

In Pari Delicto (“In Equal Fault”), or Not? Accounting Firm’s Assertion of Client’s Wrongdoing Not a Defense to Malpractice Claim

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An accounting firm does auditing work for a public company. The sole shareholder and president of the public company commits fraud, but the accounting firm allegedly should have caught it.

Nicholson v. Shapiro & Associates, LLC

Can the accounting firm successfully assert the *in pari delicto* (“in equal fault”) defense, which blocks a wrongdoer-plaintiff from recovering damages in connection with the wrongdoing at issue?

In Illinois anyway (according to the First District of the state’s intermediate appellate court, answering two certified questions under Rule 308), if the wrongdoer won’t benefit from any potential recovery, this defense won’t fly.

What Happened?

Robert Pearson was the president and sole shareholder of Illinois Stock Transfer (IST), an Illinois corporation regulated by the Securities and Exchange Commission (SEC).

IST hired Shapiro & Associates (Shapiro) for accounting services, including preparing tax returns, issuing accountant’s reports, and conducting annual audits. Pearson fraudulently converted his clients’ funds to cover payroll for his employees at IST. Upon discovering the fraud, the SEC sued IST in federal court, which in turn removed Pearson from IST and appointed a receiver to take over the company.

IST's receiver (Nicholson) filed accounting malpractice claims against Shapiro, alleging the firm should have discovered Pearson's fraud. Shapiro defended by raising the *in pari delicto* defense. (As indicated above, the idea is that the plaintiff is "in equal fault" and can't profit from wrongdoing.) Shapiro used the defense to argue Pearson was the sole shareholder and president of IST—which now (through its receiver) is suing Shapiro for damages. Pearson's wrongdoing (i.e., the fraud) should (according to Shapiro, anyway) be imputed to the receiver (i.e., Shapiro argued the receiver should "stand in Pearson's shoes," in a legal sense).

Not So Fast There, Shapiro

The court didn't buy it. The plaintiff (i.e., receiver Nicholson) was not the wrongdoer. Pearson was the wrongdoer, but he was removed from IST by the federal court. The plaintiff-receiver was an administrative officer appointed by the government and was seeking damages on behalf of IST's creditors and defrauded clients. They ultimately would benefit from any recovery, not the wrongdoer.

The defense "loses its sting," according to the court, once the wrongdoer is removed from the situation and can no longer benefit from his or her wrongdoing. As such, the defense could not stop the receiver (acting ultimately for the benefit of IST's creditors and the defrauded clients) from suing the accounting firm for failing to identify Pearson's fraud.