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**ADVERSE DOMINATION, STATUTES OF LIMITATIONS AND THE
IN PARI DELICTO DEFENSE – APPLICATION IN CASES INVOLVING
CLAIMS OF ACCOUNTING MALPRACTICE AND CORPORATE FRAUD**

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I. INTRODUCTION

In *Seiden v. Frazer Frost, LLP*,¹ a receiver, Robert W. Seiden (“Seiden” or “the Receiver”) sought to avoid a statute of limitations

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¹ No. 18-00588-CJC (KESx), 2018 WL 6137618 (C.D. Cal. July 31, 2018), *aff'd*, 796 F. App'x 381 (9th Cir. 2020), *reh'g en banc denied*, 2020 U.S. App. LEXIS 4005 (9th Cir. Feb. 10, 2020).

dismissal of his claims against several auditor firms which had provided services to a Chinese technology company, China Valves Technology, Inc. (“CVTI” or “CVVT”).² The events giving rise to the claims occurred many years before the Receiver’s appointment and would, on their face, appear to have long been time-barred as a receiver takes any claim subject to defenses that could be asserted against the party in whose shoes he or she stands.³ However, the Receiver argued his claims should be deemed timely pursuant to the “adverse domination doctrine,” (the “Doctrine”),⁴ under which the limitation period may be equitably tolled subject to proof that a company’s defrauding officers/directors were “dominating/controlling” company business.⁵

² *Id.* at *6. CVTI had been capitalized via a reverse merger. A “reverse merger” is the acquisition of a private company by an existing public company. The transaction is often undertaken so the private company can bypass the lengthy, complex and expensive process of going public through a traditional public offering. See <https://www.thebalance.com/what-are-reverse-mergers-and-how-do-you-spot-one-4165740>.

³ See *Porter v. Sabin*, 149 U.S. 473 (1893).

⁴ The literature on the adverse domination doctrine is considerable. See, e.g., Christine M. Shepard, *Corporate Wrongdoing and the In Pari Delicto Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275 (2012); Michael G. Dore, *Statutes of Limitation and Corporate Fiduciary Claims: A Search for Middle Ground on the Rules/Standards Continuum*, 63 BROOKLYN L. REV. 695 (1997); Michael E. Baughman, Comment, *Defining the Boundaries of the Adverse Domination Doctrine: Is there any Repose for Corporate Directors?*, 143 U. PA. L. REV. 1065 (1995); *The Maryland Survey: 1993-1994, Recent Decisions The Maryland Court of Appeals*, 54 MD. L. REV. 670 (1995); Christopher R. Leslie, *Den of Inequity: The Case for Equitable Doctrines in Rule 10b-5 Cases*, 81 CALI L. REV. 1587 (1993); Ashley Rosen, *The Maryland Survey: 2001-2002: Recent Decisions The Court of Appeals of Maryland*, 62 MD. L. REV. 700 (2003); John R. Leonard, Case Comment, *Corporate Law—Massachusetts Limits Tolling of Statute of Limitations for Breach of Fiduciary Duties in Closely Held Corporations—Aiello v. Aiello*, 852 N.E.2d 68 (Mass. 2006), 41 SUFFOLK U. L. REV. 295 (2007); Robert W. Thompson et al., *The Limits of Derivative Actions: The Application of Limitation Periods to Derivative Actions*, 49 ALBERTA L. REV. 603 (2012); Duane Rudolph, *Workers, Dignity, and Equitable Tolling*, 15 NW. J. HUM. RTS. 126 (2017); Emil Bukhman, *Time Limits on Arbitrability of Securities Industry Disputes Under the Arbitration Rules of Self-Regulatory Organizations*, 61 BROOKLYN L. REV. 143 (1995); Matthew G. Dore, *Presumed Innocent? Financial Institutions, Professional Malpractice Claims, and Defenses Based on Management Misconduct*, 1995 COLUM. BUS. L. REV. 127 (1995).

⁵ Complaint, Case & Demand for Trial by Jury at 6, *Seiden v. Frazer Frost, LLP*, No. 18-cv-00588 CJC (KESx) (C.D. Cal. Apr. 9, 2018), ECF No. 1 [hereinafter Receiver’s Complaint].

The Receiver further argued that even if he was wrong about the limitation/accrual, he should survive a limitation-based dismissal motion, anyway. Had the shareholders brought a timely derivative action against the auditors, a motion to dismiss their claims would have been granted because, he argued, a derivative action brought by shareholders standing in the shoes of the same corporation that injured the shareholders would have been vulnerable to an *in pari delicto* defense based on the corporation's fraudulent conduct and unclean hands.⁶ This would have resulted, he argued, in such derivative action necessarily failing, had it been brought, requiring, as a matter of law, that the shareholders be deemed to have lacked the "motivation" to file a futile suit.⁷ The Receiver concluded that Doctrine-based tolling occurs unless someone "motivated" to sue gains factual knowledge sufficient to timely interpose claims seeking redress. Therefore, he urged, the shareholders must be deemed to have lacked "motivation" as they must be deemed to have known any claims they might file would be dismissed on grounds of *in pari delicto*. According to the Receiver, the combination of the adverse domination doctrine and the *in pari delicto* doctrine had to be construed to render all his claims timely.⁸

Part II describes the facts underlying the Receiver's case, arguments made regarding the interpretation of the Doctrine and a hypothetical auditor-raised *in pari delicto* defense, and the trial court's reasoning, resulting in a with-prejudice dismissal of the first-time-on-pleading. Part III describes the Ninth Circuit Court of Appeals' reasoning in affirming the trial court's analysis and decision, clarifying the adverse domination theory and the proper application of the *in pari delicto* doctrine. Part IV examines application of the *in pari delicto*

⁶ Applicability of the *in pari delicto* doctrine as a defense in shareholder derivative actions has been the subject of several scholarly articles. See, e.g., Shepard, *supra* note 4; Henry duPont Ridgely, *Avoiding the Thickets of Guesswork: The Delaware Supreme Court and Certified Questions of Corporation Law*, 63 SMU L. REV. 1127 (2010); Maaren A. Choksi, *Interpreting In Pari Delicto in the Wake of Kirschner v. KPMG LLP*, 29 AM. BANKR. INST. J. 44 (2010); Sandra S. O'Loughlin & Christopher J. Bonner, *2013-2014 Survey of New York Law: Business Associations*, 65 SYRACUSE L. REV. 641 (2015); Lee C. Buchheit et al., *The Dilemma of Odious Debt*, 56 DUKE L. J. 1201, 1258-59 (2007); Richard P. Swanson, *Accountants' Liability, Theories of Liability*, SN073 ALI-ABA 23 (ALI 2008).

⁷ Plaintiff's Opposition to Defendants' Motion to Dismiss at 10, *Seiden v. Frazer Frost, LLP*, No. 18-cv-00588 CJC (KESx) (C.D. Cal. July 9, 2018), ECF No. 25.

⁸ *Id.*

doctrine in the context of shareholder derivative actions, generally, where the adverse domination doctrine is at issue. This section focuses on a leading case from the New York Court of Appeals, *Kirschner v. KPMG LLP*,⁹ in which an outside auditor asserted an *in pari delicto* defense in a shareholder derivative action, discussing how the *Seiden* litigation would have turned out if the rules in *Kirschner* had been applied.¹⁰ Part V discusses application of *in pari delicto* arguments not only in derivative actions, but actions filed by Bankruptcy Trustees or others who step into the shoes of adversely dominated corporations. Equitable considerations, the authors conclude, should figure prominently in evaluating potential applicability of limitation period tolling where adverse domination claims are interposed and *in pari delicto* arguments proffered in derivative litigation.

II. THE FACTS, CLAIMS AND ARGUMENTS IN THE TRIAL COURT

A. The Receiver's Allegations of Auditor Misconduct

Plaintiff Robert W. Seiden, Esq., the receiver for CVTI filed claims against several auditor firms (“Defendants” or the “Auditors”)¹¹ for aiding and abetting and/or negligently allowing the alleged common law misconducts of the officers and directors of CVTI, a China technology company that became a public entity, via a reverse merger. The Receiver alleged that between 2008 and 2011, Defendants assisted CVTI in raising \$64.7 million by repeatedly signing off on fraudulent documents.¹² The Auditors were retained from January 2008 through September 2012 to audit CVTI financial statements, review SEC filings, and complete tax work.¹³ The Receiver alleged the Auditors failed to fulfill their engagement letter obligations to CVTI from January 2008-December 2012,¹⁴ by failing, *inter alia*, to properly report what the Receiver characterized as “obvious” related-party transactions, under PCAOB and GAAP

⁹ 938 N.E.2d 941 (N.Y. 2010).

¹⁰ *Id.* at 945.

¹¹ The defendant firms were Frazer Frost, LLP; Moore, Stephens, Wurth, Frazer & Terbet, LLP; Frazer, LLP; and Frost, PLLC.

¹² Receiver's Complaint, *supra* note 5, at 6.

¹³ *Id.* at 7.

¹⁴ *Id.* at 8.

standards.¹⁵ Neither details of the referenced misconduct nor existence of same was at issue in the dismissal motion practice that followed complaint filing.

The Defendants were Public Company Accounting Oversight Board (“PCAOB”) registered audit firms with their principal places of business in Brea, California, except one auditor who had a principal place of business in Little Rock, Arkansas, but performed audit-related work for CVTI in Orange County, California.¹⁶ The Receiver alleged five causes against the Auditors: negligence and gross negligence; breach of contract; aiding, abetting, or participation in breaches of fiduciary duty; aiding, abetting, or participation in a fraudulent scheme; and unjust enrichment arising out of Defendants’ audit work between 2008 and 2012, which claims he pleaded were currently actionable.¹⁷

On September 12, 2016, Seiden was appointed as Receiver of

¹⁵ *Id.* “PCAOB” is the common abbreviation for the Public Company Accounting Oversight Board which is a private-sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002 to oversee accounting professionals who provide independent audit reports for publicly traded companies. “GAAP” is the common abbreviation for generally accepted accounting principles.

¹⁶ *Id.* at 3.

¹⁷ Among other things, the Receiver alleged the Auditors reviewed CVTI’s third quarter 2010 financial statements in connection with CVTI’s Form 10-Q. Before the third quarter 2010 Form 10-Q was filed, CVTI’s CEO Fang allegedly informed Defendants about misrepresentations made by him in connection with an acquisition involving Changsha Valves including misrepresentations regarding: (i) the seller’s identity; (ii) the related parties’ role in acquisition; (iii) the acquisition price; (iv) the acquisition structure; and (v) the allocation of assets and liabilities. *Id.* at 14. Notwithstanding alleged receipt of the above information, according to the Receiver, the Defendants confirmed the misinformation in the first and second quarter of 2010 but failed to take appropriate steps to communicate this to CVTI’s management or audit committee. Accordingly, the Receiver maintained that the third quarter 2010 Form 10-Q was filed with known misstatements. *Id.* Despite the Auditor’s alleged awareness there should be “heightened skepticism” for the 2011 audit, they did not, he alleged, take appropriate steps which would have detected CVTI’s failure to make the \$1.7 million VAT payment in connection with Hanwei Valve, which CVTI had recorded in its books. That failure allegedly resulted in an audit report with an unqualified opinion for financial statements that overstated net income 6.22% and understated tax liability. *Id.* The Receiver further complained Defendants failed to comply with “other contractual obligations” by performing independent testing to make sure no material misstatements were made. *Id.* at 14-15. He also complained that the Auditors CVTI’s 2010 Form 10-K inaccurately stated the audit was conducted in accord with PCAOB standards and that CVTI’s financial statements fairly presented the Company’s position and results in conformity with U.S. GAAP.

CVTI by the District Court of the State of Nevada in and for the County of Clark, in the action captioned *Michael Markbreiter, et al. v. China Valves Technology, Inc., et al.*¹⁸ On February 2, 2017, the Nevada Court entered a Final Order and Judgment against CVTI, which also set forth the general powers of Plaintiff, as the Receiver which included the “[a]uthority to commence, continue, join in, and/or control any action, suit or proceeding, of any kind or nature, in the name of CVVT”¹⁹

Seiden’s complaint alleged that the limitation period was tolled as of the date he was appointed,²⁰ and that “[t]he Receiver did not discover and could not have discovered with the exercise of reasonable diligence have discovered Defendants’ participation in the CVVT’s activities and the true nature of Defendants’ . . . injury suffered before his appointment” and that “Defendants’ wrongful acts . . . were inherently undiscoverable . . . until after the appointment of the Receiver and there is no basis by which knowledge can be imputed to the Receiver that pre-dates the appointment.”²¹ Nineteen months after his appointment, on April 9, 2018, Seiden filed his complaint pleading he “did not discover and could not have discovered with the exercise of reasonable diligence . . . Defendants’ participation in CVVT’s activities and the true nature of Defendants’ wrongful actions and the injury suffered before his appointment in September 2016.”²² He alleged “the domination of CVVT by the executives who committed the bad acts with Defendants made the discovery of the bad acts by the Receiver impossible until sometime after the appointment of the Receiver and the removal of the bad actors,”²³ in

¹⁸ Seiden v. Frazer Frost, LLP, No. SACV 18-00588-CJC (KESx), 2018 WL 6137618, at *3 (C.D. Cal. July 31, 2018).

