liability under the securities laws. In *Smith v. SEC*, the Second Circuit explained:

> It is "well established" that Section 22(a) of the Securities Act of 1933 and Section 27 of the Securities Exchange Act of 1934 "confer general equity powers upon the district courts" that are "invoked by a showing of a securities law violation." *SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1103 (2d Cir. 1972) (citing 15 U.S.C. §§ 77v(a), 78aa). "[O]nce the equity jurisdiction of the district court properly has been invoked, the court has power to order all equitable relief necessary under the circumstances," *SEC v. Materia*, 745 F.2d 197, 200 (2d Cir. 1984) . . . .[38]

32. *Id.* (quoting Esbitt v. Dutch-Am. Mercantile Corp., 335 F.2d 141, 143 (2d Cir. 1964)).
33. *Id.* (citing SEC v. Am. Bd. of Trade, Inc., 830 F.2d 431, 436 (2d Cir. 1987)).
34. *Id.* (citing SEC v. Koenig, 469 F.2d 198, 202 (2d Cir. 1972)).
35. 15 U.S.C. § 77v(a) (2012).
36. *Id.* § 78aa(a).
37. *Id.* § 77v(a) (emphasis added); *compare id.* § 78aa(a) ("The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits *in equity* and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." (emphasis added)).
38. Smith v. SEC, 653 F.3d 121, 127 (2d Cir. 2011); *see also In re* Bayou Grp., LLC, 564 F.3d 541, 548 (2d Cir. 2009).

Similarly, in *SEC v. First Financial Group of Texas*, the Fifth Circuit stated:

> The district court's exercise of its equity power in this respect is particularly necessary in instances in which the corporate defendant, through its management, has defrauded members of the investing public; in such cases, it is likely that, in the absence of the appointment of a receiver to maintain the status quo, the corporate assets will be subject to division and waste to the detriment of those who were induced to invest in the corporate scheme and for whose benefit, in some measure, the SEC injunctive action was brought.[39]

After the SEC makes a "proper showing," the district court exercises that equitable jurisdiction through the entry of an injunctive order.[40] In that order, the court asserts its jurisdiction over the defendant's property[41] and establishes the receivership by appointing a receiver and empowering the receiver to take physical and legal control of that property.[42] In the course of the case, the court exercises its equity powers to determine how that property will be administered and distributed.[43] The objective of the receivership is to "preserve and increase the estate for the benefit of all the creditors, investors, owners and parties to this case."[44]

To fully analyze the role of a receiver in a securities enforcement action, four important consequences of this statutory grant of equitable jurisdiction must be considered:

(1) Court Discretion to Do Equity: By its nature, a grant of equitable jurisdiction broadly allows the court to determine both what constitutes an equitable result and how to equitably accomplish that result.[45] "[O]ne common thread keeps emerging out of the cases involving equity receiverships—that is, a district court has extremely broad discretion in supervising an equity receivership and in determining the appropriate procedures to be used in its administration."[46]

These decisions are committed to the court's discretion and will only be overturned on appeal upon a showing of an abuse of discretion.[47] In *SEC v. Hardy*, the Ninth Circuit explained, "[A] district court's power to supervise an equity receivership and to determine the appropriate action to be taken in the administration of the receivership is extremely broad."[48] The court also explained the necessity of this broad discretion. "The basis for broad deference to the district

39. 645 F.2d 429, 438 (5th Cir. 1981) (footnote omitted).

40. 15 U.S.C. §§ 77t(b), 78u(d)(1) (2012); *see also* Aaron v. SEC, 446 U.S. 680, 689 (1980).

41. SEC v. Capital Consultants, LLC, 397 F.3d 733, 747–48 (9th Cir. 2005); SEC v. Safety Fin. Serv., Inc., 674 F.2d 368, 373 (5th Cir. 1982).

42. *See* SEC v. Loving Spirit Found. Inc., 392 F.3d 486, 490 (D.C. Cir. 2004).

43. *See id.*

44. Javitch v. First Union Sec., Inc., 315 F.3d 619, 621 (6th Cir. 2003); *see also* SEC v. Forte, No. 09-63, 2012 WL 1719145, at *1 (E.D. Pa. May 16, 2012) ("preserving the Receivership Assets with the objective of maximizing the recovery of defrauded Investors" (brackets omitted)).

