No. ________

In The
Supreme Court of the United States

ROBERT F. ANDERSON, AS CHAPTER 7 TRUSTEE FOR INFINITY BUSINESS GROUP, INC.,

Petitioner,

v.

MORGAN KEEGAN & COMPANY, INC., KEITH E. MEYERS,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Bankruptcy trustees have the rights and powers of a hypothetical judgment lien creditor. 11 U.S.C. 544(a). Section 544(a) allows trustees to recover funds for the estate by "standing in the shoes" of such a creditor who can assert causes of action belonging to the debtor. Trustees exercise their powers under this section "without regard to any knowledge of the trustee or of any creditor." *Ibid.*

The circuit courts have sharply split on whether Section 544(a) insulates a trustee from the debtor's knowledge. The Seventh and Fifth Circuits, and a Ninth Circuit Bankruptcy Appellate Panel, have held Section 544(a) shields a trustee from a debtor's knowledge, even if state law provides otherwise. The Fourth Circuit, in contrast, held here that state law can subject a trustee to a debtor's knowledge, notwithstanding the language of Section 544(a). This allows those who harm a debtor to raise the *in pari delicto* defense and deny recovery for innocent creditors. *In pari delicto* has deprived creditors of the opportunity to recover billions of dollars from third-party wrongdoers, and that toll will only grow if this issue is not addressed by this Court.

The question presented is:

Whether a bankruptcy trustee seeking recovery on behalf of creditors under 11 U.S.C. 544(a) is subject to the debtor's knowledge.

CORPORATE DISCLOSURE STATEMENT

Debtor Infinity Business Group, Inc. neither has nor had a parent corporation, and no publicly held corporation owns or owned 10% or more of Debtor Infinity Business Group, Inc.'s stock.

RELATED CASES

Anderson v. *Meyers (In re Infinity Business Group, Inc.)*, Adv. Pro. No. 12-80208-JW, U.S. Bankruptcy Court for the District of South Carolina. Judgment entered Oct. 15, 2019.

Anderson v. *Morgan Keegan & Company, Inc. (In re Infinity Business Group, Inc.)*, No. 3:19-03096-JMC, U.S. District Court for the District of South Carolina. Judgment entered Mar. 31, 2021.

Anderson v. *Morgan Keegan & Company, Inc. (In re Infinity Business Group, Inc.)*, No. 21-1536, U.S. Court of Appeals for the Fourth Circuit. Judgment entered April 19, 2022, rehearing denied June 2, 2022.

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PETITION FOR A WRIT OF CERTIORARI

Certain managers of Infinity Business Group, Inc. (IBG) secretly implemented a fraudulent accounting policy which overstated accounts receivable and revenue. Evidence showed that respondents Morgan Keegan & Co., Inc. and Keith E. Meyers helped employ and conceal this fraud. IBG wound up bankrupt, with its innocent creditors, many of whom were individual investors deceived by the fraud, suffering substantial losses. Petitioner Robert F. Anderson, IBG's Chapter 7 Trustee, sued Meyers and Morgan Keegan for their role in it. The courts below allowed management's knowledge to insulate Meyers and Morgan Keegan from liability under *in pari delicto*, an affirmative defense which denies recovery to a knowing participant in wrongdoing.

Bankruptcy trustees have two independent means to obtain and bring a debtor's legal claims against third parties: 11 U.S.C. 541(a)(1), which includes such claims in the debtor's estate, or 11 U.S.C. 544(a), which grants trustees a creditor's state law right to assert claims belonging to the debtor "without regard to any knowledge of the trustee or of any creditor." The circuit courts unanimously hold that Section 541(a)(1) subjects trustees to a debtor's knowledge and consequently to *in pari delicto*. This petition presents a different question: whether Section 544(a)'s express exclusion of the trustee's knowledge also excludes the debtor's knowledge from claims brought pursuant to that section. On this question, the circuit courts have sharply and irreconcilably split.

This Court should grant certiorari to resolve this split. *In pari delicto* arises in hundreds of bankruptcy cases and, to date, has deprived trustees of the ability to recover billions of dollars on behalf of innocent creditors. Even circuits which apply *in pari delicto* under Section 541(a)(1) stress the appeal and logic of avoiding the defense under a different statute. Properly construed, Section 544(a)'s exclusion of the trustee's knowledge necessarily excludes the debtor's knowledge as well. Trustees proceeding under Section 544(a) therefore are not subject to *in pari delicto*. There is no sound reason to delay consideration of this important, recurring, and substantial question.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1–21) is reported at 31 F.4th 294. The opinion of the district court (Pet. App. 22–117) is reported at 628 B.R. 213. The bankruptcy court's decision is reported at 497 B.R. 794, and relevant excerpts of that decision are included in the Appendix (Pet. App. 118–135).

JURISDICTION

The court of appeals entered its judgment on April 19, 2022. A petition for rehearing was denied on June 2, 2022. Pet. App. 136–137. On August 11, 2022, the Chief Justice extended the time within which to file this petition to and including October 11, 2022, and the

petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Bankruptcy Clause of the United States Constitution, Article I, Section 8, Clause 4:

> The Congress shall have the power * * * [t]o establish * * * uniform Laws on the subject of Bankruptcies throughout the United States.

11 U.S.C. 541(a)(1):

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal and equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. 544(a):

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

STATEMENT

A. Background Facts.

IBG offered merchants and banks a proprietary streamlined bad check collection service. The company was a promising venture, but it needed cash to fund its growth. It therefore hired Meyers and Morgan Keegan in 2006 to secure capital.

IBG's accounting originally complied with generally accepted accounting principles. C.A. App. 748–749.