¹⁹ *Id.* In certain legal documents, China Valves is referred to as CVVT, rather than CVTI—the abbreviation CVVT is used herein in some instances to be consistent with quoted language. Accordingly, CVTI and CVVT are used interchangeably throughout this article with both abbreviations referring to China Valves Technology, Inc.

²⁰ Receiver’s Complaint, *supra* note 5, at 3.

²¹ *Id.* at 6.

²² *Id.*

²³ *Id.* Although poorly pleaded, the Receiver may have meant to allege (or should have alleged) that *CVTI’s* shareholders could not have discovered the wrongdoing prior to the Receiver’s appointment. CVTI’s shareholders’ potential discovery—despite the adverse domination—was certainly the issue upon which the court focused in evaluating the motion to dismiss the complaint.

other words, he affirmatively pleaded his complaint was timely and that the statute of limitations was tolled pursuant to the Doctrine.

B. The Receiver's Adverse Domination Tolling Theory

Because CVTI was allegedly under the control and domination of its wrongdoing directors, Seiden urged that the limitation period was required to be tolled until some point after the Receiver's appointment. That point was not identified in the complaint but, presumably, it would have been the time the bad acts alleged could have been discovered so the Receiver could seek relief.²⁴ All applicable limitation periods were tolled, he argued, notwithstanding the relatively short California limitations periods applicable to his common law claims.²⁵

Under California's discovery rule, limitations periods begin to run once the plaintiff has notice or information of circumstances that would put a reasonable person on notice of wrongdoing and that the claims the Receiver alleged accrued "when the plaintiff . . . discovered all facts essential to his cause of action . . . when plaintiff either (1) actually discovered his injury and its negligent cause or (2) could have discovered injury and cause through the exercise of reasonable

²⁴ *Id.*

²⁵ California law was applicable because the subject agreements between CVTI and the Auditors all contained California choice of law provisions. Plaintiff's negligence and gross negligence claims were governed by a two-year limitation period under CAL. CODE CIV. PROC. § 339(1) (West 2020). His breach of contract and breach of fiduciary duty claims had four-year limitation periods under CAL. CODE CIV. PROC. §§ 337, 343 (West 2019). His fraud and unjust enrichment claims were governed by three-year limitation periods under CAL. CODE CIV. PROC. § 338 (West 2019). As Judge Carney would hold, citing *City of Vista v. Robert Thomas Sec., Inc.*, 101 Cal. Rptr. 2d 237, 241 (Cal. Ct. App. 2000), "where [the] gravamen of [the] complaint is fraud, claims are subject to a three-year statute of limitations." *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx), 2018 WL 6137618, at *5 (C.D. Cal. July 31, 2018). The Receiver did not contest these statutes of limitations applied to his claims nor the fact that at least six years had passed before he commenced his action. Rather, the Receiver asserted that the applicable limitation periods were tolled under the adverse domination doctrine and did not begin to run until the Receiver's appointment in September 2016, which effectively removed the adversely dominating directors. *See Seiden v. Frazer Frost, LLP*, 796 F. App'x 381, 382 (9th Cir. 2020).

diligence.”²⁶ The Auditors submitted multiple court documents showing the facts underlying the Receiver’s claims were not only available to shareholders before he was even appointed, but that they had already pleaded and litigated them in a securities class action litigation.²⁷ The same facts the Receiver claimed were impossible to discover had been litigated, starting in 2011, seven years before he filed his complaint.²⁸ The defense argued the limitations period had long ago expired, based on shareholder knowledge of the pertinent facts which were set forth in a publicly filed securities class case which had in fact been dismissed.²⁹

Seiden was appointed as a receiver in an action against CVTI insiders on or about September 12, 2016.³⁰ His Complaint was filed April 9, 2018—more than eighteen months later.

The question before Judge Carney, the trial judge, had to do with proper interpretation of the Doctrine upon which the Receiver was relying—Judge Carney stated the issue as follows:

“The doctrine of adverse domination allows ‘tolling for claims alleging wrongdoing by those who control the corporation.’” *In re Verit Indus., Inc.*, 172 F.3d 61, at *2 (9th Cir. 1999) (quoting *Federal Deposit Ins. Corp. v. Jackson*, 133 F.3d 694, 698 (9th Cir. 1998)). The doctrine also applies to toll the statute of limitations in actions against third-parties. *See Admiralty Fund v. Peerless Ins. Co.*, 143 Cal. App. 3d 379, 390 (Ct. App. 1983) (applying adverse domination doctrine in action against third-party insurance company where the plaintiff corporation asserted it was prevented from discovering its loss until its own “wrongdoer employees” were removed). “The doctrine carries the same requirement of notice before accrual is deemed to

²⁶ *April Enters. Inc. v. KTTV*, 195 Cal. Rptr. 421, 432 (Cal. Ct. App. 1983) (internal quotations and citations omitted).

²⁷ Notice of Motion and Motion to Dismiss Complaint at Exs. A-E to Declaration of Lawrence A. Steckman, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. June 8, 2018), ECF No. 23, Attach. Nos. 2-6.

²⁸ *Id.*

²⁹ *See* Notice of Motion and Motion to Dismiss Complaint at 9-20, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. June 8, 2018), ECF No. 23.

³⁰ Receiver’s Complaint, *supra* note 5, at 3. *See also Seiden*, 2018 WL 6137618 at *3.

have occurred. As with the discovery rule, the test is whether plaintiff knows or should know of the claim.” *Hecht v. Resolution Tr. Corp.*, 333 Md. 324, 352 (1994). “When a plaintiff relies on a theory of fraudulent concealment, delayed accrual, equitable tolling, or estoppel to save a cause of action that otherwise appears on its face to be time-barred, he or she must specifically plead facts which, if proved, would support the theory.” *Mills v. Forestex Co.*, 108 Cal. App. 4th 625, 641 (2003).³¹

Citing *Allen v. Ramsay*,³² the court explained:

A receiver occupies no better position than that which was occupied by the person or party for whom he acts and the receiver takes the property and the rights of one for whom he was appointed in the same condition and subject to the same equities as existed before his appointment and any defense good against the original party is good against the receiver.³³

The judge in *Allen* further explained:

The showing of excuse for late filing must be made in the complaint. Formal averments or general conclusions to the effect that the facts were not discovered until a stated date, and that the plaintiff could not reasonably have made an earlier discovery, are useless. The complaint must set forth specifically (1) *the facts of the time and manner of discovery; and* (2) *the circumstances which excuse the failure to have made an earlier discovery.*³⁴

The Receiver argued the reason the limitation period was tolled, as to him, was because CVTI management was engaged in fraud and would not sue itself (or the Auditors who supposedly enabled their fraud)—therefore, until the corruption ended, the Doctrine required the limitation periods be tolled, as to him.³⁵ Judge

³¹ *Seiden*, 2018 WL 6137618 at *5.

³² 4 Cal. Rptr. 575 (Cal. Ct. App 1960).

³³ *Id.* at 583 (citations omitted).

³⁴ *Id.* at 581 (citations and internal quotations omitted).

³⁵ Plaintiff’s Opposition to Defendants’ Motion to Dismiss, *supra* note 7, at 6.

Carney, however, explained that to obtain Doctrine-based tolling, plaintiff must not only show that the wrongdoing directors/officers controlled the company, but he must also negate the possibility that an informed stockholder or director could have induced the corporation to sue for relief,³⁶ by showing management's control was so extensive as to preclude discovery.³⁷ The assumption underlying the Doctrine is that "with control comes non-disclosure and without knowledge of directors' wrongful activities plaintiffs have no meaningful opportunity to bring suit."³⁸

The Defense submitted a table containing a side-by-side juxtaposition of relevant paragraphs of the Receiver's complaint, against two previously dismissed federal class complaints (a pleading and repleading, after dismissal), as well as a previously filed SEC complaint against the CVTI insiders, and another SEC complaint filed against the Auditors.³⁹ All the pleadings were publicly available. All the facts were known to the public, at least as of January 11, 2011, through the "Citron Report," in a published article attached to the Complaint.⁴⁰

These same facts formed the basis of a shareholder derivative action against CVTI, filed on September 14, 2011.⁴¹ This derivative

³⁶ *Mosesian v. Peat, Marwick, Mitchell & Co.*, 727 F.2d 873, 879 (9th Cir. 1984).

³⁷ *See Admiralty Fund v. Peerless Ins. Co.*, 191 Cal. Rptr. 753, 759-60 (Cal. Ct. App. 1983) ("[T]he dishonest president and other high ranking officers controlled the [company's] operations to such an extent as to preclude discovery, the tolling of a discovery of loss provision should be considered," otherwise, the shareholders would receive no protection during the time the wrongdoers controlled the company.); *Smith v. Superior Court*, 266 Cal. Rptr. 253, 255 (Cal. Ct. App. 1990) ("A statute of limitations tolls when a claim arises from a director's or employee's defalcation and the wrongdoers' control *makes discovery impossible.*") (emphasis added). Shareholder discovery of the facts of a fraud defeats adverse domination—tolling sometimes occurs but only where domination prevents discovery of wrongdoing. *Id.* (citing *San Leandro Canning Co. Inc. v. Perillo*, 295 P. 1026, 1028 (Cal. 1931)).

³⁸ *Hecht v. Resolution Tr. Corp.*, 635 A.2d 394, 402 (Md. 1994).

³⁹ Notice of Motion and Motion to Dismiss Complaint at Ex. A to Declaration of Lawrence A. Steckman, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. June 8, 2018), ECF No. 23, Attach. No. 2.

⁴⁰ *See also In re China Valves Tech. Sec. Litig.*, No. 11 Civ. 0796, 2012 WL 4039852, at *3 & n.21 (S.D.N.Y. Sept. 12, 2012) (discussing the Citron Report).

⁴¹ The shareholder derivative action was stayed pending a decision on the motion to dismiss the Class Action claim against CVTI and was ultimately voluntarily dismissed. *See* Notice of Motion and Motion to Dismiss Complaint at Exs. J-K to Declaration of Lawrence A. Steckman, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. June 8, 2018), ECF No. 23, Attach. Nos. 11-12.

action, which did not plead any claims against any Auditor Defendant, was discontinued without prejudice and never re-filed.⁴² The trial court concluded, with respect to discovery:

Defendants do not dispute that Plaintiff has properly alleged the domination of CVVT by the directors who committed the alleged bad acts with Defendants. While tolling may be appropriate in situations where there is such domination and control as to preclude non-wrongdoing employees or shareholders from “discovery,” it is not warranted under the facts of this case. Plaintiff has not alleged, nor could he, that the directors’ domination and control of CVVT precluded discovery of Defendants’ alleged wrongdoing. Here, it is not controverted that there were several actions brought against CVVT and Defendants prior to Plaintiff’s appointment as Receiver for CVVT. These actions set forth factual allegations that give rise to Plaintiff’s causes of actions, and clearly put the public on notice of CVVT and Defendants’ wrongdoing.⁴³

To properly allege entitlement to Doctrine-based equitable tolling, plaintiff must establish such “domination” that interested parties must have been precluded from discovering the wrongdoing, disabling a motivated person from suing.⁴⁴ Restated, plaintiff must “negate the possibility” that an informed stockholder or director could have known enough to sue for relief, within the limitation period.⁴⁵ Uncontradicted motion evidence showed the shareholders did discover the insiders’ wrongdoing and sued on the same facts the Receiver claimed were non-discoverable. The same gravamen of fact was repeated in class and derivative suits and two SEC complaints, prior even to the Receiver’s appointment.⁴⁶

⁴² *Id.*

⁴³ Seiden v. Frazer Frost, LLP, No. SACV 18-00588-CJC (KESx), at 13, 2018 WL 6137618, at *6 (C.D. Cal. July 31, 2018), ECF No. 32.

⁴⁴ *Id.*

⁴⁵ *Id.* at 12-13 & n.7 (citing *Mosesian v. Peat, Marwick, Mitchell & Co.*, 727 F.2d 873, 879 (9th Cir. 1984)).