45. SEC v. Hardy, 803 F.2d 1034, 1037 (9th Cir. 1986) ("[I]t is a recognized principle of law that the district court has broad powers and wide discretion to determine the appropriate relief in an equity receivership." (citations and internal quotation marks omitted)).

46. FDIC v. Bernstein, 786 F. Supp. 170, 177 (E.D.N.Y. 1992).

47. *Hardy*, 803 F.2d at 1037.

48. *Id.*

court's supervisory role in equity receiverships arises out of the fact that most receiverships involve multiple parties and complex transactions."[49]

(2) Legal Rules of Decision Do Not Apply: The second consequence of the court's equitable jurisdiction is that its equitable determinations are not bound by the substantive rules of decision that apply in proceedings on legal claims. In this crucial respect, equitable proceedings are fundamentally different from legal proceedings. In the classic treatise *Equity Jurisprudence*, Pomeroy summarized this aspect of equity jurisdiction:

> That equity did to a large extent interfere with and prevent the practical operation of legal rules, and did thus furnish to suitors a corrective of the harshness and injustice of the common law, history and the very existing system incontestably show . . . . And even in the present condition of equity as an established department of the national jurisprudence, whenever a court determines the rights of parties by enforcing an equitable doctrine which differs from and perhaps conflicts with the legal rule applicable to the same facts, such court does still, in very truth, exercise a corrective function, and wield an authority by which it relieves the rigor and often the injustice of the common law.[50]

The Supreme Court has recognized that legal rules of decision do not apply when Congress grants the district court equitable jurisdiction. In *Holmberg v. Armbrecht*, the plaintiffs brought an action to enforce the liability imposed by the Federal Farm Loan Act upon the shareholders of a bank.[51] The defendants contended that the action was barred by the applicable statute of limitations under New York law.[52] The Supreme Court rejected this defense, observing, "When Congress leaves to the federal courts the formulation of remedial details, it can hardly expect them to break with historic principles of equity in the enforcement of federally-created equitable rights."[53] The Court explained:

> The present case concerns not only a federally-created right but a federal right for which the sole remedy is in equity. . . . Traditionally and for good reasons, statutes of limitation are not controlling measures of equitable relief. Such statutes have been drawn upon by equity solely for the light they may shed in determining that which is decisive for the chancellor's intervention, namely, whether the plaintiff has inexcusably slept on his rights so as to make a decree against the defendant unfair. . . . Equity eschews mechanical rules; it depends on flexibility. . . . *And so, a suit in equity may lie though a comparable cause of action at law would be barred.*[54]

49. *Id.*

50. 1 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 54, at 70–71 (Spencer W. Symons ed., 5th ed. 1941).

It is also significant that Rule 66 of the Federal Rules of Civil Procedure explicitly mandates respect for and adherence to the historical role of a receiver. *See* FED. R. CIV. P. 66 ("[T]he practice in administering an estate by a receiver or a similar court-appointed officer must accord with the historical practice in federal courts or with a local rule.").

51. 327 U.S. 392, 393 (1946).

52. *Id.*

53. *Id.* at 395.

54. *Id.* at 395–96 (emphasis added) (citations omitted).

Similarly, in *Broadbent v. Advantage Software, Inc.*, the Tenth Circuit concluded, "Accordingly, in fashioning relief in an equity receivership, a district court has discretion to summarily reject formalistic arguments that would otherwise be available in a traditional lawsuit."[55] In that case, the Tenth Circuit affirmed the district court's rejection of the defendant's contract and statute of limitations defenses on the grounds that the receivership proceeding was an equitable proceeding and such legal defenses simply did not apply.[56] The court stated:

> In this case, it was proper for the district court to summarily reject appellants' statute of limitations and various contract law arguments in favor of treating appellants like all other similarly situated claimants. Indeed, the district court is authorized and expected to determine claims in an equity receivership based on equitable, rather than formalistic, principles.[57]

The defenses addressed in *Holmberg* and *Broadbent* are legal defenses, unlike the *in pari delicto* defense. The point remains, however, that in an equitable proceeding, like a securities law enforcement action, it is in the district court's discretion to determine whether the *in pari delicto* defense should be allowed to bar the receiver's claim. Indeed, the conclusion is all the more compelling because the *in pari delicto* defense is an equitable defense.