After IBG hired Meyers and Morgan Keegan, an undisputedly fraudulent accounting policy was established which materially overstated IBG's revenues and accounts receivable by recognizing check collection fees before they were earned. *E.g.*, *id.* at 737–738, 750–756. Certain members of IBG's management knowingly helped implement this change.[1] Pet. App. 131–133. But a majority of IBG's shareholders and management were unaware of these fraudulent acts.

Meyers and Morgan Keegan at a minimum knew about the fraudulent policy, C.A. App. 1406–1408; understood it violated basic accounting rules, *id.* at 738–739, 804, 916; and suggested misleading disclosure language that did not describe the actual policy or its fraudulent nature in IBG's financial statements which were used to raise capital from IBG's innocent creditors, *id.* at 1417–1418, 1792–1793.[2] It was undisputed

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[1] CEO Bryon Sturgill, CFO Haines Hargrett, President and Chairman Wade Cordell, COO Brad Cordell, and General Counsel John Blevins (collectively, the Management Defendants) were defendants below, together with their related personal entities and IBG's auditor. All defendants except Morgan Keegan and Meyers confessed judgment or defaulted and are, practically speaking, judgment-proof.

[2] The Fourth Circuit affirmed the bankruptcy court's factual finding that Meyers and Morgan Keegan did not know the policy was fraudulent. Pet. App. 16–17. While the Trustee disagrees with this holding, see Tr. Pet. for Reh'g & Reh'g En Banc at 8–14, Meyers' and Morgan Keegan's specific knowledge that the policy was fraudulent is not required to prove the Trustee's claims and does not affect the question presented here.

that they did not disclose the fraudulent new policy to IBG's innocent management and shareholders.

Evidence showed that the fraudulent policy caused IBG to incur net operating losses of over $24 million. C.A. App. 783–784. The company sought relief under Chapter 7 of the Bankruptcy Code. The Trustee thereafter sued Meyers and Morgan Keegan for, among other claims, aiding and abetting breach of fiduciary duty, breach of fiduciary duty, Rule 10b-5 securities fraud, and common law fraud for their role in the implementation and concealment of the fraudulent accounting policy. The Trustee brought these claims in an adversary proceeding before the United States Bankruptcy Court for the District of South Carolina standing alternatively in the shoes of IBG under 11 U.S.C. 541 and in the shoes of creditor with a lien over IBG's property under 11 U.S.C. 544. *Id.* at 19. These claims arose under a combination of federal law, South Carolina law (where IBG had its principal place of business), and Nevada law (where it was incorporated).

B. The Courts Below Held Management's Knowledge Barred the Trustee's Claims.

Meyers' and Morgan Keegan's chief affirmative defense was *in pari delicto*. *In pari delicto* "precludes a plaintiff who participated in the same wrongdoing as the defendant from recovering damages from that wrongdoing." Pet. App. 130. They argued that the Management Defendants knew IBG's accounting was

fraudulent, that this knowledge was imputed to IBG, and that IBG therefore was a "wrongdoer" which cannot recover from Meyers or Morgan Keegan. *Ibid*. Going one step further, they argued that the Trustee "stands in the shoes" of IBG and likewise cannot recover from Meyers and Morgan Keegan. *Ibid.* In other words, Meyers and Morgan Keegan argued that the Trustee is subject to whatever relevant knowledge IBG had via the Management Defendants.

The bankruptcy court agreed with Meyers and Morgan Keegan. Citing the Fourth Circuit's decision in *Grayson Consulting* v. *Wachovia Securities, LLC (In re Derivium Capital)*, 716 F.3d 355 (2013), regarding a trustee's powers under Section 541(a)(1), the bankruptcy court found that the Trustee "stands in the shoes" of IBG and therefore is subject to the Management Defendants' knowledge and, by extension, to *in pari delicto*. Pet. App. 130–131. It then found that the Management Defendants' knowledge barred the Trustee's claims against Meyers and Morgan Keegan.[3] *Id.* at 131–134. The Trustee appealed to the United States District Court for the District of South Carolina. The district court affirmed the legal conclusion that trustees are subject to *in pari delicto* because the court believed it was bound by *Derivium Capital*, which again only examined Section 541(a)(1). *Id.* at 87. It likewise

[3] The bankruptcy court also found for Meyers and Morgan Keegan on the merits of the Trustee's claims, and the district court affirmed. Pet. App. 117, 134. The Trustee appealed those conclusions to the Fourth Circuit, but the court did not reach them as its *in pari delicto* holdings were dispositive of the appeal.

affirmed the application of *in pari delicto* on its merits. *Id.* at 88–108. The Trustee thereafter appealed to the Fourth Circuit, which reviewed the bankruptcy court's order directly. See *Coleman* v. *Community Tr. Bank (In re Coleman)*, 426 F.3d 719, 724 (4th Cir. 2005).

Relying on "the logic" of *Derivium Capital*, the Fourth Circuit affirmed the bankruptcy court's conclusion that the Trustee is subject to *in pari delicto*. Pet. App. 14–15. The court also held Section 544(a) does not change the result:

> This conclusion does not run afoul of 11 U.S.C. §544(a)'s prohibition on considering 'any knowledge of the trustee or of any creditor' because *in pari delicto* has nothing to do with the knowledge of those actors. At most, the defense implicates the knowledge (and deeds) of the *debtor*, which Section 544 says nothing about.

Id. at 15 n.1 (emphasis in original). The Fourth Circuit then affirmed the bankruptcy court's second conclusion that *in pari delicto* operated as a bar in this case. *Id.* at 16–21. The court subsequently denied the Trustee's petition for rehearing. *Id.* at 136–137.