⁴⁶ The Receiver cited *Farmers & Merchants Nat’l Bank v. Bryan*, 902 F.2d 1520 (10th Cir. 1990), for the proposition that a jury issue should be held to exist as to the directors’ knowledge of wrongdoing but the facts underlying the fraud were publicly disclosed in 2011, and the shareholders sued based on them. See Appellant’s

C. The Receiver's *in pari delicto* Argument

The Receiver, however, argued that, as a matter of law, even if the shareholders knew about the wrongdoing, because a receiver was involved, he should prevail, nevertheless.⁴⁷ His argument was as follows. Under the Doctrine, the persons discovering the wrongdoing must be “motivated” to seek relief and, he argued, the injured shareholders could not be deemed “motivated.”⁴⁸ According to the Receiver, had the shareholders sued the Auditors derivatively, the Auditors would have raised an *in pari delicto* defense.⁴⁹ Because the shareholders would be suing derivatively, through a receiver, they (he) would be standing in the shoes of CVTI, the wrongdoing entity. This would be true even though the claims were being brought by shareholders seeking redress for the Auditor’s alleged wrongdoing, permitting or encouraging the adverse directors. In other words, the shareholders would be, in law and according to the Receiver, the “wrongdoers,” requiring dismissal. Because the shareholders would have known their derivative action against the Auditors would be dismissed under an *in pari delicto* defense, the Receiver argued they must be deemed, in law, to have been “unmotivated” to bring a suit they knew they could not win, allowing Domination-based tolling to occur, despite actual discovery of the facts underlying the claims, for lack of a motivated person to sue for relief.

The defense argued the outcome of the Receiver’s hypothetical shareholder derivative action was pure speculation and, moreover, his “lack of motivation argument” was inconsistent with the fact of the filing of the initial class suit, and the filing of an amended class complaint after the initial class claims were dismissed by Judge Kaplan, which showed the shareholders were, in fact, motivated to

Opening Brief at 34, *Seiden v. Frazer Frost, LLP*, 796 Fed. App’x 381 (9th Cir. 2020) (No. 18-561767), ECF No. 10. The Defense argued that cases which refuse to dismiss claims with prejudice because knowledge is an issue of fact do not control cases in which shareholder knowledge is certain especially where those with knowledge did sue, in multiple pleadings, on those same facts. *See* Appellee’s Answering Brief at 44, *Seiden v. Frazer Frost, LLP*, 796 Fed. App’x 381 (9th Cir. 2020) (No. 18-56176), ECF No. 17.

⁴⁷ *See* Appellant’s Opening Brief, *supra* note 46, at 1-3.

⁴⁸ *Id.* at 17.

⁴⁹ *Id.* at 3-4, 10-11.

seek redress.⁵⁰ Judge Carney rejected his (hypothetical) *in pari delicto* argument. It would allow an injured party to sit by, not suing, despite knowledge of the facts underlying a fraud, based on his or her own speculation as to what a court might decide, if such a case were later brought, by a receiver.⁵¹ He held that an injured shareholder must take action to protect his or her rights or live with the consequences of his or her inaction, including potentially applicable limitation periods elapsing.⁵² The Defense also argued—and Judge Carney held “it is far from clear that this defense would have completely barred a shareholder derivative action against Defendants for the acts alleged in the Complaint,”⁵³ a holding consistent with authority.⁵⁴

At oral argument of the Auditors’ dismissal motion, Judge Carney posed the following question to the Receiver:

THE COURT: ...the question I have for you is: The wrongful conduct is of the people in charge. And if a derivative case is brought on behalf of the company because the people in charge are the alleged crooks, I

⁵⁰ The Receiver distinguished the redress sought in the previously dismissed securities class action litigation as being brought on behalf of the class plaintiffs, as individual, shareholders, and not on behalf of the corporate entity, itself. Because class plaintiffs were not seeking relief on behalf of CVVT, those actions, he argued, should not preclude Receiver claims filed on behalf of CVVT as opposed to individual shareholders. *See* Plaintiff’s Opposition to Defendant’s Motion to Dismiss Complaint, *supra* note 7, at 3 (asserting “[a]lthough generally based on the same bad acts, the claims previously litigated were direct shareholder claims based on securities law.”).

⁵¹ *See* Seiden v. Frazer Frost, LLP, No. SACV 18-00588-CJC (KESx), 2018 WL 6137618, at *9 (C.D. Cal. July 31, 2018), ECF No. 32.

⁵² *Id.* at *9.

⁵³ *Id.* at *8.

⁵⁴ The Receiver relied on *Rosenfeld v. Zimmer*, 254 P.2d 137, 138 (Cal. Dist. Ct. App. 1953), which involved a fraudulent transaction in which plaintiff shareholders had unclean hands, along with defendant corporation Euclid Properties, Inc., which falsified loan documents to obtain funds to repay loans made by the Rosenfeld plaintiffs and another shareholder (Mrs. Coren). It did not involve adverse domination, just a fraudulent scheme involving shareholders, who were bringing the derivative action. *Id.* at 138-40. “[P]laintiffs’ cause of action was barred by the doctrine of unclean hands of plaintiffs and defendant Euclid, the corporation on whose behalf plaintiffs instituted the present action,” and “[s]ince the evidence disclosed that plaintiffs and defendant Euclid had intended to and actually did misrepresent the facts to the Massachusetts Mutual Life Insurance Company in obtaining a loan from it, by which they hoped to benefit, they came into a court of equity with unclean hands.” *Id.* at 138, 140.

don't see how that doctrine gets applied to the plaintiff, because I have those cases all the time. And if I am understanding what your saying is: The wrongful conduct of the defendants will prevent a shareholder who's truly disinterested and independent from prevailing. And I'm not following—why is that?⁵⁵

The Receiver's counsel was unable to effectively respond to Judge Carney's question.⁵⁶

Once CVTI's innocent shareholders discovered the subject wrongdoing, application of *in pari delicto* to benefit the Auditors in a [hypothetical] derivative action would, Judge Carney reasoned, have been a perversion of the *in pari delicto* doctrine.⁵⁷ It would prevent an injured shareholder from prevailing (on behalf of the company), through a receiver, against the wrongdoing directors and anyone allegedly aiding them.⁵⁸ Judge Carney's questioning made clear that it would make no sense to apply *in pari delicto* in a derivative case under these circumstances as it would punish innocent shareholders suing derivatively for CVTI director misconduct and allow an auditor, if it had really engaged in wrongdoing, to be unjustly enriched (assuming *arguendo* it participated in a fraud).⁵⁹

The Receiver tried to save his claims arguing that whether CVTI's shareholders would have been subject to the defense of *in pari delicto* required a fact intensive inquiry as to whether the wrongdoing of the managers should be imputed to the corporation.⁶⁰

⁵⁵ Transcript of Proceedings at 17:19-18:3, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. July 30, 2018), ECF No. 38.

⁵⁶ *Id.* at 18-20, 24-27.

⁵⁷ *Id.* at 24-27.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ Judge Carney cited *In re Amerco Derivative Litig.*, 252 P.3d 681, 694-97 (Nev. 2011) (holding under Nevada law corporation directors' actions are imputed to the corporation, remanding the action for a determination of whether the *in pari delicto* defense applied), and explained that "an agent's acts will not be imputed to the corporation if the 'adverse interest' exception applies, which requires the court to determine whether the agent's actions were 'completely and totally adverse to the corporation.'" *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx), at 17-18, 2018 WL 6137618, at *8 (C.D. Cal. July 31, 2018). "The 'adverse interest' exception is 'very narrow' and includes actions such as 'outright theft or looting or embezzlement.'" *Id.* "If the agent's wrongdoing benefits the corporation in any way, the exception does not apply. If the court determines the director or officer's acts

Under California law, such determination requires the court to assess whether “(1) the public cannot be protected because the transaction has been completed, (2) serious moral turpitude is involved, (3) the defendant is the one guilty of the greatest moral fault, and (4) to apply the rule will be to permit the defendant to be unjustly enriched at the expense of the plaintiff.”⁶¹ Judge Carney stated he thought it far from clear the *in pari delicto* defense “would have completely barred a shareholder derivative action against Defendants for the acts alleged in the Complaint.”⁶²

Judge Carney noted that although the Receiver alleged CVTI’s former directors and officers entered into transactions to funnel money to their personal benefit, which could constitute a “total abandonment” of CVTI’s interest, the adverse interest exception would prevent the imputation of their acts to CVTI.⁶³ The fact that CVTI may have benefited from some of these transactions, indicated, to him, CVTI was “not completely harmed by the transactions,” as it would have acquired ownership interest in the companies.⁶⁴ If CVTI benefited, the adverse interest exception would not apply—and, thus, he concluded “It is too speculative to assume that the defense of *in pari delicto* would apply to CVTI’s shareholders.”⁶⁵

should be imputed to the corporation, it must then make a secondary determination of whether the defense of *in pari delicto* should apply to the action at issue.” *Id.*

⁶¹ *Id.* at 17 (citing *In re Amerco Derivative Litig.*, 252 P.3d at 696); see also *Maudlin v. Pac. Decision Scis. Corp.*, 40 Cal. Rptr. 3d 724, 732-33 (Cal. Ct. App. 2006).

⁶² *Seiden*, No. SACV 18-00588-CJC (KESx), at 17, 2018 WL 6137618, at *8 (C.D. Cal. July 31, 2018), ECF No. 32.

⁶³ *Id.* at 17-18.

⁶⁴ *Id.* at 17. In fact, and in addition, the Receiver’s allegation is that prior to the disclosure of the wrongdoing and the theft of funds by the CVTI insiders, CVTI was benefitted by more than \$60 million. Receiver’s Complaint, *supra* note 5, at 2.

⁶⁵ *Seiden*, No. SACV 18-00588-CJC (KESx), at 17-18, 2018 WL 6137618, at *8 (C.D. Cal. July 31, 2018), ECF No. 32. The Receiver appealed Judge Carney’s dismissal of his complaint. See Notice of Appeal, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. August 29, 2018), ECF No. 33. He argued, in part based on an argument that the finding that his *in pari delicto* argument was “speculative,” should not have resulted in dismissal, but rather a determination by the trial court of whether, in fact, an *in pari delicto* defense against a shareholder derivative action would have been meritorious. See Appellant’s Opening Brief, *supra* note 46, at 31-32. Judge Carney was overly generous—consideration of the *Maudlin* factors shows a hypothetical *in pari delicto* defense, raised in a hypothetical derivative action, would likely have failed. See Appellee’s Answering Brief, *supra* note 46, at 33-40. First, protecting the public and preventing wrongdoers from benefiting from their conduct, was absent as all alleged wrongdoing and all

Whether an action by CVTI's shareholders against the auditors would have been successful, he concluded, was, in any event, not the point of the adverse domination doctrine regarding whether an informed shareholder or director had the "ability" to sue.⁶⁶ Rather, he explained: "the mere existence of a potential barrier to suing" does not negate the "ability to enforce a corporate cause of

transactions related thereto were completed by the time of public dissemination of the underlying facts in January 2011—applying *in pari delicto* would have injured innocent shareholders and protected those accused of wrongdoing, allowing unjust enrichment. *Id.* at 34. Second, preventing a shareholder derivative action due to *in pari delicto* or unclean hands would allow the auditor to retain the purported benefit of its wrongful conduct and thus be unjustly enriched at the expense of CVTI and its shareholders, which would make no sense. *Id.* at 35. Third, while an *in pari delicto* defense can be asserted in a derivative action, the defense "must not be applied where to do so would create an injustice." *Hill v. Younkin*, 79 Cal. Rptr. 509, 512 (Cal. Ct. App. 1969).

[T]he fundamental purpose of the [*in pari delicto*] rule must always be kept in mind, and the realities of the situation must be considered. Where, by applying the rule, the public cannot be protected because the transaction has been completed, where no serious moral turpitude is involved, where the defendant is the one guilty of the greatest moral fault, and where to apply the rule will be to permit the defendant to be unjustly enriched at the expense of the plaintiff, the rule should not be applied [I]n some cases, . . . effective deterrence is best realized by enforcing the plaintiff's claim rather than leaving the defendant in possession of the benefit; or the forfeiture resulting from unenforceability is disproportionately harsh considering the nature of the illegality. In each case, how the aims of policy can best be achieved depends on the kind of illegality and the particular facts involved.

