



COMMENTARY

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Massachusetts' Highest Court Narrows *In Pari Delicto* Defense



IN SHORT

The Situation: In *Merrimack College v. KPMG LLP*, a college sued its independent auditor for the auditor's failure to report fraud by the college's financial aid director.

The Result: The Massachusetts Supreme Judicial Court ("SJC") ruled that for purposes of the *in pari delicto* defense, only the conduct of senior management could be imputed to a plaintiff corporation.

Looking Ahead: This decision limits the availability of the defense, departs from traditional agency principles, and has implications for service providers to corporations, including so-called "gatekeepers" like accountants and lawyers.

The Massachusetts Supreme Judicial Court has recently narrowed the scope of corporate imputation in the context of the *in pari delicto* defense, which will impact corporations' ability to rely on their third-party consultants.

In *Merrimack College v. KPMG LLP*, a college sued its independent auditor for the auditor's failure to catch fraud by the college's financial aid director. The auditor's defense was that because the financial aid director was an agent of the college, the college's claims were barred by the doctrine of *in pari delicto*. In this case of first impression, the SJC held that because the financial aid director was not a member of the college's senior management, her conduct should not be imputed to the college, and the college's claims were not barred.

The SJC's departure from traditional agency principles will allow corporations to rely on their third-party "gatekeepers" with more confidence that they can recover from those gatekeepers for losses incurred from the conduct of mid-level employees. This decision therefore puts more pressure and potential liability on corporate gatekeepers, such as auditors and law firms, to monitor corporate wrongdoing.

This *Commentary* explores the limits of the SJC's holding in *Merrimack College* and identifies a trend in some jurisdictions to increase the burden on corporate gatekeepers.

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FOUR KEY TAKEAWAYS

1. The SJC has departed from traditional agency principles, deciding to impute only the conduct of senior management, officers, and directors to a corporation, where that corporation's outside auditor attempts to assert an *in pari delicto* defense.
2. The SJC's holding with respect to imputation applies only in the context of the *in pari delicto* defense.



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Corporations remain exposed to risks of vicarious liability for the wrongdoing of any agent, not just senior management, against an innocent third party

3. This decision is part of a trend to put more pressure on gatekeepers to improve corporate monitoring.
4. Whether the SJC would extend the *Merrimack* decision to create a blanket auditor exception remains an open question.

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