(3) No Statutory Limitation on Court's Equitable Powers: No statute restricts the district court's discretion in determining what relief to fashion for a securities fraud. Just as nothing in either section 22(a) of the Securities Act of 1933[58] or section 27(a) of the Securities Exchange Act of 1934[59] explicitly authorizes a district court to appoint a receiver, nothing in either statute limits that authority. As the Ninth Circuit explained in *SEC v. Wencke*, "The power of a district court to impose a receivership or grant other forms of ancillary relief does not . . . depend on a statutory grant of power from the securities laws. Rather, the authority derives from the inherent power of a court of equity to fashion effective relief."[60]

(4) The Receiver's Role Is to Marshall and Distribute Assets: The fourth consequence is that, at its core, the district court's appointment of a receiver is only a means to carry out the court's statutory responsibility to accomplish an equitable result in enforcing the duties and liabilities that the securities laws impose.[61] In that sense then, the court and the receiver share a unitary role. On this point, the Sixth Circuit concluded in *Liberte Capital Group, LLC v. Capwill*, "The receiver's role, and the district court's purpose in the appointment, is to safeguard the disputed assets, administer the property as suitable, and to assist

55. 415 F. App'x 73, 78 (10th Cir. 2011).
56. *Id.* at 77–80.
57. *Id.* at 79.
58. 15 U.S.C. § 77v(a) (2012).
59. *Id.* § 78aa(a).
60. 622 F.2d 1363, 1369 (9th Cir. 1980) (footnote omitted).
61. Gordon v. Washington, 295 U.S. 30, 37 (1935) ("A receivership is only a means to reach some legitimate end sought through the exercise of the power of a court of equity. It is not an end in itself.").

the district court in achieving a final, equitable distribution of the assets if necessary."[62] Similarly, in *SEC v. Loving Spirit Foundation Inc.*, the D.C. Circuit stated, "Neither a plaintiff nor a defendant, the receiver functions as an arm of the court, . . . appointed to ensure that prevailing parties can and will obtain the relief it orders . . . ."[63]

The courts in *Liberte Capital* and *Loving Spirit* properly concluded that the role of a receiver in a regulatory enforcement action is to assist the court in marshaling and distributing assets based on principles of equity. The courts in *Holmberg* and *Broadbent* properly concluded that, in achieving an equitable result in a case, the district court and, therefore, the receiver are not bound by formulistic legal rules. With that definition of the receiver's role fixed, the application of the *in pari delicto* defense to a receiver's third-party claims can be analyzed.

IV. Equity Justifies Rejecting the *In Pari Delicto* Defense to a Receiver's Third-Party Claims

Because the *in pari delicto* defense is an equitable doctrine and a court appoints a receiver on equitable grounds, the determination of whether the *in pari delicto* defense applies to a receiver's third-party claims should depend only on whether it is equitable to allow the defense in the circumstances of the case. It is certainly arguable that the analysis should not turn on any state or federal law.

Equitably, the defense should not be applied to a receiver's third-party claims for several reasons. First, neither of the two premises for the defense that the Supreme Court identified in *Bateman Eichler* is applicable. As noted above, these premises were (1) "courts should not lend their good offices to mediating disputes among wrongdoers"; and (2) "denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality."[64] However, a dispute resulting from a receiver's third-party claim is not a dispute among wrongdoers.[65] And denying relief to a receiver will not deter illegality.[66]

Second, denying relief to the receiver may actually encourage the third-party defendant's wrongful acts.

Third, allowing the *in pari delicto* defense to a receiver's third-party claims would undermine one of the primary purposes of a receivership, which is to pursue such claims for the benefit of defrauded victims.[67] The only effect of denying relief to a receiver is to deny relief to defrauded investors. The *in pari delicto* defense allows the perpetrator's wrongdoing to victimize those investors a second time.