REASONS FOR GRANTING THE PETITION

A. The Circuit Courts Are Deeply Divided on the Question Presented.

1. The Fourth Circuit Subjects Trustees to the Debtor's Knowledge Under Section 544(a).

The Fourth Circuit first reached this question in *Pyne* v. *Hartman Paving, Inc. (In re Hartman Paving, Inc.)*, 745 F.2d 307 (1984). Hartman Paving secured a note given by a creditor with a technically defective deed of trust. *Id.* at 308. Hartman Paving later petitioned for Chapter 11 bankruptcy and became a debtor-in-possession. *Ibid.* Debtors-in-possession represent their own estates and assume the role of a trustee, subject to certain exceptions not relevant here. *Holywell Corp.* v. *Smith*, 503 U.S. 47, 50 (1992); 11 U.S.C. 1107(c). They consequently may bring their own claims as a trustee under Section 544(a). *Fallon Family L.P.* v. *Goodrich Petroleum Corp. (In re Goodrich Petroleum Corp.)*, 894 F.3d 192, 197 (5th Cir. 2018).

Hartman Paving's prepetition knowledge of the deed rendered the deed effective against Hartman Paving as a debtor, notwithstanding any defects in its form. *Hartman Paving*, 745 F.2d at 309. The question became whether Hartman Paving nevertheless could avoid this knowledge as a debtor-in-possession, and thereby avoid the deed, under 11 U.S.C. 544(a). Over a dissent, the court held that Section 544(a) did not allow Hartman Paving to avoid its personal knowledge. *Hartman Paving*, 745 F.2d at 310. The court held that

"[b]ecause Hartman had actual notice, he cannot now claim that the improper acknowledgement caused him injury." *Id.* at 310 n.5. The court further held that allowing Hartman Paving to avoid its actual knowledge "permits Hartman to turn a legal 'fiction' found in § 544(a) to unfair personal gain." *Ibid.* Hartman Paving's knowledge as a debtor thus prevented it from avoiding the deed of trust under Section 544(a).

This rule was soon abandoned. The Fourth Circuit a few years later held that a debtor-in-possession's knowledge is not considered under Section 544(a), without citing *Hartman Paving*. *Crestar Bank* v. *Neal (In re Kitchin Equip. Co. of Va., Inc.)*, 960 F.2d 1242, 1245 (1992). Lower courts within the Fourth Circuit refused to follow *Hartman Paving* because it did not analyze Section 544(a)'s limitation that trustees assert their rights "without regard to any knowledge of the trustee or any creditor." *E.g.*, *Dunes Hotel Assocs.* v. *Hyatt Corp. (In re Dunes Hotel Assocs.)*, 194 B.R. 967, 979–980 (D.S.C. 1995); see also *The Willows II, LLC* v. *Branch Banking & Tr. Co. (In re The Willows II, LLC)*, 485 B.R. 528, 532 (Bankr. E.D.N.C. 2013) (following *Hartman Paving* as to Section 544(a)(3) but holding that the debtor's knowledge is not imputed under Section 544(a)(1)); *Barclays Am./Mortg. Corp.* v. *Wilkinson (In re Wilkinson)*, 186 B.R. 186, 192 (Bankr. D. Md. 1995) ("The *Hartman Paving* decision has been widely criticized and narrowly construed."). The *Dunes Hotel* court recognized a "universally accepted principle that the debtor's actual knowledge is not imputed to either the trustee or the debtor-in-possession under § 544(a)"

and suggested *Hartman Paving* was no longer good law. *Dunes Hotel*, 194 B.R. at 979.

Hartman Paving therefore effectively was a dead letter until the Fourth Circuit below resurrected it in substance. The Fourth Circuit first held that state law gives creditors no greater rights in the debtor's property than the debtor had, and thus they are subject to the same defenses as the debtor. Pet. App. 15. A trustee standing in the creditor's shoes pursuant to Section 544(a) likewise is subject to those defenses, including *in pari delicto* based on the debtor's knowledge. *Ibid.* The court then answered the question *Hartman Paving* never asked when it held that the "without regard" language in Section 544(a) did not compel a different result because it "says nothing about" excluding the debtor's knowledge. *Id.* at 15 n.1. In doing so, the court reignited a split with those circuits which years earlier soundly rejected *Hartman Paving*'s consideration of the debtor's knowledge under Section 544(a).

2. The Seventh and Fifth Circuits, and the Ninth Circuit Bankruptcy Appellate Panel, Hold Section 544(a) Disregards the Debtor's Knowledge.

1. Two years after *Hartman Paving*, the Seventh Circuit was presented with the same question but reached the opposite result, principally because of Section 544(a)'s "without regard" language. *Sandy Ridge Oil Co.* v. *Centerre Bank N.A. (In re Sandy Ridge Oil Co.)*, 807 F.2d 1332, 1335–1336 (1986). *Sandy Ridge*

remains good law within the Seventh Circuit. *E.g.*, *In re Archdiocese of Milwaukee*, 483 B.R. 855, 861 (Bankr. E.D. Wisc. 2012).

Sandy Ridge purchased oil well services from Halliburton and executed a promissory note secured by leases on six wells. *Sandy Ridge*, 807 F.2d at 1333. One of the lease mortgages technically violated state law because it did not include the preparer's name. *Ibid.* After Sandy Ridge petitioned for Chapter 11 bankruptcy and became a debtor-in-possession, it sought to avoid that mortgage due to this deficiency. *Ibid.* Halliburton urged the Seventh Circuit to adopt *Hartman Paving* and hold that Sandy Ridge's actual knowledge of the mortgage as a debtor meant Sandy Ridge could not avoid it as a debtor-in-possession. *Id.* at 1334–1335.