Maudlin, 40 Cal. Rptr. 3d at 732 (citations and internal quotations omitted). Accordingly, the Auditors' counsel argued that it was not particularly "speculative" how a court would have decided whether to apply an *in pari delicto* defense—it was virtually certain that it would have been denied. Appellee's Answering Brief, *supra* note 46, at 39. The Ninth Circuit would likely hold that had the purported *in pari delicto* defense been raised, it would not have been viable under controlling precedent which holds that *in pari delicto* "must not be applied where to do so would create an injustice." *Hill*, 79 Cal. Rptr. at 512; *Maudlin*, 40 Cal. Rptr. 3d at 732 ("how the aims of policy can best be achieved depends on the kind of illegality and the particular facts involved."); Moreover, the Nevada Supreme Court, applying the same standards set forth in *Maudlin*, reversed a finding that an *in pari delicto* defense precluded a derivative action. *In re Amerco Derivative Litig.*, 252 P.3d at 694-97 (reversing dismissal of derivative action in reliance on *in pari delicto* doctrine, holding collusion of corporate insiders with third parties did not deprive corporation of standing to sue third parties). See also Appellee's Answering Brief, *supra* note 46, at 39-40.

⁶⁶ See *Seiden*, No. SACV 18-00588-CJC (KESx), at 18, 2018 WL 6137618, at *9 (C.D. Cal. July 31, 2018), ECF No. 32.

action.”⁶⁷ He set forth the central question regarding the adverse domination doctrine:

The central question animating the discovery rule, and the corollary doctrine of adverse domination, is whether someone could have discovered wrongdoing, and *sought* redress. To speculate as to the potential outcome of a wholly separate action is outside the scope of the adverse domination inquiry. Indeed, for the Court to determine whether CVVT’s shareholders were subject to the defense of *in pari delicto* would essentially require a mini-trial on the merits of *another litigation*, before the Court could address the merits of this action.⁶⁸

Record evidence of multiple prior litigations and public disclosure of the facts through the 2011 Citron Report showed the shareholders knew the facts, including the existence and effect of Defendants’ wrongdoing—“the majority of Plaintiff’s present allegations . . . provided constructive notice of Defendants’ alleged wrongdoing in the course of their auditing engagement with CVVT.”⁶⁹ Judge Carney relied on the reasoning of *In re Emerald Casino, Inc.*,⁷⁰ in which the Seventh Circuit held “the mere existence of a potential barrier to suing” does not negate the ability “to enforce a corporate cause of action.”⁷¹ In *Emerald Casino*, a Chapter 7 trustee had sued former casino officers, directors and shareholders for, among other things, breach of fiduciary duties in connection with the casino’s loss of its gaming license.⁷² The cause of action accrued in 2001, but the Chapter 7 trustee did not sue until 2008, beyond the five-year statute of limitation under Illinois law.⁷³ The trustee argued the Doctrine tolled the statute of limitations when the corporation was controlled by the wrongdoing officers or directors, but the trial judge held the Doctrine was

⁶⁷ *In re Emerald Casino, Inc.*, 867 F.3d 743, 762 (7th Cir. 2017) (applying the Doctrine and rejecting plaintiff trustee’s argument that creditor’s committee lacked the “ability” to sue because it could not have successfully brought a derivative claim on behalf of the corporation for lack of standing) (citations omitted).

⁶⁸ *Seiden*, 2018 WL 6137618, at *9.

⁶⁹ *Id.*

⁷⁰ 867 F.3d 743 (7th Cir. 2017).

⁷¹ *Id.* at 762 (internal quotations and citations omitted).

⁷² *Id.* at 760-763.

⁷³ *Id.*

inapplicable because the Chapter 11 creditor's committee had the knowledge, ability and motivation to sue before the case was converted to a Chapter 7 but chose not to do so.⁷⁴ On appeal, the Chapter 7 trustee argued the committee was unable to sue because it did not have derivative standing to assert claims against the directors and officers, and therefore, the creditor's committee was not "motivated" to pursue the lawsuit because a gaming license sale was pending during the period.⁷⁵ The Seventh Circuit affirmed. The fact that the bankruptcy court *might* have denied derivative standing to the creditor's committee was insufficient to demonstrate the committee could not sue for redress.⁷⁶ Even if the committee lacked the motivation to sue, that would not alter the outcome—"would-be plaintiffs must live with their choice. A plaintiff d[oes] not lack motivation to sue just because its chosen course of action proved to be unsuccessful in the end."⁷⁷

Judge Carney found the Receiver failed to meet his burden. He did not show a sufficient basis to avail himself of equitable tolling under the Doctrine and he could not shield his claims from a dismissal by speculating how a possible *in pari delicto* defense would have turned out.⁷⁸ He dismissed the Receiver's claims, with prejudice, notwithstanding it was a first time on pleading.⁷⁹ Nothing could change the dates of the relevant events including the dates during which the Auditors were engaged and the time the Citron Report publicly disclosed the gravamen of the factual case that resulted in, *inter alia*, the shareholder class action, naming one of the auditor defendants, nor subsequent multiple SEC actions and a derivative litigation, not naming the Auditors. The Receiver appealed to the Ninth Circuit.⁸⁰

III. THE ARGUMENTS BEFORE THE NINTH CIRCUIT COURT OF

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.*

⁷⁷ *Id.* at 763.

⁷⁸ See *In re Verit Indus., Inc.*, 172 F.3d 61, at *3 (9th Cir. 1999) (holding that the plaintiff did not meet the burden to invoke the adverse domination theory because the transactions at issue were disclosed in filings with the SEC, and the corporation's largest shareholder sued the company's directors for claims asserted in the plaintiff's complaint).

⁷⁹ See *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx), at 19, 2018 WL 6137618, at *9 (C.D. Cal. July 31, 2018), ECF No. 32.

⁸⁰ See Notice of Appeal, *supra* note 65.

APPEALS

A. Ninth Circuit Ruling on Adverse Domination

On appeal, the two central questions, as in the trial court, were how to properly understand the Doctrine and, in particular, its relation to shareholder knowledge of facts showing wrongdoing and whether the *in pari delicto* defense, as the Receiver attempted to use it, should be construed to save his claims.⁸¹ The Defense began by setting forth the traditional formulation of the Doctrine: “[I]t is generally held that an action for fraud committed against a corporation is tolled for the period that those responsible for the fraud remain in control of the corporation. The principle does not apply after discovery of the fraud by a protesting stockholder.”⁸² In other words, shareholder discovery of the facts of a fraud defeats Domination-based tolling where domination is so extensive that it prevents discovery of wrongdoing sufficient to allow a shareholder to seek relief.⁸³

⁸¹ Specifically, the Receiver argued any shareholder derivative action against the Auditors, prior to the Receiver’s appointment, would have been subject to an *in pari delicto* defense. See Appellant’s Opening Brief, *supra* note 46, at 17. CVVT shareholders would have had no motivation to bring a derivative action prior to the Receiver’s appointment, he argued, even if they knew of the corporate wrongdoing and the involvement of the Auditors, because such a suit would have been futile and subject to dismissal based on principles of *in pari delicto*. *Id.* Thus, even if the wrongdoing were previously discovered, the Doctrine would still serve to toll the limitations period until appointment of the Receiver, who would not be subject to the *in pari delicto* defense. See *Fed. Deposit Ins. Corp. v. O’Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (“[D]efenses based on a party’s unclean hands or inequitable conduct do not generally apply against that party’s receiver.”).

⁸² *Burt v. Irvine Co.*, 47 Cal. Rptr. 392, 417 (Cal. Dist. Ct. App. 1965) (internal citations omitted) involved the potential tolling of a limitations period when those directors responsible for the fraud remained in control of the company. *Id.* Although *Burt* did not involve a receiver, there is no special rule as to application of the Doctrine for receivers.

⁸³ See *Smith v. Superior Ct.*, 266 Cal. Rptr. 253, 255 (Cal. Ct. App. 1990) (citing *San Leandro Canning Co. v. Perillo*, 295 P. 1026, 1028 (Cal. 1931)) (one of the Receiver’s lead authorities for the proposition—“A statute of limitations tolls when a claim arises from a director’s or employee’s defalcation and the wrongdoers’ control makes discovery impossible.”) (emphasis added). *Smith* also cited *Admiralty Fund v. Peerless Ins. Co.*, 191 Cal. Rptr. 753, 759 (Cal. Ct. App. 1983) (“near absolute control can place the shareholder . . . in a position of incapacity, and may make discovery of any wrongdoing impossible . . . if . . . in fact the dishonest president and other high ranking officers controlled the Fund’s operations to such an extent as to preclude discovery, the tolling of a discovery-of-loss provision should

The Receiver relied on three cases showing, he argued, that his interpretation of the Doctrine was correct, namely *Whitten v. Dabney*,⁸⁴ *San Leandro Canning Co. v. Perillo*,⁸⁵ and *Damian v. A-Mark Precious Metals, Inc.*⁸⁶ His argument on appeal was that, even if a shareholder knows of actionable misconduct and has the ability and incentive to seek redress, under California State law, the limitations period is not tolled until the removal of the directors exercising adverse control.⁸⁷ Accordingly, a shareholder or a later appointed receiver still gets the benefit of tolling to file his own claims, despite shareholder knowledge, as long as the adverse domination is ongoing, regardless of whether shareholders obtain knowledge of the wrongdoing prior to removal of the adverse directors and regardless of any statute of limitation.⁸⁸

The Receiver argued the cases Judge Carney cited in support of his decision were all improperly relied upon, namely *Burt v. Irvine Co.*,⁸⁹ *Smith v. Superior Court*,⁹⁰ *Admiralty Fund v. Peerless, Inc.*

be considered.”) (emphasis added). The Receiver contended these cases were inconsistent with his lead authorities, discussed immediately below.

⁸⁴ 154 P. 312 (Cal. 1915).

⁸⁵ 295 P. 1026 (Cal. 1931).

⁸⁶ No. CV 16-7198 FMO (SSx), 2017 WL 6940515 (C.D. Cal. Aug. 28, 2017).

⁸⁷ See Appellant’s Opening Brief, *supra* note 46, at 24-27.

⁸⁸ The Receiver also advanced this argument in the District Court but, on appeal, focused more on *Whitten*, arguing *Whitten* treated the adversely dominated corporation as an “infant” under the law, without standing to sue and, therefore, the limitation period should be tolled as against an adversely dominated corporation until adverse director(s) were expelled, regardless of whether shareholders knew of the alleged wrongdoing during the adversely dominated corporation’s period of “infancy,” when the wrong-doing directors were in place. See Appellant’s Opening Brief, *supra* note 46, at 21-23. The Receiver urged that the doctrine of *stare decisis* should have compelled the District Court to ignore the large body of California case law from California’s lower courts which provided that statutes of limitations under the adverse domination doctrine are not tolled when shareholders of the adversely dominated company have knowledge of the basis for a civil action and an incentive to seek redress for the wrongful acts of those dominating the company. *Id.* at 3-5. His theory regarding the predominance of *Whitten* was contingent on the Ninth Circuit concluding *Whitten* stood for the proposition that adverse domination created an absolute limitations toll, regardless of whether or when corporation shareholders had prior knowledge of the basis for claims of wrongdoing. The Auditors disputed his interpretation of *Whitten*. See Appellee’s Answering Brief, *supra* note 46, at 24-30.

⁸⁹ 47 Cal. Rptr. 392, 417 (Cal. Dist. Ct. App. 1965).

⁹⁰ 266 Cal. Rptr. 253, 255 (Cal. Ct. App. 1990).

Co.,⁹¹ *Mosesian v. Peat, Marwick, Mitchell & Co.*,⁹² *Healthtrac, Inc. v. Sinclair*,⁹³ and *California Union Insurance Company v. Am. Diversified Sav. Bank*.⁹⁴ All of these cases had held the Doctrine precludes tolling where, despite domination, shareholders obtain knowledge of the wrongdoing and have the ability and motivation to seek redress. The Receiver argued each was wrongly decided because they did not follow what the Receiver called the “Whitten rule.”⁹⁵ He argued these California Court of Appeals cases and cases before the Ninth Circuit must all be disregarded in favor of (his interpretation) of the California Supreme Court precedent, *Whitten*. He also argued Ninth Circuit decisions in *Mosesian* and the district court decision in *Healthtrac* were federal question cases involving interpretation of federal common law, not California law and so both should be disregarded, under controlling California Supreme Court authority.⁹⁶

The Receiver’s central argument was that *Whitten* sets forth a bright-line, allegedly well-settled “rule” with respect to interpretation of the adverse domination doctrine, namely that if a company is controlled by principals accused of bad acts which harm the company, all statutes of limitations on claims against the company (arising from the bad acts) are tolled during such periods of domination, regardless of whether (and when) the company’s shareholders might obtain knowledge of the existence of potential claims and their ability to sue regarding same.

The Auditors argued the Receiver’s interpretation was incorrect. In *Whitten*, a shareholder was held by the trial courts to be time-barred from seeking relief because a *different shareholder* had become aware of the subject fraud but did not sue.⁹⁷ The question was whether the first shareholder’s knowledge commenced the limitation period for the second shareholder, then unaware of the fraud and only having recently learned of the facts.⁹⁸ The *Whitten* Court held the first shareholder’s knowledge did not bar the second from filing suit

⁹¹ 191 Cal. Rptr. 753, 757-58 (Cal. Ct. App. 1983).

