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## Court Bars Derivative Claims Against Third-Party Conspirators

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The Court of Chancery recently held that derivative claims against the nominal defendant's alleged co-conspirators were barred by Delaware's *in pari delicto* doctrine, which precludes recovery by a party that knowingly engaged in the misconduct giving rise to the loss.

The June 17 opinion in *In re American International Group Inc.* rejects the complicated and imprecise analysis necessary to allocate responsibility among alleged wrongdoers, and forecloses as bad policy the potential for corporate wrongdoers to seek recompense from third-party co-conspirators when the illicit enterprise goes awry. Consistent with risks inherent in the corporate form, shareholders seeking to recover losses sustained by the corporation can pursue derivative claims only against the offending fiduciaries within the corporate family and, potentially, from a limited universe of external corporate "agents."

### The claims

The first amended combined complaint alleged a complex matrix of direct (by AIG) and derivative claims against 43

individual and corporate defendants. The claims involved essentially two widely publicized illegal schemes: an illegal insurance bid-rigging scheme among AIG, various Marsh & McLennan entities, ACE, Limited and two ACE subsidiaries and a sham reinsurance scheme involving AIG, General Re Corp. and a General Re subsidiary. In an opinion decided earlier this year, the court dismissed conspiracy claims against AIG's auditor, PricewaterhouseCoopers, under New York's *in pari delicto* doctrine, dismissed conspiracy claims against various officers and employees of AIG for lack of personal jurisdiction and permitted claims against former AIG directors to proceed. The court's recent opinion addressed conspiracy claims asserted derivatively against the non-AIG entities and one individual.

### The doctrine

Because the parties did not address choice of law in their briefing, the court applied Delaware law. Citing recent Delaware precedent explained that under the *in pari delicto* (Latin for "in equal fault") doctrine, a party generally is barred from recovering damages if its losses are substantially caused by its own illegal activities. "Substantially" does not mandate a finding of equal participation, but simply that each party acted with scienter in the sense that each was a knowing and substantial participant in the wrongful scheme. There are at least two discrete exceptions to the doctrine: *in pari delicto* will not bar claims where the plaintiff engaged in illegal acts because of duress or where an illegal contract is intrinsically unequal, nor will it bar claims

that implicate important, countervailing public policies.

### The holding

The vice chancellor determined that the derivative claims asserted on behalf of AIG against third parties unquestionably implicated *in pari delicto*, in that the well-pleaded allegations of the complaint established that the harm for which damages were sought resulted from AIG's substantial participation in the alleged schemes.

The court rejected plaintiffs' argument that two exceptions prevented the application of *in pari delicto*. First, the court found that there was no basis to find that AIG was less culpable, or acted through its inside agents under duress. On the contrary, the well-pleaded allegations of the complaint establish that AIG was a sophisticated (and "legendarily aggressive") industry giant that freely could have rejected involvement in either alleged scheme, and in fact was the principal architect of the alleged reinsurance scandal. Duress, noted the court, "does not exist where a party simply chooses to participate in illegal activity because doing so is the better business decision."

The court likewise rejected the contention that *in pari delicto* should not apply because it ultimately may be proven that only mid-level AIG managers were involved in the illegal conduct. First, this contention was found to conflict with the well-pleaded allegations of the complaint. Second, the court noted that when "a corporation empowers managers with the discretion to handle certain matters and to deal with third parties, the corporation is charged with the knowledge of those

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managers," thus, under the circumstances alleged, whether AIG's senior executive team knew of the schemes or not, the company is charged with knowledge and in pari delicto applies.

The court also rejected the plaintiffs' argument that, on principles of policy, it would be unjust to bar claims on behalf of corporations where the culpable fiduciaries were motivated in part by self-interest, where innocent insiders might have been able to thwart the illegal activity and where stockholders impacted by a loss of enterprise value are themselves innocent. As to the first point, the court pointed out that AIG was an intended and actual beneficiary of both schemes, and that faithless fiduciaries frequently are motivated by self-interest; thus, to recognize an exception where the errant fiduciaries were not motivated solely by self-interest — such as under the "adverse interest" exception, which permits corporations to sue co-conspirators — would swallow the in pari delicto doctrine whole. The court rejected the second point on essentially the same ground: The improper acts of a faithless fiduciary are imputed to the corporation, and recognizing an "innocent insider" exception essentially would extinguish the in pari delicto doctrine altogether. The court rejected the final argument largely because, as described below, the innocent stockholders do have a derivative remedy for enterprise loss.

## The policy considerations

Several important policy considerations were amplified by the court, among them, the practical ramifications of allocating responsibility among willing participants in an illegal scheme and the desirability of a judicially sanctioned process by which wrongdoing corporate actors can mitigate the consequences of their actions by allocating responsibility to co-participants. Regarding the former, the vice chancellor noted that courts should not be tasked with engaging in an inefficient and socially unproductive accounting between wrongdoers. To do so would require that courts engage in an "extremely complex economic and fault-

finding inquiry involving speculation about the extent to which each participant was a net winner or loser as a result of its illegal conduct." The court noted that in criminal conspiracies, "some participants are likely to come out better than others. But, in this context there is no societal interest in making sure that each party gets its 'fair' share of the conspirators' societally unfair bargain."

As to the second policy consideration, the court cautioned against giving "corporations a greater ability to recover from misfortunes arising from their illicit conduct than is afforded to individuals." Such an accommodation would "seem to dampen the incentive for law compliance by preserving the hope that the costs of an exposed conspiracy might be shifted to the corporation's partners in crime."

## shareholders who sue derivatively

So where does this leave stockholders who, by their investment, suffer a loss of enterprise value occasioned by the acts of faithless fiduciaries who act in concert with third parties? Not without a remedy: First, the corporation may recover for losses caused by fiduciaries within the corporate family. In pari delicto does not bar derivative claims against culpable officers and directors, even if the misconduct was motivated by a desire to increase the corporation's profits or stock price. Second, while beyond the scope of the holding, the vice chancellor noted that derivative conspiracy claims arguably could be asserted against a discrete universe of external corporate "agents," such as outside auditors or counsel for the corporation's compliance committee. If such agents — who are employed to help ensure the lawful operation of the corporation — fail in their duties as gatekeepers, "there is a strong argument to be made that they ought to be accountable for their malpractice and not be immunized by the very actions that were not discovered due to their failure to meet expected professional standards."

The limitations imposed by the application of in pari delicto to derivative

claims against third-party conspirators are consistent with unavoidable risks inherent in the corporate form: A corporation act through fiduciaries authorized to act on its behalf. When those fiduciaries "seek to increase profit by causing the corporation to engage in illegal conduct, the corporation is responsible to innocent third parties. Although not pleasant for stockholders, this corporate liability is essential to the continued tolerance of the corporate form, as any other result would lack integrity." This principle enjoys perfect symmetry with a rule that limits the recovery of lost enterprise value from the offending fiduciaries and certain of the external agents intimately involved in the discharge their duties. •