62. 462 F.3d 543, 551 (6th Cir. 2006); *see also* SEC v. Illarramendi, No. 3:11CV78(JBA), 2012 WL 234016, at *5 (D. Conn. Jan. 25, 2012).

63. 392 F.3d 486, 490 (D.C. Cir. 2004) (citations omitted).

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

65. *See* Jones v. Wells Fargo Bank, N.A., 666 F.3d 955, 965 (5th Cir. 2012); FDIC v. O'Melveny & Myers, 61 F.3d 17, 19 (9th Cir. 1995).

66. *See Jones*, 666 F.3d at 966.

67. *Id.*

This reason to bar the defense finds substantial support in the Supreme Court's decision in *Bateman Eichler*. In that case, the Court held that the *in pari delicto* defense should not be allowed to defeat the plaintiff's insider trading claims. The Court stated:

> In addition, the public policy considerations that undergirded the *in pari delicto* defense were frequently construed as precluding the defense even where the plaintiff bore substantial fault for his injury: "[T]here 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."[68]

In the context of a receiver's third-party claims, the same public policy considerations apply, even if the receivership entity's agents participated with the defendants in harming the entity and creditors. In *Bateman Eichler*, the Supreme Court stated that the purpose of the federal securities laws is the "protection of the investing public and the national economy through the promotion of 'a high standard of business ethics . . . in every facet of the securities industry.'"[69] Allowing the *in pari delicto* defense to a receiver's third-party claims in a regulatory enforcement case would also undermine that purpose.

In *Bateman Eichler*, the Supreme Court concluded:

> [A] private action for damages in these circumstances may be barred on the grounds of the plaintiff's own culpability only where (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.[70]

Neither of these tests is met when a receiver sues a third-party defendant for the damages to the receivership entity caused by the defendant's participation in the entity's fraud. The receiver did not participate in the entity's violations of the securities laws. And precluding the receiver's third-party claims would significantly interfere with both the effective enforcement of the securities laws and the protection of the investing public.

Fourth, a receiver is an involuntary successor, appointed through the processes of a court of equity, and the equities that apply to the receiver's claims are completely different than those that might apply to a voluntary successor's claims. If a voluntary successor to the perpetrator's assets were to pursue the perpetrator's third-party claims for its own benefit, there would be no public interest in shielding the successor's claim from the *in pari delicto* defense, and it would not be necessary for the protection of the investing public. Also, it can be reason-

68. *Bateman Eichler*, 472 U.S. at 307 (quoting 1 Joseph Story, Commentaries on Equity Jurisprudence 305 (13th ed. 1886)). Similarly, in *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968), *overruled on other grounds by Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 765, 777 (1984), the Supreme Court rejected the *in pari delicto* defense to an antitrust claim, emphasizing "the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes." *Id.* at 138.

69. *Bateman Eichler*, 472 U.S. at 315 (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186–187 (1963)).

70. *Id.* at 310–11.

ably presumed that the successor had an opportunity to investigate the perpetrator's assets. But each of these equities is reversed when the plaintiff is an involuntary successor—a receiver appointed by the court to protect the interests of defrauded investors.[71]

For these reasons, a district court exercising its equitable jurisdiction in a regulatory receivership action could disallow the *in pari delicto* defense to a receiver's third-party claims.[72] Of course, the particular equities of each case should be considered, but the general equities of a regulatory receivership could very well mandate a finding that it would be inequitable to the defrauded victims and the purpose of the receivership to bar a receiver's claims against third parties on the basis of the *in pari delicto* doctrine.

V. In the Court's Discretion, the Order Appointing the Receiver Can Preemptively Disallow the *In Pari Delicto* Defense

Because the equitable parameters of the receivership are established when the district court enters an order appointing the receiver, can that order expressly disallow the *in pari delicto* defense to the receiver's third-party claims? This is more a question of process than of substance. This article has already presented justification for the position that, in exercising its equity jurisdiction, the district court can, and generally should, reject the defense. The question here is whether the court can, in its discretion, do this in the order that appoints the receiver. The issue arises because, of course, the court enters this order before the receiver commences any third-party litigation and, therefore, before the potential targets of the litigation have an opportunity to be heard on the *in pari delicto* issue.