⁹² 727 F.2d 873, 879 (9th Cir. 1984).

⁹³ 302 F. Supp. 2d 1125, 1127-28 (N.D. Cal. 2014).

⁹⁴ 948 F.2d 556, 565 (9th Cir. 1991).

⁹⁵ See Reply Brief of Plaintiff-Appellant Robert W. Seiden, Receiver for China Valves Technology, Inc. at 12-20, *Seiden v. Frazer Frost, LLP*, 796 Fed. App’x 381 (9th Cir. 2020) (No. 18-561767), ECF No. 30.

⁹⁶ *Id.* at 14-15.

⁹⁷ See Appellee’s Answering Brief, *supra* note 46, at 25-27.

⁹⁸ *Id.*

because he was not in a position to know the facts underlying the fraud—the *Whitten* Court explained:

It is susceptible of demonstration that the first stockholder knew of all these matters and that as to him this right of action may be barred. Is this also a bar to the prosecution of the same action by another stockholder who has acted promptly upon learning of the fraud? Clearly this cannot be so [E]ven if it be said (and in saying it we do not decide it) that such a complaint as this shows that the plaintiff stockholder has waited too long before commencing his action, and that therefore the plea of the statute of limitations must be sustained against his action, this does not operate as a bar to the corporate rights when prosecuted by another stockholder Whatever, therefore may have been the rights of the Providence stockholders to prosecute this action after notice, the right of these plaintiffs is not barred under their allegation that they first acquired notice and knowledge of the efforts of the Providence stockholders in 1910.⁹⁹

Whitten's result was predicated on the fact that a stockholder who lacked knowledge would not be barred by the limitation period if he "acted promptly upon learning of the fraud."¹⁰⁰

In contrast to *Whitten*, all the CVTI stockholders knew (or should have known) the underlying facts sufficient to bring a claim since at least January 2011 when the Citron Report was published,

⁹⁹ *Whitten v. Dabney*, 154 P. 312, 315-16 (Cal. 1915). The California Official Reports Headnotes from the *Whitten* case, though non-binding, are instructive: "The provision of the statute of limitations applicable to such action by a stockholder is subdivision 4 of section 338 of the Code of Civil Procedure, providing that actions for relief on the ground of fraud or mistake must be commenced within three years, but that the cause of action is not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake." *Whitten v. Dabney*, 171 Cal. 621, 622 (1915).

¹⁰⁰ *Whitten*, 154 P. at 315. *Whitten* did *not* decide on the (hypothetical) rights of the 1906 shareholders—it stated it was *not* deciding whether a shareholder who "waited too long" could be the one to initiate an action on behalf of the adversely dominated company. *Id.* ("[E]ven if it can be said (and in saying it we do not decide it) that such a complaint . . . shows that the Plaintiff stockholder has waited too long . . . this does not operate as a bar to the corporate rights when prosecuted by another stockholder [who was not on inquiry notice of the claims].") *Id.* at 316.

disclosing same. The Receiver's claims, in contrast, were time-barred because the public, including all the shareholders, who did, in fact, sue, discovered or could have discovered the basis for the Receiver's claims against the Auditors *before* the court appointed a receiver.¹⁰¹ The limitation periods for all the Receiver's claims were triggered in January 2011, when the facts were publicly disclosed.¹⁰² The Receiver argued Judge Carney erroneously looked to California's discovery rule rather than *Whitten*,¹⁰³ but no court has held *Whitten* stands for the proposition for which the Receiver argued—nor has any court held knowledge and filing of multiple pleadings based on the same gravamen of facts should be ignored in assessing whether the Doctrine should resuscitate otherwise time-barred and, in *Seiden*, already adjudicated claims. The Receiver's interpretation of *Whitten* was just wrong.

The Receiver's second lead authority, *San Leandro Canning Co.*, involved neither a receiver, nor parties with knowledge of a fraud, nor parties with an incentive and ability to sue for redress, let alone ones who actually did sue on the same facts.¹⁰⁴ Like *Whitten*, *San Leandro* expressed a reasonable proposition, namely that where a company is dominated by fraudulent directors, the limitation period may, in some circumstances, be tolled—but it did not deal with the situation presented in *Seiden*, where the facts of the fraud were available to every shareholder and actually sued upon.¹⁰⁵ *San Leandro* does *not* stand for the proposition that a receiver gets to revive time-barred claims where domination does not prevent shareholders from obtaining knowledge of claims just because a receiver is appointed after the limitation period runs.

¹⁰¹ *Whitten* did not involve a receiver trying to revive stale claims where people, knowing the same facts, had already sought redress in court. *Whitten* did not even rely on the Doctrine. It involved a statutory interpretation and application of the statute of limitations under California *Code of Civil Procedure Section 338*. See *Whitten*, 154 P. at 315 (“[T]he right to prosecute the action is governed by the provisions of section 338, subdivision 4 . . .”).

¹⁰² See *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx), at 14-15 & n.8, 2018 WL 6137618, at *7 n.8 (C.D. Cal. July 31, 2018), ECF No. 32.

¹⁰³ See Appellant's Opening Brief, *supra* note 46, at 24-25.

¹⁰⁴ See *San Leandro Canning, Co v. Perillo*, 295 P. 1026 (Cal. 1931).

¹⁰⁵ *Id.*

Plaintiff's third lead authority, *Damian v. A-Mark Precious Metals, Inc.*,¹⁰⁶ contains a correct statement of the rules governing the Doctrine: "In California, under the doctrine of adverse domination, a statute of limitations tolls when a claim arises from a director's or employee's defalcation *and the wrongdoers' control makes discovery impossible.*"¹⁰⁷ The Receiver omitted this quote from his citation and analysis of *Damian*.¹⁰⁸ The CVTI executives' wrongdoing did not "make discovery impossible" and the allegations which formed the gravamen of the Receiver's Complaint were discovered and litigated—the law is that tolling is appropriate where control prevents discovery of facts sufficient to seek redress, not where it does not.¹⁰⁹

The Receiver, in his opening appellate brief, argued he should be deemed to be like an "infant," unable to discover facts that would allow him to timely sue to vindicate the CVTT shareholders' rights, a

¹⁰⁶ 2017 WL 6940515 (C.D. Cal. Aug. 28, 2017). In citing *Damian*, the Receiver relied on a non-binding, inapposite authority. Towards the end of the *Damian* decision, just prior to the conclusion, the following statement appears in bold: "This Order is not intended for publication. Nor is it intended to be included in or submitted to any online service such as Westlaw or Lexis." *Id.* Nonetheless, District Judge Carney's dismissal of the Receiver's Complaint did address the Receiver's reliance on *Damian* stating:

Plaintiff's reliance on *Damian v. A-Mark Precious Metals, Inc.*, is misplaced. In *Damian*, the court found that the two directors controlled the receivership entities, which precluded the possibility of an action against them until the receiver was appointed. However, the court in *Damian* did not engage in any analysis regarding whether the facts of the alleged fraudulent transfer and fraud claims were discoverable prior to the receiver's appointment, nor were there facts in the record suggesting that those claims were previously discoverable.

Seiden v. Frazer Frost, LLP, No. SACV 18-00588-CJC (KESx), 2018 WL 6137618 at *7 n.9 (C.D. Cal. July 31, 2018) (internal citations omitted).

¹⁰⁷ *Damian*, 2017 WL 6940515 at *8, (quoting *Smith v. Superior Ct.*, 266 Cal. Rptr. 253, 255 (Cal. Ct. App. 1990) and citing *San Leandro Canning Co.*, 295 P. at 1028. (emphasis added) (internal quotations omitted)).

¹⁰⁸ See Plaintiff's Opposition to Defendants' Motion to Dismiss, *supra* note 7, at 6, 16.

¹⁰⁹ See generally *Beal v. Smith*, 189 P. 341, 345 (Cal. Dist. Ct. App. 1920) (adverse domination does not toll limitations "against an innocent stockholder who was without knowledge of the fraud.") (citing *Whitten*, 154 P. 312) (emphasis added); *Pour Roy v. Gardner*, 10 P. 2d 815, 819 (Cal. Dist. Ct. App. 1932) (emphasis added) ("[W]here the circumstances are such as to put a person of ordinary intelligence and prudence on inquiry, or where there are gross laches in not making any effort to discover the real facts which might have been discovered by the use of slight diligence, the statute of limitations cannot be avoided, and the knowledge which thus might have been obtained is imputed as of the time of the commission of the fraud.").

form of “incapacity.”¹¹⁰ Unlike an infant who cannot bring an action to protect his or a company’s rights, however, the Defense argued the Receiver was appointed *after* the shareholders had already learned of the wrongdoing and after five cases litigated the facts. The Defense argued, moreover, that whereas the “minority” of an infant reasonably justifies tolling so the infant, upon reaching majority, can make a reasoned decision whether to bring an action, no comparable “disability” should save the Receiver’s claims.¹¹¹ Unlike an infant, with neither knowledge or ability to sue to protect his rights, CVTI shareholders had both knowledge and ability—and they sued.¹¹² The Doctrine had been held inapplicable where a stockholder did discover the fraud,¹¹³ and that rule, the Defense argued, was wholly consistent with applicable discovery rules:

Under the [California] discovery rule, the statute of limitations begins to run when the plaintiff suspects or should suspect that her injury was caused by wrongdoing and that someone has done something wrong to her A plaintiff need not be aware of the specific facts necessary to establish the claim; that is a process contemplated by pretrial discovery So long

¹¹⁰ See Appellant’s Opening Brief, *supra* note 46, at 25-27.

¹¹¹ See Appellee’s Answering Brief, *supra* note 46, at 14-15.

¹¹² The Receiver relied on *Goldberg v. Berry*, 247 N.Y.S. 69, 75 (N.Y. App. Div. 1930) to support his assertion that knowledge should not defeat Doctrine-based tolling but, in *Goldberg*, the court held the knowledge of one shareholder did not trigger the limitation period running as to shareholders who lacked that knowledge so persons unaware of a claim (due to domination) would not be compromised by the fact that one person with knowledge could have sued but chose not to do so, for his own reasons. The Receiver also cited *Allen v. Wilkerson*, 396 S.W.2d 493, 501-02 (Tex. Civ. App. 1965) for the proposition that notice to shareholders does not start the limitation period running but, in *Allen*, one shareholder knew of the wrongdoing and could have brought a derivative suit. The court held one shareholder’s knowledge and decision not to sue should not prejudice other shareholders, lacking such knowledge. *Id.* *Allen*, notably, relied on *Goldberg* and *Whitten*, both involving situations where one shareholder had knowledge, but others did not, and courts ruling knowledge of one shareholder should not compromise the rights of other shareholders, lacking such knowledge. *Id.*

¹¹³ See *Burt v. Irvine Co.*, 47 Cal. Rptr. 392, 417 (Cal. Dist. Ct. App. 1965) (“[I]t is generally held that an action for fraud committed against a corporation is tolled for the period that those responsible for the fraud remain in control of the corporation. The principle does not apply after discovery of the fraud by a protesting stockholder . . .”).

as a suspicion exists, it is clear that a plaintiff must go find the facts; she cannot wait for the facts to find her.¹¹⁴

The Receiver argued, as he did in the trial court: “To the extent necessary, the Receiver asserts the doctrine of equitable tolling in this matter . . .” and that “the domination of CVVT by the executives who committed the bad acts with Defendants made discovery of the bad acts by the Receiver impossible until sometime after the appointment of the Receiver and the removal of the bad actors.”¹¹⁵ The Defense responded there should be no equitable tolling because the Receiver failed to plead facts which, if proved, supported his theory.¹¹⁶

Citing *Allen v. Ramsay*, the court explained:

A receiver occupies no better position than that which was occupied by the person or party for whom he acts and the receiver takes the property and the rights of one for whom he was appointed in the same condition and subject to the same equities as existed before his appointment and any defense good against the original party is good against the receiver.¹¹⁷

In language particularly apposite, the court explained:

The *showing of excuse for late filing must be made in the complaint*. Formal averments or general conclusions to the effect that the facts were not discovered until a stated date, and that the plaintiff could not reasonably have made an earlier discovery, are useless. The complaint must set forth specifically (1) *the facts of the time and manner of discovery*; and (2) *the circumstances which excuse the failure to have made an earlier discovery*.¹¹⁸

¹¹⁴ *Apple Valley Unified Sch. Dist. v. Vavrinek, Trine, Day & Co.*, 120 Cal. Rptr. 2d 629, 635 (Cal. Ct. App. 2002) (quoting *Jolly v. Eli Lilly & Co.*, 751 P.2d 923, 927-28 (Cal. 1998)). The defense noted other courts reached similar conclusions, citing *In re Marvel Ent. Grp., Inc.*, 273 B.R. 58, 75 (D. Del. 2002) (holding that the Doctrine is essentially a corollary of the discovery rule—under the Doctrine—“the statute of limitations is allowed to run once someone has sufficient knowledge and ability to seek redress on the corporation's behalf.”).

