

2011 ABA LPL Bert W. Levit Essay Contest Hypothetical

You are a law clerk for a judge on the highest court in the newly-founded state of Halcyon. Your judge is uncertain how she wants to decide the issue below. She has asked you to draft an opinion making the best argument for how you believe it should be decided, but also addressing the best contrary arguments.

The matter before the court is a consolidation of two appeals. In the first case, Desperate Investment Co. (“Desperate”) had fallen on hard times and was struggling to stay in business. Desperate’s CEO, Stan Afloat, was extremely concerned that the company, which had been passed down through three generations of his family, would go belly-up under his management. After many sleepless nights, Stan decided there was only one solution: to launch a Ponzi scheme disguised as a true investment fund. Stan hated the idea of breaking the law, but figured it was the only way he could avert laying-off all of Desperate’s employees and bringing shame to his retired mother, who had passed the company down to him in good financial condition. Stan resolved that the moment the markets rebounded, he would end the Ponzi scheme and pay each investor everything that was promised, even if it meant tapping into his personal assets.

Stan called Will N. Participant, Esq., Desperate’s primary outside counsel. Stan explained to Will the financial troubles that Desperate was facing and his proposed solution. Will had serious concerns about engaging in such illegality, but he also had a lot of money tied up in Desperate, both in outstanding legal bills and shares he owned in the company. Concerned that if Desperate did not go forward with the Ponzi scheme it would go bankrupt and he would lose a fortune, Will agreed to prepare the disclosure documentation needed for the sham investment fund.

Six months later, following an investigation by the Halcyon Attorney General, Desperate’s Ponzi scheme was exposed and Desperate filed for bankruptcy. A court-appointed trustee, Tina Tomaso, was assigned as Desperate’s successor.

Tina brought a lawsuit against Will N. Participant, accusing him of fraud, aiding and abetting fraud, and malpractice. The trial court dismissed the lawsuit for lack of standing. The trial court’s opinion dismissing the case read as follows: “The doctrine of *in pari delicto* bars one wrongdoer from suing another wrongdoer for a fraud the two parties committed together. Those who break the law are not entitled to the aid of courts to adjust differences arising out of their illegal transactions. Here, the Trustee stands in the shoes of Desperate, which has defrauded thousands of investors. She inherited only the claims that Desperate could have asserted, which do not include the present cause of action against Desperate’s partner in crime. While the innocent investors and creditors harmed by the alleged fraud can sue Mr. Participant for fraud, Ms. Tomaso lacks standing to do so.” The Fifth Division of Halcyon’s appellate court affirmed without opinion.

In the second case on appeal, Scheming Investment Co. (“Scheming”) was founded for the sole purpose of perpetrating a Ponzi scheme. It hired Noel Iddle, Esq. to draw up

disclosure papers for the sham fund, asking him to “make sure everything is legal.” Noel, a solo practitioner fresh out of law school, drew up the disclosure documents and made sure that all the appropriate regulatory filings were made. Noel did not, however, appreciate that the fund was just a Ponzi scheme. Though naïve, Noel was quite scrupulous and never would have agreed to assist Scheming if he had known that it was doing something illegal. The fund went out to the market and attracted many investors until the truth about Scheming came out.

After Scheming filed for bankruptcy, its court-appointed trustee, Salvador Santiago, sued Noel for fraud, aiding and abetting fraud, and malpractice. The trial court rejected Noel’s motion to dismiss the case against him, holding that Noel had a professional duty to his client to inform it of the illegality of its conduct. The trial court’s opinion reasoned that dismissing a case like this at the pleading stage would provide inadequate incentives for lawyers to meet their professional duty and inadequate deterrence against participating in their clients’ fraudulent schemes. The trial court rejected the idea that Scheming’s conduct deprived Salvador of standing, saying that such conduct can be considered in apportioning fault between the parties but does not affect Salvador’s threshold right to sue. After a trial, the jury found that Noel was 40% responsible for the collapse of Scheming and judgment was entered against him in the amount of \$1 million. Noel appealed the trial court’s decision denying his motion to dismiss, but the Sixth Division of Halcyon’s appellate court affirmed without opinion.

Halcyon’s Supreme Court agreed to hear both cases and consolidated them for appeal. The sole issue on appeal is whether a party who has engaged in fraud (or that party’s successor) has **standing** to sue a lawyer based on conduct relating to the fraud itself, or if such a claim is barred by the doctrine of *in pari delicto*. Your judge is not interested in any issue other than that of standing. Since there is no case law in Halcyon addressing this issue, your judge has asked you to look to leading cases in other jurisdictions as instructive authority.