The Seventh Circuit declined to follow *Hartman Paving* because "its reasoning appear[s] to conflict with the Bankruptcy Code," particularly the "without regard" language in Section 544(a). *Sandy Ridge*, 807 F.2d at 1335. The court recognized that state law generally determines the rights in a debtor's property, but congressional legislation compelled a different federal rule in Section 544(a). *Ibid.* "The natural interpretation of this language is that actual knowledge of the encumbrance will never prohibit a trustee from invoking § 544(a)(3)." *Ibid.* It explained that *Hartman Paving* did not properly give effect to the "without regard" language and impermissibly created a distinction between trustees (whose knowledge is disregarded) and debtors-in-possession (whose knowledge *Hartman*

Paving held is relevant). *Id.* at 1336. In the end, the Seventh Circuit held that Congress did not intend a debtor's knowledge to prevent a trustee/debtor-in-possession from exercising rights under Section 544(a). *Ibid.*

This Court did not then have an opportunity to resolve the split created by *Sandy Ridge*. While Section 544(a) prohibits consideration of actual knowledge, it subjects trustees/debtors-in-possession to constructive notice that any person would have received. *Sandy Ridge*, 807 F.2d at 1336. The *Sandy Ridge* court certified to the Indiana Supreme Court the question of whether state law conferred constructive notice of the mortgage on Sandy Ridge. *Id.* at 1338. The Indiana Supreme Court held Sandy Ridge had constructive notice, which the Seventh Circuit determined meant Sandy Ridge could not avoid the mortgage under Section 544(a)(3). *Sandy Ridge Oil Co.* v. *Centerre Bank N.A. (In re Sandy Ridge Oil Co.)*, 832 F.2d 75, 76 (7th Cir. 1987) (*Sandy Ridge II*). Certiorari was not proper because the final decision rested on an independent question of state law. This case presents the question without that constraint.

2. The Fifth Circuit reached the same result in an unpublished opinion. *Boudreaux* v. *Dolphin Press Inc. (In re Dolphin Press Inc.)*, 196 F.3d 1257, 1999 WL 800170 (Sept. 17, 1999) (Tbl.). This Court has considered unpublished opinions when defining the extent of a circuit split. *E.g.*, *Johnson* v. *United States*, 529 U.S. 694, 699 n.3 (2000) (citing, among others, *United States* v. *Sandoval*, 69 F.3d 531 (1st Cir. 1995) (unpublished)).

Dolphin Press, though unpublished, is good law within the Fifth Circuit. *E.g.*, *Johnson* v. *Edwards (In re Cmty. Home Fin. Servs., Inc.)*, 583 B.R. 1, 63 (Bankr. S.D. Miss. 2018), aff'd in part, rev'd in part on other grounds *sub nom*. *Edwards Family P'ship* v. *Johnson*, No. 3:18-CV-154, 2020 WL 5878209 (S.D. Miss. Oct. 2, 2020).

Dolphin Press, the debtor, sought to avoid a security interest in a piece of equipment because Boudreaux, a creditor, failed to file the financing statement. Boudreaux nevertheless argued that its interest was perfected because Dolphin Press had actual knowledge of the financing statement's contents. *Dolphin Press*, 1999 WL 800170, at *1. Citing Section 544(a) and *Sandy Ridge*, the Fifth Circuit held that "Dolphin's actual knowledge of the financial [*sic*] statement does not prevent it from invoking § 544(a)." *Ibid.*; see also *Vineyard* v. *McKenzie (In re Quality Holstein Leasing)*, 752 F.2d 1009, 1014 (5th Cir. 1985) (holding a trustee's powers under Section 544(a) "serve essentially to marshal all of the debtor's assets, including some that the debtor itself could not recover, in order to enhance the resources available to the pool of creditors").

3. The Ninth Circuit recognized the split between *Sandy Ridge* and *Hartman Paving* and found it unnecessary to then decide the issue. *Probasco* v. *Eads (In re Probasco)*, 839 F.2d 1352, 1354 n.2 (1988). But a Ninth Circuit Bankruptcy Appellate Panel, established under 28 U.S.C. 158(b) to hear appeals from bankruptcy courts in lieu of district courts, later adopted *Sandy Ridge*. *Wonder-Bowl Props.* v. *Kim (In re Kim)*,

161 B.R. 831, 836–837 (1998). Bankruptcy appellate panel decisions are binding on all bankruptcy courts in the Ninth Circuit. *Philadelphia Life Ins. Co.* v. *Proudfoot (In re Proudfoot)*, 144 B.R. 876, 879 (B.A.P. 9th Cir. 1992). *Kim* remains good law within the Ninth Circuit. *E.g.*, *Love* v. *Wiseman*, 614 B.R. 573, 584–585 (N.D. Cal. 2020).

Wonder-Bowl obtained a judgment against Kim but failed to include the required information when recording it with the state court. *Kim*, 161 B.R. at 832. Kim thereafter petitioned for Chapter 11 bankruptcy and became a debtor-in-possession. *Ibid.* After Kim filed his petition, Wonder-Bowl corrected its recording to obtain a lien over Kim's property. *Ibid.* The bankruptcy court avoided the lien under Section 544(a). *Id.* at 833. On appeal, Wonder-Bowl argued in part that Kim's actual knowledge of the judgment prevented him from avoiding the lien. *Id.* at 836. The bankruptcy appellate panel noted the split between *Hartman Paving* and *Sandy Ridge* and adopted the Seventh Circuit's rule. *Id.* at 836–837. Critically, the court held that "[a]ctual knowledge of a prepetition debtor, therefore, should be given no more weight in a section 544 action brought by a debtor in possession than it would be given in such an action brought by a trustee." *Id*. at 837.