In most circumstances, due process considerations suggest that a court should give the parties a full opportunity to be heard before the ruling on their claims and defenses. On this basis, the potential defendants would certainly argue for the same treatment here.

However, it may be appropriate for the district court to deny the defense in the order of appointment, for several reasons. First, as discussed in Part III above, the equitable nature of a receivership proceeding gives the court very broad discretion to determine not only an equitable result but also an equitable process to achieve that result.

Second, as also discussed in Part III above, the district court's control over the receivership entity's claims against third parties is complete and exclusive.

71. Scholes v. Lehmann, 56 F.3d 750, 754–55 (7th Cir. 1995).

72. *See* Fine v. Sovereign Bank, 634 F. Supp. 2d 126, 143 (D. Mass. 2008) ("Massachusetts courts would allow a receiver to avoid the defense if the equities so required."); Javitch v. Transam. Occidental Life Ins. Co., 408 F. Supp. 2d 531, 538 (N.D. Ohio 2006) (rejecting argument that receiver's claim was precluded by *in pari delicto*); Freeman v. Dean Witter Reynolds, Inc., 865 So. 2d 543, 550 (Fla. Dist. Ct. App. 2003) ("[T]he receiver may also pursue certain claims that would be barred by the defense of *in pari delicto* if pursued by the corporation that was placed in receivership."); Albers v. Cont'l Ill. Bank & Trust Co., 17 N.E.2d 67, 69 (Ill. App. Ct. 1938) (discussing earlier holding that the defense of *in pari delicto* was "unavailing against receivers"); ISP.com LLC v. Theising, 805 N.E.2d 767, 773 (Ind. 2004) (permitting "a receiver to assert claims free of defenses, such as *in pari delicto*").

In providing relief to defrauded investors, the district court is empowered to enter any equitable remedy against any party, and is not bound to apply the traditional limits of legal claims for relief and the defenses to them. Consequently, it is entirely within the court's discretion, based on its sense of equity, to determine the circumstances under which third parties should be held liable. The dictates of the law are applicable only to the extent the district court determines that it is equitable to apply those dictates.

A third justification for barring the *in pari delicto* defense in the order appointing the receiver is that it will reduce the expenses of the receivership by eliminating the costs that would otherwise be incurred in litigating the issue in every lawsuit against a third party. It would thereby enhance the defrauded investors' recoveries. By making the litigation less complex, it would also expedite both the distribution to defrauded investors and the closing of the receivership estate. Although these considerations may not, by themselves, justify this result, they are appropriate considerations in the court's exercise of its equity jurisdiction.

Fourth, denying the *in pari delicto* defense in the order appointing the receiver is analogous to other common provisions in the appointment order that, without notice or an opportunity to be heard, deny important substantive and procedural rights held by parties in contexts other than the receivership process. For example, one common provision in a receivership order is an anti-litigation provision that prohibits parties from filing or pursuing lawsuits against the receivership entity.[73] Another such provision, now also commonly included, is an anti-bankruptcy provision, which prohibits creditors from filing an involuntary bankruptcy petition against the receivership entity.[74] Other analogous provisions have the effect of prohibiting enforcement of security interests,[75] or otherwise exercising control over receivership property.[76]

In any event, a defendant's due process interest can be vindicated through a summary procedure by which the defendant seeks modification of this provision in the appointment order.[77] The focus of the procedure would be on whether

73. SEC v. Byers, 609 F.3d 87, 91 (2d Cir. 2010) (upholding anti-litigation injunction); SEC v. Wencke, 622 F.2d 1363, 1369 (9th Cir. 1980) (upholding anti-litigation injunction, given "the inherent power of a court of equity to fashion effective relief").

74. *See, e.g.*, *Byers*, 609 F.3d at 92.

75. SEC v. Nadel, No. 8:09-cv-87-T-26TBM, 2009 WL 2868642, at *2–3 (M.D. Fla. Sept. 3, 2009); SEC v. Lauer, No. 03-80612-CIV-MARRA, 2006 WL 2660752, at *1–6 (S.D. Fla. Aug. 2, 2006).