¹¹⁵ Receiver's Complaint, *supra* note 5, at 6.

¹¹⁶ *See Mills v. Forestex Co.*, 134 Cal. Rptr. 2d 273, 286-87 (Cal Ct. App. 2003).

¹¹⁷ *Allen v. Ramsay*, 4 Cal. Rptr. 575, 583 (Cal. Dist. Ct. App. 1960).

¹¹⁸ *Id.* at 581.

The Complaint alleged no such circumstances or excuse,¹¹⁹ just that CVTI was dominated and the Receiver alleging that this, in itself, entitled him to equitable tolling. He disregarded the rest of the rule, limiting Doctrine-based tolling to cases where defrauding party control was not negated by the possibility an informed and motivated shareholder or director could seek redress.¹²⁰

The Ninth Circuit began by observing the Receiver's case turned on Doctrine interpretation which, as the trial court held, requires a showing of such substantial control by corrupt insiders that discovery of their wrongdoing is made impossible.¹²¹ It noted that the Ninth

¹¹⁹ In *Denholm v. Houghton Mifflin Co.*, 912 F.2d 357, 362 (9th Cir. 1990), the Ninth Circuit held that: “[t]o obtain the benefit of the late-discovery exception to the statute of limitations, the *complaint* must allege facts showing that the cause of action could not with reasonable diligence have been discovered prior to three years before the suit.” To access adverse domination tolling, plaintiff must “show full, complete and exclusive control in the directors or officers charged”—and they can do so in just one way, namely, by “effectively negat[ing] the possibility that an informed stockholder or director could have induced the corporation to sue.” *Mosesian v. Peat, Marwick, Mitchell & Co.*, 727 F.2d 873, 879 (9th Cir. 1984). The Receiver, in his reply brief, euphemistically referred to the facts he pleaded as “similar” facts. *See* Appellant’s Opening Brief, *supra* note 46, at 8-9. But reading the paragraphs containing the same factual allegations, side by side, revealed that he had just parroted allegations from the pleadings of earlier filed class, derivative and SEC complaints. Appellee’s Supplemental Excerpts of the Record at Ex. A, Supp. ER 007-10, *Seiden v. Frazer Frost, LLP*, 796 Fed. Appx. 381 (9th Cir. 2020) (No. 18-56176).

¹²⁰ The Receiver argued that because his claims were neither “class claims” nor “derivative claims,” his claims, despite being based on the same facts, were not brought previously, *see* Appellant’s Opening Brief, *supra* note 46, at 9-11, and that he should be able to now bring his claims, even though they were previously interposed as the substantive predicate of at least five litigated complaints. *See* Notice of Motion and Motion to Dismiss Complaint at Ex. A to Declaration of Lawrence A. Steckman, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. June 8, 2018), ECF No. 23, Attach. No. 2. The Auditors argued that no case has held that the adverse domination doctrine mandates that suit be brought in any particular form, e.g., a private, class or derivative pleading but, rather, only that facts sufficient to allow “redress” to be sought by a person with an incentive and ability to seek to remedy for damage the adverse domination has caused. *Id.* The Defense further argued that the shareholders, in their previous class suit, could have sued for common law fraud, aiding and abetting a fiduciary breach and contract breach, the latter, potentially, as a third-party beneficiary of the subject written engagements, as well as on theories of negligence and gross negligence—they could and did seek “redress” based on the same facts as those upon which the Receiver’s claims were based. *Id.*

¹²¹ *Seiden v. Frazer Frost, LLP*, 796 Fed. App’x 381, 382 (9th Cir. 2020) (citing *Smith v. Superior Court*, 266 Cal. Rptr. 253, 255 (Cal Ct. App. 1990); Admiralty

Circuit had previously held Doctrine-based tolling was unavailable where discovery of the alleged bad acts was possible, notwithstanding control by the wrongdoers.¹²² The Defense had cited *California Union Insurance Co. v. American Diversified Savings Bank*,¹²³ a Ninth Circuit case interpreting the Doctrine under California law, which the Receiver argued was wrongly decided in light of (his interpretation of) *Whitten*,¹²⁴ but the Receiver's argument was rejected on procedural and interpretive grounds:

Seiden argues that *California Union* was wrongly decided because it failed to follow *Whitten v. Dabney*, 154 P. 312 (Cal. 1915), which he claims stands for the proposition that equitable tolling under the doctrine of adverse domination applies whenever a corporation is controlled by corrupt insiders. This argument fails for two reasons. First, even if we agreed with Seiden, a three-judge panel of this court is not at liberty to overrule *California Union*'s construction of California law. Second, we disagree that there is any tension between *Whitten* and *California Union*'s interpretation of the adverse domination doctrine. In *Whitten*, certain shareholders and directors conspired to defraud the corporation they controlled, and "sedulously

Fund v. Peerless Ins. Co., 191 Cal. Rptr. 753, 758–59 (Ct. Ct. App. 1983); Burt v. Irvine Co., 47 Cal. Rptr. 392, 417 (Cal. Dist. Ct. App. 1965)).

¹²² Cal. Union Ins. Co. v. Am. Diversified Savings Bank, 948 F.2d 556, 565–66 (9th Cir. 1991).

¹²³ 948 F.2d 556 (9th Cir. 1991).

¹²⁴ *Whitten v. Dabney*, 154 P. 312 (Cal. 1915). California federal courts have interpreted and applied the Doctrine in the same manner as California's state courts. The Defense explained in its brief "[t]o exploit Doctrine tolling, the party bringing suit must have been unable to discover the wrongdoing and, so, been unable to seek redress to remedy adverse effects of domination." Appellee's Answering Brief, *supra* note 46, at 22. See *Cal. Union Ins. Co.*, 948 F.2d at 565 (noting this Doctrine "may be appropriate in situations where there is such domination and control as to preclude non-wrongdoing employees from discovery") (emphasis added); *Mosesian*, 727 F.2d at 879 (holding that to establish equitable tolling under the adverse domination doctrine, a receiver must establish both: (1) exclusive control and domination by corrupt directors and (2) *the inability of other shareholders or employees to discover the wrongdoing of the directors*) (emphasis added); *In re Marvel Ent. Grp., Inc.*, 273 B.R. 58, 75 (D. Del. 2002) (under the Doctrine—"[T]he statute of limitations is allowed to run once someone has sufficient knowledge and ability to seek redress on the corporation's behalf.").

concealed” their self-dealing from innocent shareholders. 154 P. at 315. On these facts, the California Supreme Court held that director malfeasance tolled the statute of limitations for an innocent shareholder’s claim, filed promptly after that shareholder’s discovery of the wrongdoing. *Id.* at 314–16. That is perfectly consistent with *California Union*.¹²⁵

The Ninth Circuit then turned specifically to the facts before it, explaining and holding:

[U]ncontroverted evidence demonstrates that, well within the statute of limitations, CVVT’s shareholders discovered or should have discovered the wrongdoing Seiden alleges. Specifically, in 2011, the same year a Citron Research report publicized CVVT’s alleged wrongdoing, shareholders sought redress in a class-action lawsuit against both CVVT and Frazer Frost, as well as a derivative lawsuit against CVVT. In 2014, the SEC filed a fraud action against CVVT. As the district court observed, “[t]he SEC had the ability to uncover the facts relevant to Plaintiff’s causes of actions and make them public.” *Seiden v. Frazer Frost, LLP*, No. 8:18-00588-CJC (KESx), 2018 WL 6137618, at *6 (C.D. Cal. July 31, 2018). Indeed, all of these actions implicated Frazer Frost in the wrongdoing Seiden now alleges. Accordingly, the district court properly held that adverse domination did not toll Seiden’s claims. *Cf. Mosesian v. Peat, Marwick, Mitchell & Co.*, 727 F.2d 873, 876–79 (9th Cir. 1984).¹²⁶

¹²⁵ *Seiden v. Frazer Frost, LLP*, 796 Fed. App’x 381, 382 (9th Cir. 2020). *See Cal. Union Ins. Co.*, 948 F.2d at 565 (holding that the Doctrine “may be appropriate in situations where there is such domination and control as to preclude non-wrongdoing employees from discovery.”) (emphasis added). The Doctrine, however, has never been held to resuscitate stale claims where knowledge is sufficient to allow a party with incentive to seek “redress” to do so. *Seiden*, 796 Fed. App’x at 382-83.

¹²⁶ *Seiden*, 796 Fed. App’x at 383. In *Mosesian*, the Ninth Circuit held that to establish equitable tolling under the adverse domination doctrine, a receiver must establish both: (1) exclusive control and domination by corrupt directors and (2) *the inability of other shareholders or employees to discover the wrongdoing of the directors*). 727 F.2d 873, 879 (9th Cir. 1984). The Receiver relied heavily on

Turning to the Receiver's *in pari delicto* argument, the Ninth Circuit explained and held:

The district court also properly held that CVVT shareholders were able to seek redress for the wrongdoing Seiden alleges here. Seiden argues that notwithstanding Frazer Frost's wrongdoing, shareholders had no ability to sue Frazer Frost prior to his appointment as Receiver because Frazer Frost would have had an ironclad *in pari delicto* defense. *Seiden is incorrect. Even if Frazer Frost had a plausible in pari delicto defense against derivative claims brought by CVVT shareholders, defenses—hypothetical or otherwise—do not toll otherwise applicable statutes of limitations.* The district court correctly determined that Seiden's failure to plead adverse domination could not be cured by any amendment.¹²⁷

Had derivative claims against the Auditors been barred by the *in pari delicto* doctrine, it would have resulted in a windfall to the (alleged) wrongdoing auditor which would have created a gross injustice, contrary to the policies underlying the equitable *in pari delicto* doctrine. Preventing shareholders in a derivative action from recovering from a third-party due to the wrongdoing of directors in cahoots with the third party would have been a miscarriage of justice.

IV. KIRSCHNER V. KPMG: APPLICABILITY OF THE *IN PARI DELICTO* DEFENSE TO A SHAREHOLDER DERIVATIVE ACTION

Rosenfeld v. Zimmer, 254 P.2d 137, 138-40 (Cal Dist. Ct. App. 1953), which involved a fraudulent transaction in which the plaintiff shareholders, Victor and Morris Rosenfeld, had unclean hands, along with defendant corporation Euclid Properties, Inc., which falsified loan documents to obtain funds to repay loans made by the Rosenfeld plaintiffs and another shareholder (Mrs. Coren). *Rosenfeld* did not involve adverse domination, but, rather, a fraudulent scheme involving the shareholders, themselves, who were bringing the derivative action. *Id.* (“[C]ause of action was barred by the doctrine of unclean hands of plaintiffs [Victor and Morris Rosenfeld] and defendant Euclid, the corporation on whose behalf plaintiffs instituted the present action . . . [s]ince the evidence disclosed that plaintiffs and defendant Euclid had intended to and actually did misrepresent the facts to the Massachusetts Mutual Life Insurance Company in obtaining a loan from it, by which they hoped to benefit, they came into a court of equity with unclean hands.”).

¹²⁷ *Seiden*, 796 F. App'x at 383 (emphasis added).

FILED AGAINST AN OUTSIDE AUDITOR

Interpretation of the adverse domination doctrine urged by the Receiver, were it adopted, would allow for and encourage collusion between a receiver and shareholders who failed to act within the limitations period, for their own purposes. Shareholders with actual knowledge of wrongdoing and the motivation to seek redress could elide the statute of limitations by seeking appointment of a receiver who could litigate claims, about which the shareholders knew, but failed to act, notwithstanding all the policies underlying why limitation periods exist,¹²⁸ and regardless of how stale the claims had become. This is not the law and never has been the law, as the trial and Ninth Circuit decisions in *Seiden* make clear.