4. Because Section 544(a) shields a debtor-in-possession from the debtor's knowledge, it also shields a trustee from that knowledge. See *Goodrich Petroleum*, 894 F.3d at 197 (noting debtors-in-possession assume the role of a trustee under Section 544(a)); see

also *N.L.R.B.* v. *Bildisco & Bildisco*, 465 U.S. 513, 517 n.2 (1984) (observing that the terms debtor-in-possession and trustee are not always fully interchangeable but, for the question presented, "the analysis is the same whether it is the debtor-in-possession or the trustee in bankruptcy"). Excluding the debtor's knowledge eliminates the *in pari delicto* defense in cases brought pursuant to Section 544(a). *In pari delicto* requires the injured party to be at least an active, voluntary, and knowing participant in the conduct complained of. *E.g.*, *Pinter* v. *Dahl*, 486 U.S. 622, 636 (1988); *McAdam* v. *Dean Witter Reynolds, Inc.*, 896 F.2d 750, 757 (3d Cir. 1990); *Woolf* v. *S. D. Cohn & Co.*, 515 F.2d 591, 604 (5th Cir. 1975), vacated on other grounds, 426 U.S. 944 (1976); *Peterson* v. *McGladrey & Pullen, LLP*, 676 F.3d 594, 596 (7th Cir. 2012); *American Int'l Grp., Inc.* v. *Greenberg (In re Am. Int'l Grp., Inc.)*, 976 A.2d 872, 884 (Del. Ch. 2009). While the injured party need not be a willful or intentional participant, see *Pinter*, 486 U.S. at 633, the Trustee is unaware of a court which subjects an unknowing participant in wrongful conduct to *in pari delicto*. This circuit split therefore controls the Fourth Circuit's decision below which rested solely on applying *in pari delicto* to the Trustee.

B. This Case Is Worthy of This Court's Review.

1. This Issue Is Recurring and Important.

This issue implicates the recovery of billions of dollars in losses suffered by countless innocent

creditors across the country. Due to the lack of clarity on this issue, creditors in some circuits are denied recovery that may be available to them elsewhere, thereby allowing third parties who harm debtors to escape liability solely based on the debtor's location. The effects of this inequity will multiply if the economy heads into recession and bankruptcy filings increase. This Court's resolution is needed to ensure the national uniformity of Section 544(a). See U.S. Const. Art. I, § 8, Cl. 4.

1. *In pari delicto* routinely arises when bankruptcy trustees seek recovery for harm third parties caused to the debtor. The Trustee's research has identified hundreds of bankruptcy court and district court decisions concerning *in pari delicto* in such cases. These cases present a variety of *in pari delicto* issues, many of which concern how and when it applies. It is patent that the defense is recurrent and consumes substantial time and resources of trustees, other litigants, and the courts. A determination of whether the defense applies in the first instance will provide needed guidance and potentially relief.

Cumulatively, *in pari delicto* has prevented trustees from recovering billions of dollars on behalf of innocent creditors. Defendants have used it to defeat recovery in cases large and small. For example, the firms which allegedly assisted Bernie Madoff's Ponzi scheme used *in pari delicto* to dismiss the complaint against them seeking $2 billion in damages incurred by innocent investors. *Picard* v. *JPMorgan Chase & Co. (In re Bernard L. Madoff Invest. Sec. LLC)*, 721

F.3d 54, 63–66 (2d Cir. 2012), cert. denied, 573 U.S. 945 (2014). Innocent creditors lost the opportunity to pursue recovery of over $340 million stemming from "a complex tale of sophisticated financial chicanery" involving the acquisition of Dictaphone Corp. *Nisselson* v. *Lernout*, 469 F.3d 143, 147, 153 (1st Cir. 2006), cert. denied, 550 U.S. 918 (2007); *Baena* v. *KPMG LLP*, 453 F.3d 1, 6–10 (1st Cir. 2006). *In pari delicto* resulted in the dismissal of another claim involving over $100 million in fraudulently obtained investments. *Grassmueck* v. *American Shorthorn Assn.*, 402 F.3d 833, 836–837 (8th Cir. 2005). The defense also resulted in the dismissal of a case seeking at least $3.5 million in recovery. *Claybrook* v. *Broad & Cassel, P.A. (In re Scott Acquisition Corp.)*, 364 B.R. 562, 569–573 (Bankr. D. Del. 2007). And the Trustee here seeks to recover over $24 million for IBG's creditors, many of whom are individual small investors deceived by the fraud. C.A. App. 783–784. Other examples in the case law of *in pari delicto* barring recovery for innocent creditors are legion.

In pari delicto's frequent and devastating application to bankruptcy trustees has generated a substantial body of scholarly work criticizing its use in bankruptcy. See, *e.g.*, Hon. Meredith Jury, *Fourth Circuit: Defense of* In Pari Delicto *is Applicable Against Bankruptcy Trustee Pursuing Litigation on Behalf of Estate*, 2022-17 Comm. Fin. News. NL 32 (May 2, 2022); George W. Kuney, *Should the Trustee in Bankruptcy Succeed to the "Equal Guilt" of the Debtor? Putting the Burden of Imputation of Wrongdoing on Third Parties for* In Pari Delicto *Purposes*, 2017 Norton Ann.

Surv. of Bankr. L. 1 (2017); Brett S. Theisen, *Inequitable: In Pari Delicto vs. Bankruptcy Trustees*, 35-MAR Am. Bankr. Inst. J. 26 (2016); Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing To Do With What Is § 541 Property of the Estate*, 21 Emory Bankr. Dev. J. 519 (2005); Tanvir Alam, *Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How In Pari Delicto Has Been Perverted to Prevent Recovery for Innocent Creditors*, 77 Am. Bankr. L.J. 305 (2003). There are dozens of other publications. These analyses do not address the precise question presented here regarding Section 544(a), but they demonstrate the intense interest among bankruptcy practitioners and scholars regarding *in pari delicto*'s impact.