76. SEC v. Am. Capital Invs., Inc., No. 95-55386, 1996 WL 608527, at *3–4 (9th Cir. Oct. 22, 1996).

77. A summary proceeding is "a truncated form of process." SEC v. Ross, 504 F.3d 1130, 1141 (9th Cir. 2007). "[T]he use of these summary procedures promotes judicial efficiency and reduces litigation costs to the receivership, thereby preserving receivership assets for the benefit of all claimants." SEC v. Sunwest Mgmt., Inc., No. 09-6056-HO, 2009 WL 3245879, at *10 (D. Or. Oct. 2, 2009).

A summary proceeding may have the following characteristics that distinguish it from a plenary proceeding:

(a) The responding party is not served with a formal complaint and summons; rather, any process that provides notice and an opportunity to be heard is sufficient. *See, e.g.*, SEC v. Wencke, 783 F.2d 829, 836–38 (9th Cir. 1986).

(b) Discovery may be allowed only upon a showing of good cause. *See, e.g.*, *id.* at 838; SEC v. Vassallo, No. 5-09-0665 LKK/DAD, 2011 WL 3875640, at *3 (E.D. Cal. Sept. 1, 2011).

the defendant should be granted leave to assert the *in pari delicto* defense in its answer to the complaint. Because the focus is not on the evidentiary question of whether the defense should be sustained, the delay and expense of discovery on the *in pari delicto* issue would be deferred until after the court granted the defendant leave to assert the defense. In determining whether to grant the requested leave, the court would apply no presumption or supposition that the *in pari delicto* defense barred the receiver's third-party claims. Rather, the issue would be whether the defendant pled facts which, if proven, require, as a matter of fairness and equity, that the receiver's claims be barred due to the entity's fraud. As argued in this article, the mere fact that the receiver "stands in the shoes of the entity" would not suffice. Equity would bar the receiver's recovery only when the conduct of the beneficiaries of that recovery would justify it. That result might be warranted if the entity's guilty insiders had substantial claims against the receivership estate and might participate in the receiver's recovery on the third-party claim. However, even under those circumstances, the court could well decide that denying the guilty insiders' participation in the receiver's recovery by denying the guilty insiders' claims against the receivership is more equitable than denying recovery to innocent creditors by barring the receiver's claims against third parties.

Similar summary procedures have been fully recognized in many contexts within a regulatory enforcement action. Perhaps the most common of these is when the receiver requests an order compelling a "relief" or "nominal" defendant to disgorge receivership property.[78] Beyond that, the list of circumstances in which district courts have employed summary procedures is long and diverse: a party's request to modify an anti-litigation provision;[79] an investor's request to release funds from a freeze order;[80] a receiver's request to establish a distribution plan and to allow, disallow, and subordinate claims;[81] a proceeding to determine whether the creditor could exercise setoff rights;[82] a post-judgment

(c) An evidentiary hearing is conducted only if the court determines that there are disputed facts. *Vassallo*, 2011 WL 3875640, at *3.

(d) To save time and reduce costs, the process is concluded on a more expedited basis. SEC v. Elliott, 953 F.2d 1560, 1566 (11th Cir. 1992).

78. "A relief defendant is a person who holds the subject matter of the litigation in a subordinate or possessory capacity as to which there is no dispute." CFTC v. Walsh, 618 F.3d 218, 225 (2d Cir. 2010) (citations and internal quotation marks omitted). "Federal courts may order equitable relief against a person who is not accused of wrongdoing in a securities enforcement action where that person: (1) has received ill-gotten funds and (2) does not have a legitimate claim to those funds." SEC v. Cavanagh, 155 F.3d 129, 136 (2d Cir. 1998) (footnote omitted). For a full discussion of claims against relief defendants, see Phelps & Rhodes, *supra* note 1, §§ 9.01–9.04.

79. *See, e.g.*, SEC v. Illarramendi, No. 3:11cv78 (JBA), 2012 WL 5832330, at *2–3 (D. Conn. Nov. 16, 2012).

80. *See, e.g.*, SEC v. Black, 163 F.3d 188, 196–99 (3d Cir. 1998).