Apparently recognizing this, the Receiver fell back on the argument that a shareholder's derivative action against the Auditors would not have been brought because the shareholders would have

¹²⁸ Katharine F. Nelson, *The 1990 Federal "Fallback" Statute of Limitations: Limitations by Default*, 72 NEB. L. REV. 454, 464-66 (1993) (quoting *Agency Holding Corp. v. Malley-Duff & Assocs., Inc.*, 483 U.S. 143, 156 (1987)) ("Statutes of limitations are designed to protect defendants by giving them repose. Defendants do not have to live their entire lives fearing that they will be sued for past deeds. As a result, time-bars help stabilize commercial and property transactions. With a known period of liability, defendants can arrange their personal and commercial lives accordingly. They can also collect and preserve evidence against the possibility of suit while the evidence is fresh. Moreover, time-bars protect defendants from unfair surprise and the prejudice of having to defend themselves years after the claim arose when the evidence and witnesses may be scarce or lost. Statutes of limitations thus force plaintiffs to assert their claims in a timely fashion when the evidence and witnesses' memories are fresh. Periods of limitations also assist the courts, and thus society, by preserving resources and promoting the legitimacy of the judicial process. They play a major role in reducing the courts' crowded dockets by deterring litigants from filing most time-barred claims. Untimely claims that are filed can usually be dismissed in a pretrial motion. As a result, the courts do not have to waste valuable time and resources litigating stale claims. More importantly, statutes of limitations promote accuracy and fairness. Through time-bars the courts avoid dealing with unreliable witnesses and stale, or even false, evidence. Discussing the policies underlying statutes of limitations, the Supreme Court has said: 'A federal cause of action "brought at any distance of time" would be "utterly repugnant to the genius of our laws." Just determinations of fact cannot be made when, because of the passage of time, the memories of witnesses have faded, or evidence is lost. In compelling circumstances, even wrongdoers are entitled to assume that their sins may be forgotten.' Finally, to the extent that the public perceives that time-bars prevent frivolous claims and promote accuracy, they also help preserve the public's perception of the courts' legitimacy.").

known they would have lost and, therefore, that knowledge would have negated their motivation to seek derivative suit redress. Per the Receiver's argument, CVTI shareholders' potential knowledge of the wrongdoing by the controlling directors (and the alleged parallel wrongdoing of the Auditors) should not terminate the tolling of the limitations period because, in their view, a successful shareholder's derivative action was never feasible.¹²⁹

Both Judge Carney and the Ninth Circuit rejected the Receiver's argument. Judge Carney found that the Receiver's theory that the Auditors could dismiss an derivative action based on *in pari delicto* was speculative and contrary to good policy—after all, in that context, the Auditors, who allegedly aided and abetted the fraud, would be able to escape liability for claims brought, albeit derivatively, by the victims of the fraud, namely the shareholders.¹³⁰ Judge Carney did not definitively determine that an *in pari delicto* defense in a derivative action brought against the auditors would have failed. Rather, he found the Receiver's assertions “too speculative to assume that the defense of *in pari delicto* would apply to CVVT's shareholders. . . . [And therefore, determination of the viability of an *in pari delicto* defense] would essentially require a mini-trial on the merits of *another litigation*, before the Court could address the merits of this action.”¹³¹

In other contexts, such as a legal malpractice actions, for example, a court necessarily does engage in what amounts to a mini-trial or a case-within-a case to resolve an essential claim element, i.e., whether an attorney's negligence was the “but for” cause of a plaintiff's injury or loss. However, an important distinction between the CVVT litigation and a malpractice action exists. The mini-trial in which Judge Carney refused to engage would not have resolved an essential element of the Receiver's claims -- only whether the Receiver

¹²⁹ The Receiver also asserted that the prior (dismissed) securities class action lawsuits (which the defense established were based on the same gravamen of facts), were of no moment. *See* Appellant's Opening Brief, *supra* note 46, at 10-11. He urged that because they were brought by shareholders, in their individual capacities, rather than derivatively on CVTI's behalf, they were really *different claims*. *Id.* The defense responded that the issue was not whether they were nominated “class” or “derivative” but whether the factual predicate underlying the claims, however nominated, was the same. *See* Appellee's Answering Brief, *supra* note 46, at 16-20.

¹³⁰ *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx), 2018 WL 6137618, at *8-9 (C.D. Cal. July 31, 2018).

¹³¹ *Id.* at *8-9.

could assert those claims. This determination, as Judge Carney noted, would have been necessary to resolve “*before* the Court could address the merits of this action.”¹³² The Ninth Circuit agreed with Judge Carney, stating that even if the auditors had a plausible *in pari delicto* defense against derivative claims brought by CVVT shareholders, defenses, hypothetical or otherwise do not toll otherwise applicable statutes of limitations.¹³³

The Receiver, seeking a rehearing *en banc*, asserted that he should be granted “a panel rehearing of this case to properly consider the role that *in pari delicto* played in the Receiver’s argument, as well as how it showed the shareholders, even with knowledge, had no ability to bring their derivative claims”¹³⁴ The Ninth Circuit denied the Receiver’s Petition for a rehearing in a unanimous 3-0 decision.¹³⁵ Neither the Ninth Circuit nor the trial judge resolved whether the Receiver’s assertion that the Auditors would have been able to successfully assert an *in pari delicto* defense to any shareholder derivative claims. The Receiver’s assertions were deemed so speculative and attenuated, as to not warrant a mini-trial to determine whether the Court should address the pleading merits.¹³⁶ It held the Receiver’s allegations were insufficient to warrant tolling of the otherwise applicable statute of limitations.¹³⁷

The *Seiden* trial and appeal courts refused to assess the likelihood that the Receiver might have prevailed on his hypothetical *in pari delicto* defense, to try to avoid a limitations dismissal. However, in other contexts, courts have evaluated hypothetical *in pari delicto* defenses with, as commentators have observed, varying and inconsistent results.¹³⁸

The issue of whether an accountant can be liable to his own client, in negligence, or contract for failure to perform his obligations with the implied obligation of due care frequently arises. Bankruptcy trustees, receivers or other persons who step into the client’s shoes, including, for example, the FDIC or SIPC, often aggressively assert claims. The theory frequently proffered is that, but for the accountant’s

¹³² *Id.* at *9.

¹³³ *Seiden v. Frazer Frost, LLP*, 796 F. App’x 381, 383 (9th Cir. 2020).

¹³⁴ Plaintiff-Appellant’s Petition for Panel Rehearing or Rehearing *En Banc* at 11, *Seiden v. Frazer Frost, LLP*, 796 Fed. App’x 381 (9th Cir. 2020) (No. 18-561767).

¹³⁵ *Seiden v. Frazer Frost, LLP*, 2020 U.S. App. LEXIS 4005 (9th Cir. Feb. 10, 2020).

¹³⁶ *Seiden*, 2018 WL 6137618, at *9.

¹³⁷ *Seiden*, 796 F. App’x at 383.

¹³⁸ Swanson, *supra* note 6, at 44-48.

negligence, the company would not have become insolvent, and the accountant's negligence, therefore, was the cause of (or contributed to) the company's downfall.¹³⁹ This commonly asserted theory was propounded aggressively by the Receiver in support of CVTI's claims against its auditors.¹⁴⁰ In such cases, where a corporation or a third-party who has stepped into the corporation's shoes sues an auditor, the auditor will often argue that its alleged negligence or fraud was the result of the corporation's (or company officer's) fraud, thus giving rise to an *in pari delicto* defense.¹⁴¹

In *Kirschner v. KPMG LLP*,¹⁴² the New York Court of Appeals held that the *in pari delicto* doctrine would bar a shareholder derivative action, filed under New York law, against an outside auditor sued for professional malpractice or negligence based on the auditor's failure to detect a corporation fraud.¹⁴³ The Receiver did not cite *Kirschner* before either the California District Court or the Ninth Circuit Court of Appeals in support of his assertion that a shareholder derivative action against the Auditors would have been futile due to the Auditors' ability to raise the *in pari delicto* defense.¹⁴⁴ It is not clear whether the Receiver's failure to cite *Kirschner* was an oversight, or whether it was intentional. *Kirschner* suggests that acceptance of the *in pari delicto* defense under the circumstances of that case was actually contingent on the absence of adverse domination. *Kirschner* involved certification of questions to the New York Court of Appeals from the Second Circuit and Delaware Supreme Court. The question from Delaware was:

Would the doctrine of *in pari delicto* bar a derivative claim under New York law where a corporation sues its outside auditor for professional malpractice or

¹³⁹ *Id.* at 44.

¹⁴⁰ See Receiver's Complaint, *supra* note 5, at 13-15.

¹⁴¹ Swanson, *supra* note 6, at 44-45.

¹⁴² 938 N.E.2d 941 (N.Y. 2010).

¹⁴³ *Id.* at 945.

¹⁴⁴ As set forth above, CVTI's shareholders did file a shareholder derivative action against the corporation for the same activities that were the subject of the *Seiden* litigation. The shareholders, however, did not seek relief against the auditors in the derivative action, which was eventually voluntarily dismissed, without prejudice and without explanation. See Notice of Motion and Motion to Dismiss Complaint at Exs. J-K to Declaration of Lawrence A. Steckman, *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx) (C.D. Cal. June 8, 2018), ECF No. 23, Attach. Nos. 11-12.

negligence based on the auditor's failure to detect fraud committed by the corporation; and, the outside auditor did not knowingly participate in the corporation's fraud, but instead, failed to satisfy professional standards in its audits of the corporation's financial statements?¹⁴⁵

The question the Delaware Supreme Court certified was answered in the affirmative.¹⁴⁶

The New York Court of Appeals would have applied the *in pari delicto* doctrine, but with a caveat that: “the certified question should be answered ‘Yes,’ *assuming the adverse interest exception does not apply.*”¹⁴⁷ The adverse interest exception, as interpreted by *Kirschner*, applies to situations in which the agent or adverse actor has “*totally abandoned* his principal's interests and [was] acting entirely for his own or another's purpose.”¹⁴⁸ The reason that the Court of Appeals added this caveat is because it chose to apply general principles of agency which normally bind a principal to its agent's actions intended to benefit a company. The Court of Appeals held that “[t]o allow a corporation to avoid the consequences of corporate acts simply because an employee performed them with his personal profit in mind would enable the corporation to disclaim, at its convenience, virtually every act its officers undertake.”¹⁴⁹ Therefore, under New York law, even if a corporate officer's actions have an ultimate adverse impact on the corporation, if the officer's initial intent was to benefit the corporation, the adverse interest doctrine will not apply.¹⁵⁰

¹⁴⁵ *Kirschner*, 938 N.E.2d at 949 (emphasis omitted).

¹⁴⁶ *Id.* at 945.

¹⁴⁷ *Id.* at 959 (emphasis added).

¹⁴⁸ *Id.* at 952.

¹⁴⁹ *Id.*

¹⁵⁰ While many courts have considered auditor liability in this context, approaches to the issue are varied. Some courts, such as the *Kirschner* court, have followed *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir. 1982), relying on tort-liability objectives. These courts impute the corporate officers' fraud to the corporation if the fraud led to any short-term benefit and, relying on this imputation, preclude claims against a corporation's auditor. Other courts have focused primarily on agency law principle, precluding a collusive auditor—but not a negligent auditor—from raising an *in pari delicto* defense. See Shepard, *supra* note 4, at 317. Because a third party who does not deal with a principal in good faith has no basis in agency law to invoke imputation, so the argument goes, it has no basis to benefit from an *in pari delicto* defense. Still other courts have used a combination of both these approaches or have simply held that, as a policy matter, auditors may not invoke imputation. See *id.*

Had the Receiver relied on *Kirschner* and had the California courts followed the principles it enunciated; he would have been placed in a box from which he could not have escaped. For the Receiver to establish the availability of an *in pari delicto* defense, he would have had to negate the CVTI shareholders' ability and motivation to seek derivative relief against the Auditors—in other words, he would also have had to establish there was no adverse domination by the officers who committed the fraud. This would have undermined his argument for tolling the limitation period which was premised on his allegation that CVTI had been adversely dominated so that the alleged fraud could not have been discovered until after his appointment. He would have had to negate his entire rationale for tolling, namely, adverse domination.