This extensive body of case law and scholarly work underscores the effect of *in pari delicto*'s application in bankruptcy. It is impossible to calculate *in pari delicto*'s historic toll on creditor recovery. As the national economy teeters on the edge of recession—if it has not already entered one—this toll will only grow. Bankruptcy filings will rise, and with them will come the increased use of *in pari delicto* to deny innocent creditors recovery for harm caused by third-party wrongdoers.

2. The application of *in pari delicto* to trustees frequently arises under 11 U.S.C. 541(a)(1), where the circuit courts unanimously hold that Section 541(a)(1)'s plain language allows for the defense. *E.g.*, *Nisselson*, 469 F.3d at 153; *Official Comm. of Unsecured Creditors* v. *R.F. Lafferty & Co.*, 267 F.3d 340, 356–358 (3d Cir. 2001); *Derivium Cap.*, 716 F.3d at 367; *Peterson*, 676

F.3d at 598–599; *Grassmueck*, 402 F.3d at 836–837; *Sender* v. *Buchanan (In re Hedged-Invest. Assocs., Inc.)*, 84 F.3d 1281, 1284–1286 (10th Cir. 1996); *Official Comm. of Unsecured Creditors of PSA, Inc.* v. *Edwards*, 437 F.3d 1145, 1149–1152 (11th Cir. 2006), cert. denied, 549 U.S. 811 (2006).

But a trustee's powers extend beyond Section 541(a)(1). Cf. *Podell & Podell* v. *Feldman (In re Leasing Consultants, Inc.)*, 592 F.2d 103, 110 (2d Cir. 1979) ("The trustee in bankruptcy stands not only in the shoes of the bankrupt he fits as well into the overshoes of the bankrupt's creditors."). Trustees should not be subject to *in pari delicto* when proceeding under other bankruptcy statutes. See, *e.g.*, *Derivium Cap.*, 716 F.3d at 367 ("We recognize the appeal of those cases' reasoning—i.e., that the appointment of an innocent receiver removed the wrongdoer and changed the equities, rendering the application of the punishing *in pari delicto* doctrine unwarranted. Nevertheless, that reasoning does not comport with the plain language of Section 541."); *Hedged-Invest. Assocs.*, 84 F.3d at 1285 (recognizing "a certain appeal, both from doctrinal and public policy perspectives" of not applying *in pari delicto* to a trustee, but holding Section 541 "expressly prohibits" it).

Many circuits therefore hold that *in pari delicto* does not apply to avoidance claims brought by trustees outside of Section 541(a)(1).[4] *E.g.*, *In re Leasing*

[4] Multiple circuits similarly have held that *in pari delicto* does not apply against receivers, who are not subject to the

Consultants, 592 F.2d at 110–111 (declining to apply *in pari delicto* under Section 544(b)'s predecessor because allowing creditors to recover "does not involve the Court in a dispute between scoundrels but rather extends aid to innocent creditors, in furtherance of the aims of the Bankruptcy Act"); *McNamara* v. *PFS (In re Pers. & Bus. Ins. Agency)*, 334 F.3d 239, 246–247 (3d Cir. 2003) (declining to apply *in pari delicto* to 11 U.S.C. 548 avoidance claims because "without that [Section 541] language there is no reason not to follow the better rule, under which [the debtor's] conduct would not be imputed to the Trustee because it would lead to an inequitable result"); *Gower* v. *Farmers Home Admin. (In re Davis)*, 785 F.2d 926, 927 (11th Cir. 1986) ("Since the trustee's [11 U.S.C. 544(b) avoidance] claims are for the

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Bankruptcy Code. *E.g.*, *Jones* v. *Wells Fargo Bank, N.A.*, 666 F.3d 955, 966 (5th Cir. 2012) ("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."); *Scholes* v. *Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995) ("The appointment of the receiver removed the wrongdoer from the scene. The corporations were no more Douglas's evil zombies. Freed from his spell they became entitled to the return of the moneys—for the benefit not of Douglas but of innocent investors—that Douglas had made the corporations divert to unauthorized purposes."); *FDIC* v. *O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) ("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 trustee, receiver or similar innocent entity that steps into the party's shoes pursuant to court order or operation of law."). But see *Knauer* v. *Jonathan Roberts Fin. Grp., Inc.*, 348 F.3d 230, 236 (7th Cir. 2003) (limiting *Scholes* to avoidance claims).

benefit of creditors, the fraud of the bankrupt does not require them to be forfeited."). Avoidance seeks the return of "diverted funds from the beneficiaries of the diversions" instead of tort recovery from one who did not receive a transfer. *Knauer* v. *Jonathan Roberts Fin. Grp., Inc.*, 348 F.3d 230, 236 (7th Cir. 2003). But this distinction is immaterial. The lack of a transfer to a tortfeasor—for example, an investment bank that is not paid prepetition for a fraud in which it participated—is irrelevant. Failing to get paid does not eliminate liability for damage caused in the pursuit of that fee. *In re Rural Metro Corp.*, 88 A.3d 54, 100 (Del. Ch. 2014).

This petition gives the Court the opportunity to resolve a split under Section 544(a) and answer a question which many circuits have acknowledged for years: whether *in pari delicto* defeats claims brought as and for the benefit of innocent creditors under a statute other than Section 541(a)(1).