81. *See, e.g.*, *Sunwest Mgmt., Inc.*, 2009 WL 3245879, at *10; SEC v. Byers, 637 F. Supp. 2d 166, 184–85 (S.D.N.Y. 2009).

82. *See, e.g.*, United States v. Ariz. Fuels Corp., 739 F.2d 455, 458–59 (9th Cir. 1984).

proceeding to determine the claim of a nonparty to property;[83] and a proceeding to adjudicate an investor's rights to a promissory note.[84]

An equity court's utilization of summary procedures is fully consistent with due process,[85] unless "parties would be deprived of a full and fair opportunity to present their claims and defenses."[86] Summary proceedings are justified in the interests of equity and efficiency, so that the receivership can serve its purposes of marshaling assets and compensating defrauded investors as equitably and efficiently as possible.[87] These same justifications also warrant a provision in the appointment order denying the *in pari delicto* defense to the receiver's third-party claims. Accordingly, a district court could consider, in its discretion, including in its order appointing a receiver a provision that bars third-party defendants from asserting the *in pari delicto* defense and establishing a summary procedure to modify such a bar.

VI. Challenging This Analysis: Does State Law Apply?

Realistically, where is this equitable analysis vulnerable? If presented in court, where can it be challenged?

One strong challenge to this analysis arises from the lack of precedent for it. Every case that has addressed the issue has looked to state law alone and has not considered equitable principles more generally, as presented in this article.

The Supreme Court case of *O'Melveny & Myers v. FDIC*[88] could also be a major obstacle to the equitable analysis discussed in Part I. In *O'Melveny & Myers*, the FDIC acted as the receiver of a failed bank under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").[89] It sued a law firm for damages to the bank on claims of professional negligence and breach of fiduciary duty.[90] The law firm asserted the *in pari delicto* defense, arguing that the knowledge and misconduct of the bank's employees should be imputed to the bank and, therefore, to the FDIC under state law.[91]

83. *See, e.g.*, SEC v. Wencke, 783 F.2d 829, 836 (9th Cir. 1986).

84. *See, e.g.*, SEC v. Universal Fin., 760 F.2d 1034, 1037 (9th Cir. 1985) (per curiam).

85. *See, e.g.*, SEC v. Basic Energy & Affiliated Res., Inc., 273 F.3d 657, 668 (6th Cir. 2001) ("[A] district court does not generally abuse its discretion if its summary procedures permit parties to present evidence when the facts are in dispute and to make arguments regarding those facts." (quoting SEC v. Elliott, 953 F.2d 1560, 1567 (11th Cir. 1992))).

86. *Elliott*, 953 F.2d at 1567; *see also* SEC v. Ross, 504 F.3d 1130, 1147 (9th Cir. 2007).

87. SEC v. Byers, 609 F.3d 87, 92–93 (2d Cir. 2010) ("An anti-litigation injunction is simply one of the tools available to courts to help further the goals of the receivership. . . . The current injunction prevents small groups of creditors from placing some entities into bankruptcy, thereby removing assets from the receivership estate to the potential detriment of all."); Liberte Capital Grp., LLC v. Capwill, 462 F.3d 543, 551 (6th Cir. 2006) ("The receivership court has a valid interest in both the value of the claims themselves and the costs of defending any suit as a drain on receivership assets.").

88. 512 U.S. 79 (1994).

89. *Id.* at 80–86.

90. *Id.* at 82.

91. *See id.*

The FDIC responded that, because the bank was in federal receivership, federal law should determine the defenses to its claims and that, under federal common law, the *in pari delicto* defense does not apply to it.[92]

The Supreme Court rejected the FDIC's argument. It stated, "There is no federal general common law."[93] Accordingly, to resolve the issue, the Court turned to FIRREA, which states, "[T]he [FDIC] shall, . . . by operation of law, succeed to—all rights, titles, powers, and privileges of the insured depository institution . . . ."[94] Interpreting this statute, the Court reasoned:

> This language appears to indicate that the FDIC as receiver "steps into the shoes" of the failed S&L, . . . obtaining the rights of the insured depository institution that existed prior to receivership. Thereafter, in litigation by the FDIC asserting the claims of the S&L—in this case California tort claims potentially defeasible by a showing that the S&L's officers had knowledge—any defense good against the original party is good against the receiver.[95]