Auditors are frequently sued for failing to detect the fraud of corporate officers. Such suits can be brought as shareholder derivative actions, or by Bankruptcy Trustees or by court-appointed Receivers and, as commentators have explained:

The auditor in this scenario has a powerful defense in its corner: *in pari delicto*. Under accepted agency principles, the knowledge of a corporate officer is imputed to the corporation and the corporation is deemed to have that knowledge. Likewise, imputation makes the corporation legally responsible for an officer's fraud. The officer's fraud is, in law, the corporation's fraud which makes the corporation a wrongdoer in front of the court. The defense of *in pari delicto* prevents a wrongdoer from seeking redress against another alleged wrongdoer. Because the corporation's creditors or shareholders bring their claim on behalf of the corporation, they “step into the shoes” of the corporation and any defense that can be asserted against the corporation may be asserted against them. In the corporate fraud context, then, these doctrines work together to immunize auditors from liability.¹⁵¹

In the *Seiden* litigation, resolution of the statute of limitations issue on the pleadings was possible because multiple litigations, including class and derivative litigations, had been filed, including class claims against the Auditors, and they were resolved within the

¹⁵¹ Shepard, *supra* note 4, at 277-78.

statute of limitations and the Receiver's claims arose from the same gravamen of operative fact. This obviated the need to determine whether the auditors could have raised an *in pari delicto* defense if a derivative claim had been filed against them because they had the opportunity to seek redress for the same violations and pursued redress. The *in pari delicto* defense would *not* have been available to the Auditors against the Receiver, if he had been allowed to proceed with his claims, because the Ninth Circuit has held the *in pari delicto* defense is not available as a defense to claims brought by a receiver appointed to take over the affairs of an adversely dominated corporation.¹⁵²

However, the question the Receiver raised was whether the *in pari delicto* defense would have been available to the Auditors in a shareholder derivative action and, if so, would that possibility have negated shareholder motivation to bring such an action, allowing the Receiver to bring an action, otherwise untimely, for lack of the shareholders' "incentive" to sue.¹⁵³ Had the rule in *Kirschner* been followed, the *in pari delicto* defense would have been available to the Auditors—but only if adverse domination was not present. The possibility of availability of an *in pari delicto* defense in a (hypothetical) shareholders derivative suit would have required a fact-sensitive determination.¹⁵⁴

¹⁵² See generally *Fed. Deposit Ins. Corp. v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir. 1995) (finding that defenses based on unclean hands or inequitable conduct do not generally apply against a party's receiver because the receiver does not step into the party's shoes but "is thrust into those shoes").

¹⁵³ See Appellant's Opening Brief, *supra* note 46, at 17, 29-33.

¹⁵⁴ See Swanson, *supra* note 6, at 46.

It is clear that there is substantial confusion in this area of the law and that judges continue to struggle with *in pari delicto* and other "*Cenco*"-type defenses. When such a defense is rejected, and the suit is allowed, the theory of damages is generally one of "deepening insolvency," i.e., that had the fraud been uncovered earlier, the company at a minimum would have been much less deeply insolvent, owing less to its creditors. Even this theory has generated controversy and confusion. For example, the Third Circuit recently held there was a cause of action for "deepening insolvency" in favor of a bankruptcy trustee when the underlying challenged conduct was fraudulent (as opposed to merely negligent). But the Delaware Chancery Court rejected that view, concluding, instead, that "deepening insolvency" was not an independent cause of action, but merely a theory of damages when there was another available liability theory.

Id. (citations omitted).

V. CONCLUSION

In *Seiden*, the Receiver relied heavily on *Federal Deposit Insurance Corp. v. O'Melveny & Myers*,¹⁵⁵ for the proposition that defenses based on unclean hands or inequitable conduct do not generally apply against a receiver.¹⁵⁶ Court appointed receivers have often been treated differently from trustees in bankruptcy in this regard. United States courts have generally interpreted Bankruptcy Code section 541 as limiting a trustee's rights to those of the corporation as they existed at the time the bankruptcy proceeding commenced. Accordingly, a bankruptcy trustee -- unlike a court appointed receiver -- may be subject to any *in pari delicto* defense that could have been asserted against the bankrupt corporation.¹⁵⁷

O'Melveny has been cited with approval by courts in several circuits, including the Second Circuit.¹⁵⁸ The Second Circuit itself has approved of the principles articulated in *O'Melveny* allowing a receiver to pursue fraudulent conveyance claims on behalf of a

¹⁵⁵ 61 F.3d 17, 19 (9th Cir. 1995).

¹⁵⁶ See Shepard, *supra* note 4, at 316-17. Courts often rely on policy and fairness arguments to conclude that auditors should not be immune from liability.

¹⁵⁷ Buchheit & Gulati, *supra* note 6, at 1257.

In the case of a trustee in bankruptcy, U.S. courts have generally interpreted section 541 of the Bankruptcy Code to limit a trustee's rights to those of the corporation as they existed at the time of the commencement of the bankruptcy proceeding. Accordingly, if the bankrupt corporation had participated in the wrongdoing, it would on the date of commencement of the bankruptcy have been disabled from pursuing claims against confederate wrongdoers on *in pari delicto* grounds. The trustee, stepping into those shoes, suffers that same disability. Court-appointed receivers, however, are a different matter. Receivers are not limited by section 541 of the Bankruptcy Code, and in pursuing claims of the corporation against other wrongdoers, receivers are generally not hampered by the *in pari delicto* defenses raised by those third parties.

Id.

¹⁵⁸ See *Adelphia Comms. Corp. v. Bank of Am., N.A.*, 365 B.R. 24, 56 (Bankr. S.D.N.Y. 2007) ("With the guilty insiders having been displaced before the filing date, there is not even an arguable statutory or caselaw basis upon which to ignore the fairness considerations articulated in . . . *O'Melveny*"); see also *Colonial BancGroup, Inc. v. PricewaterhouseCoopers LLP*, No. 2:11-cv-746-BJR, 2017 U.S. Dist. LEXIS 175086, at *18 (M.D. Ala. Aug. 18, 2017); *Evans v. Armenta*, No. 14-329-GFVT, 2016 U.S. Dist. LEXIS 194540, at *7 (E.D. Ky. Jan. 26, 2016); *Javitch v. Transamerica Occidental Life Ins. Co.*, 408 F. Supp. 2d 531, 537 (N.D. Ohio 2006); *In re NJ Affordable Homes Corp.*, No. 05-60442 (DHS), 2013 Bankr. LEXIS 4798, at *110-11 (Bankr. D.N.J. Nov. 8, 2013).

corporation which had been adversely dominated.¹⁵⁹ Unless statutory requirements, such as Bankruptcy Code section 541 compel otherwise, principles of fairness should be the main determinant of whether an *in pari delicto* defense is applicable, as well as whether the limitation period should be tolled because of adverse domination.¹⁶⁰ The Ninth Circuit affirmed Judge Carney's decision¹⁶¹ and, with respect to the *in pari delicto* issue held, without citing case authority, that: "even if [the auditors] had a plausible *in pari delicto* defense against derivative claims brought by CVVT shareholders, defenses—hypothetical or otherwise—do not toll otherwise applicable statutes of limitations."¹⁶² The dissent in *Kirschner* explained that innocent shareholders bringing derivative actions should be afforded even greater protection and that "the weight of the equities favors allowing suits such as these to go forward to deter active wrongdoing or negligence by auditors and similar professionals."¹⁶³ The dissent seems to be articulating similar

¹⁵⁹ *Eberhard v. Marcu*, 530 F.3d 122, 132 (2d Cir. 2008) (citing and quoting *Scholes v. Lehmann*, 56 F.3d 750, 754 (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 . . . that Douglas had made the corporations divert to unauthorized purposes.").

¹⁶⁰ *O'Melveny* articulated an exception to the general rule that "[a] receiver occupies no better position than that which was occupied by the person or party for whom he acts . . . and any defense good against the original party is good against the receiver." 61 F.3d at 19 (quoting *Allen v. Ramsay*, 4 Cal. Rptr. 575, 583 (Cal. Dist. Ct. App. 1960)). That exception applied to the inapplicability of an *in pari delicto* defense. It did not allow a receiver to revive an already expired statute of limitations. In *Seiden*, the California District Court and the Ninth Circuit applied fairness principles, consistent with California case law, holding the limitation period should not be equitably tolled, on the grounds of adverse domination, because CVTI shareholders learned of the alleged wrongdoing of the corporate directors and had the opportunity and motivation to seek redress. See *Seiden v. Frazer Frost, LLP*, No. SACV 18-00588-CJC (KESx), at 12, 2018 WL 6137618, at *6 (C.D. Cal. July 31, 2018), ECF No. 32; *Seiden v. Frazer Frost, LLP*, 796 F. App'x 381, 383 (9th Cir. 2020).

¹⁶¹ In the absence of any directly applicable California law on the issue of whether an *in pari delicto* defense would have been applicable to a shareholder derivative action brought by CVTI's shareholders, District Judge Carney applied principles of fairness and common sense to conclude that it was unlikely that the Auditors could successfully invoke an *in pari delicto* defense against a derivative action filed in behalf of CVTI by innocent shareholders who, themselves, were allegedly victims of the fraud perpetrated by the wrongdoing directors. Transcript of Proceedings, *supra* note 55, at 17-18.

¹⁶² *Seiden v. Frazer Frost, LLP*, 796 F. App'x 381, 383 (9th Cir. 2020).

¹⁶³ *Kirschner v. KPMG LLP*, 938 N.E.2d 941, 964 (N.Y. 2010) (Ciparick, J., dissenting).

fairness concerns to those raised by Judge Carney who, plainly, could not conceive of the fairness of punishing innocent shareholders for the acts of corporation-adverse directors.¹⁶⁴ In *Seiden*, it was clear from the pleading and documentary evidence that the CVTI shareholders had prior knowledge of the misconduct underlying the Receiver's claims. As a result, no limitation period tolling was appropriate as of the time knowledge of the subject wrongdoing was acquired. In similar cases, dismissal on the pleading should be appropriate—particularly where, as in *Seiden*, the applicable limitations period had expired prior to a receiver's filing.

Both Judge Carney and the Ninth Circuit appear to have relied on their sense of fairness in dismissing the Receiver's pleading, without leave to replead, notwithstanding Judge Carney's recognition that further fact-finding might have allowed the Court to definitively determine whether CVVT's shareholders would have been subject to an *in pari delicto* defense. A three-judge panel, nevertheless, unanimously denied the Receiver's subsequent application for a rehearing and then, a rehearing *en banc* to reconsider his *in pari delicto* arguments.¹⁶⁵

Denial of the Receiver's *in pari delicto* arguments may reflect the dearth of on point case decisions.¹⁶⁶ It was certainly possible to conduct a case-within-a-case analysis and, in cases involving, for example, professional malpractice, such analysis may be necessary to determine the damages element of a claim. Whether to conduct a case-within-a-case analysis involves policy considerations. If plaintiff can show the shareholders would have been dissuaded from seeking redress through a derivative action because claims in that action would be subject to an *in pari delicto* defense, liberal pleading rules militate against dismissal.¹⁶⁷ Yet, allowing an adverse domination predicated

¹⁶⁴ Transcript of Proceedings, *supra* note 55, at 17-18.

¹⁶⁵ *Seiden v. Frazer Frost LLC*, No. 18-56176, 2020 U.S. App. LEXIS 4005 (9th Cir. Feb. 10, 2020).

¹⁶⁶ *Seiden v. Frazer Frost LLC*, No. 18-00588-CJC (KESx), 2018 WL 6137618, at *6 (C.D. Cal. July 31, 2018), *aff'd*, 796 F. App'x 381 (9th Cir. Jan. 3, 2020), *reh'g en banc denied*, 2020 U.S. App. LEXIS 4005 (9th Cir. Feb. 10, 2020).

¹⁶⁷ Significantly, the Receiver did not plead that CVTI shareholders had no motive to seek redress due to *in pari delicto*. However, after dismissal of his pleading he was not afforded an opportunity to amend his complaint to include this allegation. *See Seiden v. Frazer Frost, LLP*, 796 F. App'x 381, 383 (9th Cir. 2020) (“[t]he district court correctly determined that Seiden’s failure to plead adverse domination could not be cured by any amendment.”).

pleading to go forward based on the thin reed of a hypothetical *in pari delicto* defense being asserted in a hypothetical action seems *prima facie* to run counter to judicial economy principles and the unfairness of defendant having to defend stale claims.¹⁶⁸

In some contexts, a statute of repose may be applicable, rather than a statute of limitations and the latter may immunize a defendant from liability even where the potential claim against him could not have been discovered until after a limitation period elapsed.¹⁶⁹ *Seiden* involved application of a statute of limitations, not a statute of repose but, ultimately, the equities of subjecting the auditor defendants to having to defend the Receiver's stale claims, along with principles of judicial economy, may have seemed too much—and the justification in their minds might have been analogous to a repose-justified outcome. Given the same gravamen of alleged facts had been previously pleaded and adjudicated, in several cases, and those cases, having been dismissed with prejudice, it may have seemed unreasonable to give the Receiver an opportunity to try to re-plead claims based on those same facts, where his argument was based on how a hypothetical *in pari delicto* argument would have fared in a hypothetical derivative.

¹⁶⁸ *Agency Holding Corp. v. Malley-Duff & Assocs., Inc.*, 483 U.S. 143, 156 (1987) (“In compelling circumstances, even wrongdoers are entitled to assume that their sins may be forgotten.”).

¹⁶⁹ *See P. Stolz Family P'ship L.P. v. Daum*, 355 F.3d 92, 102 (2d Cir. 2004).