3. This case presents a different question than the prior *in pari delicto* cases where this Court denied review. For example, this Court denied certiorari on questions regarding subrogation, contribution, and standing in the Bernie Madoff case. See Petition for Writ of Certiorari at i–ii, *Picard* v. *JPMorgan Chase & Co.*, 573 U.S. 945 (2014) (No. 13-448). In *Nisselson* and *Personal & Business Insurance Agency* (restyled *Laddin* for the petition), the petitioners sought review regarding *in pari delicto*'s application under Section 541(a)(1), where there is no circuit split. See Petition for Writ of Certiorari at i, *Nisselson* v. *Lernout*, 550

U.S. 918 (2007) (No. 06-1160); Petition for Writ of Certiorari at i, *Laddin* v. *Reliance Tr. Co.*, 549 U.S. 811 (2006) (No. 05-1335). In contrast, this petition raises this important and recurring question in the context of a clear split which, to the Trustee's knowledge, this Court previously has not been asked to resolve.

2. This Case Is an Excellent Vehicle.

This case presents an excellent vehicle to resolve the deep split in the circuits.

There is no dispute about the jurisdiction of any lower court or of this Court, the dispute is ripe, and the Fourth Circuit directly ruled on the question presented in a published opinion. While the Trustee focused on *in pari delicto* under Section 541(a)(1) before the bankruptcy and district courts, he refined his argument before the Fourth Circuit to address Section 544(a). His argument originally emphasized the ultimate issue of whether *in pari delicto* applies to trustees under Section 544(a), citing *Sender* v. *Porter (In re Porter McLeod, Inc.)*, 231 B.R. 786, 794 (D. Colo. 1999), rather than the broader issue of the debtor's knowledge in general. The Fourth Circuit's holding that Section 544(a) says nothing about the debtor's knowledge rekindled a circuit split regarding that broader point. The Trustee therefore has reframed the question presented to this Court to fully capture the Fourth Circuit's holding. See *Yee* v. *City of Escondido*, 503 U.S. 519, 535 (1992).

There is no reason to allow further percolation of this issue. This Court frequently grants certiorari to

resolve splits regarding the Bankruptcy Code without waiting for them to spread. *E.g.*, *Harris* v. *Viegelahn*, 575 U.S. 510, 516 (2015) (reviewing a split between the Third and Fifth Circuits); *Clark* v. *Rameker*, 573 U.S. 122, 126–127 (2014) (reviewing a split between the Fifth and Seventh Circuits); *Ransom* v. *FIA Card Servs., N.A.*, 562 U.S. 61, 68 n.4 (2011) (reviewing a split between the Ninth Circuit on one hand, and the Fifth, Seventh, and Eight Circuits on the other); *Travelers Cas. & Sur. Co. of Am.* v. *Pacific Gas & Elec. Co.*, 549 U.S. 443, 448 (2007) (reviewing a split between the Fourth and Ninth Circuits); *Archer* v. *Warner*, 538 U.S. 314, 318 (2003) (reviewing a split between the Seventh and District of Columbia Circuits); *Dewsnup* v. *Timm*, 502 U.S. 410, 414 (1992) (reviewing a split between the Third and Tenth Circuits); *Union Bank* v. *Wolas*, 502 U.S. 151, 154 (1991) (reviewing a split between the Sixth and Ninth Circuits); *Toibb* v. *Radloff*, 501 U.S. 157, 160 (1991) (reviewing a split between the Eighth and Eleventh Circuits).

The Court's practice acknowledges the need to resolve at an early opportunity divergent interpretations of the Bankruptcy Code which greatly affect debtors and creditors nationwide. As alluded to earlier (Pet. at 17-18), allowing the split to persist will jeopardize an incalculable amount of recovery for innocent creditors while courts and litigants await final resolution.

Finally, there are no alternative grounds of decision to support the judgment. The Fourth Circuit's additional holdings that *in pari delicto* on its merits bars the Trustee's claims are subsidiary to the question

presented here—whether *in pari delicto* applies in the first instance. It is a pure question of law which involves no relevant disputed factual issues. The factual issues raised to the Fourth Circuit in connection with other issues are not germane to this petition.

The question raised here therefore warrants this Court's immediate review.

C. The Fourth Circuit's Decision Is Wrong.

Section 544(a)(1) grants trustees the "rights and powers" of hypothetical judgment lien creditors, including any state law right to bring claims belonging to debtors. *Angeles Real Est. Co.* v. *Kerxton*, 737 F.2d 416, 418 (4th Cir. 1984). This right exists under Nevada and South Carolina law, either of which may apply here. See S.C. Code Ann. § 15-39-410; *Gallegos* v. *Malco Enters. of Nev., Inc.*, 255 P.3d 1287, 1289 (Nev. 2011); *Moore* v. *Weinberg*, 644 S.E.2d 740, 745 (S.C. Ct. App. 2007); see also *Reynolds* v. *Tufenkjian*, 461 P.3d 147, 153–154 (Nev. 2020) (holding a creditor can obtain a debtor's claims for pecuniary loss). Trustees bring these claims without regard to their knowledge or any creditor's knowledge. 11 U.S.C. 544(a). The Fourth Circuit's decision subjecting trustees to *in pari delicto* because Section 544(a) says "nothing about" the debtor's knowledge is wrong for at least three reasons.

1. Properly construing the Bankruptcy Code as a whole and its relevant provisions in context confirms that excluding "knowledge of the trustee" in Section

544(a) necessarily includes excluding knowledge of the debtor.

"The Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law," and this Court thus "interpret[s] the Code clearly and predictably using well established principles of statutory construction." *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 566 U.S. 639, 649 (2012). Statutory language must be read in context of, and consistent with, how it is used and its overall place in the statutory scheme. *Robinson* v. *Shell Oil Co.*, 519 U.S. 337, 341 (1997); *Davis* v. *Michigan Dept. of Treasury*, 489 U.S. 803, 809 (1989). The meaning of statutory terms may only become evident when placed in context. *FDA* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000). Statutes therefore must be interpreted "as a symmetrical and coherent regulatory scheme," *Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 569 (1995), and "fit, if possible, all parts into an harmonious whole," *FTC* v. *Mandel Bros.*, 359 U.S. 385, 389 (1959).