Additionally, the Court explicitly rejected the view that the judiciary had a role to play in determining the liability of lawyers who provide services to federally insured financial institutions.[96] Rather, the Court stated that it was "for those who write the laws, rather than for those who interpret them" to weigh the "host of considerations that must be weighed and appraised, . . . including, for example, the creation of incentives for careful work, provision of fair treatment to third parties, assurance of adequate recovery by the federal deposit insurance fund, and enablement of reasonably priced services."[97] Accordingly, the Court remanded the matter to the Ninth Circuit to determine and apply state law.[98]

Plainly, if *O'Melveny & Myers* is extended to an equity receivership in an SEC enforcement action, the analysis offered in this article would have to be rejected and only state law would govern. Whether *O'Melveny & Myers* is distinguishable from a case involving a regulatory equity receivership is a close question. On the one hand, the case is distinguishable because, although FIRREA explicitly establishes the rights and powers of the FDIC acting as a receiver, the securities laws leave the rights and powers of an SEC receiver to the discretion of the district court sitting in equity.[99] On the other hand, the *O'Melveny & Myers* Court

---

92. *See id.* at 83; *compare* FDIC v. O'Melveny & Myers, 61 F.3d 17, 19 (9th Cir. 1995) (per curiam) (rejecting FDIC's argument that, because the FDIC is a federal instrumentality, federal law should resolve defenses against it).

93. *O'Melveny & Myers*, 512 U.S. at 83 (quoting Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938)).

94. *Id.* at 86 (quoting 12 U.S.C. § 1821(d)(2)(A)(i)).

95. *Id.* (citations and internal quotation marks omitted).

96. *Id.* at 89.

97. *Id.*

98. *Id.* On remand, the Ninth Circuit held that, under California law, the *in pari delicto* defense did not apply to the FDIC's third-party claims. FDIC v. O'Melveny & Myers, 61 F.3d 17, 19 (9th Cir. 1995) (per curiam).

99. Interestingly, no case explores the merit of this distinction. At the same time, however, only one appellate case cites *O'Melveny & Myers*, 512 U.S. at 83, 88, for the proposition that the *in pari delicto* defense applies to an SEC receiver. Knauer v. Jonathon Roberts Fin. Grp., Inc., 348 F.3d 230,

expressly rejected both the notion of a federal common law, as well as the view that the federal judiciary should weigh the equities in determining third-party liabilities.[100]

Apart from *O'Melveny & Myers*, a third, more practical challenge to the use of equity to deny an equitable defense arises because many judges may not have a full understanding of the historical supremacy of equity over legal rules and are not accustomed to the concept of denying an equitable defense to a legal claim.

VII. Conclusion

The authority of a court of equity is broad, both in determining an equitable result and in determining an equitable process to achieve that result. In exercising that authority in a securities regulatory enforcement action, the district court may appoint a receiver as a means for the court to achieve an equitable result. A district court could readily determine that equity compels the conclusion that the defendants in a receiver's third-party actions should be denied the *in pari delicto* defense. A court may also conclude that this determination is appropriate in the order appointing the receiver, especially if the order establishes a summary procedure for its modification. However, to succeed on this analysis, the Supreme Court's decision in *O'Melveny & Myers* will have to be distinguished.

235 (7th Cir. 2003). Many other appellate cases that have addressed the issue do so without considering the Supreme Court's decision in *O'Melveny & Myers*.

100. It should be noted, however, that the case law in many states also requires the consideration of equitable principles in evaluating the application of the *in pari delicto* doctrine. For example, in *Glenbrook Capital L.P. v. Dodds* (*In re Americo Derivative Litigation*), 252 P.3d 681 (Nev. 2011), the Nevada Supreme Court stated, "[T]he courts should not be so enamored with the latin phrase '*in pari delicto*' that they blindly extend the rule to every case where illegality appears somewhere in the transaction." *Id.* at 696 (citation and internal quotation marks omitted). The court went on to observe, "Other courts have similarly noted that there are public policy grounds for not applying *in pari delicto* as a bar to an action among wrongdoers." *Id.* (citation omitted).