A debtor-in-possession proceeding under Section 544(a) necessarily brings his or her personal knowledge to the case. A majority of circuits which have considered this issue hold that Section 544(a) prohibits consideration of the debtor's actual knowledge. *Dolphin Press*, 1999 WL 800170, at *1; *Sandy Ridge*, 807 F.2d at 1335–1336; see also *Kim*, 161 B.R. at 837; accord *Dunes Hotel*, 194 B.R. at 979 (recognizing the "universally accepted principle that the debtor's actual knowledge is not imputed to either the trustee or the debtor-in-possession under § 544(a)"); *Rock Hill Nat'l*

Bank v. *York Chem. Indus. (In re York Chem. Indus.)*, 30 B.R. 583, 586 (Bankr. D.S.C. 1983) (holding that "[t]he debtor's actual knowledge is not relevant" to a debtor-in-possession under Section 544(a)). This result is inescapable, as holding otherwise renders Section 544(a) largely superfluous for debtors-in-possession because their personal knowledge will regularly defeat their claims.

Trustees and debtors-in-possession stand on equal footing under Section 544(a). *Goodrich Petroleum*, 894 F.3d at 197; see also *Holywell Corp.*, 503 U.S. at 50; 11 U.S.C. 1107(c); S. Rep. No. 989, 95th Cong., 2d Sess. 117 (1978) (noting that Section 1107 "places a debtor in possession in the shoes of a trustee in every way."). Subjecting trustees to the debtor's knowledge, while insulating debtors-in-possession from it, gives trustees fewer rights than debtors-in-possession in contravention of congressional intent. For example, under this view IBG could avoid its knowledge and recover from Meyers and Morgan Keegan had it sought reorganization as a debtor-in-possession under Chapter 11, but a Chapter 7 Trustee cannot avoid IBG's knowledge and is thus barred from recovering. Congress did not intend to create such disparity between trustees and debtors-in-possession and to create such inequity for creditors.

2. The Fourth Circuit incorrectly held that Section 544(a) confers no greater rights than those held by the debtor. Pet. App. 14–15. It is generally accepted that Section 541(a)(1) does not give the trustee greater rights in the estate's property, including any legal

claims, than the debtor had. In contrast, trustees possess greater powers under Section 544(a) than the debtor had. See *Quality Holstein Leasing*, 752 F.2d at 1014 (holding Section 544(a) allows the trustee to recover some assets the debtor itself could not); *Belisle* v. *Plunkett*, 877 F.2d 512, 516 (7th Cir. 1989), cert. denied, 493 U.S. 893 (1989) ("[A]llowing the estate to 'benefit from property that the debtor did not own' is exactly what the [Section 544(a)] powers are about."). This concept frequently is invoked in connection with the estate retaining property to which it lacked good title or avoiding a lien. *E.g.*, *Belisle*, 752 F.2d at 1014; *Hamilton* v. *Washington Mut. Bank FA (In re Colon)*, 563 F.3d 1171, 1172–1173 (10th Cir. 2009). But the point nevertheless remains: Section 544(a) confers broader rights in the debtor's property than Section 541(a)(1). The Fourth Circuit's failure to recognize this distinction improperly cabined its analysis to only those rights IBG had without considering the broader powers Section 544(a) confers upon a trustee.

3. The Fourth Circuit erroneously applied the "logic" of cases interpreting Section 541(a)(1), despite its substantive differences from Section 544(a). Pet. App. 14–15. The circuit courts unanimously hold that *in pari delicto* applies to trustees who bring claims against third parties on the debtor's behalf under Section 541(a)(1). *E.g.*, *Nisselson*, 469 F.3d at 153; *R.F. Lafferty & Co.*, 267 F.3d at 356–358; *Derivium Cap.*, 716 F.3d at 367; *Peterson*, 676 F.3d at 598–599; *Grassmueck*, 402 F.3d at 836–837; *Hedged-Invest. Assocs.*, 84 F.3d at 1284–1286; *PSA, Inc.*, 437 F.3d at 1149–1152.

At the same time, *in pari delicto* does not apply under other statutes allowing a trustee to recover for the estate. *Leasing Consultants*, 592 F.2d at 111 (declining to apply *in pari delicto* under the predecessor to Section 544(b)); *Pers. & Bus. Ins. Agency*, 334 F.3d at 246–247 (declining to apply *in pari delicto* to 11 U.S.C. 548 avoidance claims); *Davis*, 785 F.2d at 927 (declining to apply *in pari delicto* to Section 544(b) avoidance claims). Other circuits recognize the logic of these cases which refuse to apply *in pari delicto* outside of Section 541(a)(1). *E.g.*, *Derivium Cap.*, 716 F.3d at 367 (recognizing the appeal of not applying *in pari delicto* to a trustee but holding Section 541(a)(1) required it); *Hedged-Invest. Assocs.*, 84 F.3d at 1285 (same); see also *Jones* v. *Wells Fargo Bank, N.A*., 666 F.3d 955, 966 (5th Cir. 2012) (declining to apply *in pari delicto* to a receiver); *Scholes* v. *Lehmann*, 56 F.3d 750, 755 (7th Cir. 1995) (same); *FDIC* v. *O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (same).

The "logic" of Section 541(a)(1) cases therefore is inapposite because, unlike that statute, Section 544(a) explicitly states that the trustee exercises his or her powers "without regard to any knowledge of the trustee or of any creditor." As explained above (Pet. at 15-16, 25-27), this language excludes consideration of the debtor's personal knowledge, and that knowledge is a requirement of *in pari delicto*. *In pari delicto* therefore does not apply against a trustee proceeding under Section 544(a) as a matter of law.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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