The Clean Hands Doctrine: Does it matter in public finance policymaking?

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The Clean Hands Doctrine is a well-established principle in equity-based legal proceedings. Broadly, it means that the party seeking relief should come to the proceeding without having taken actions that would have created or materially contributed to the problem for which they are seeking relief from another party or parties.

The doctrine, though often called by different names, remains relevant in 2015. In March 2015, the plaintiffs seeking to overturn a pension reform law passed by the Illinois legislature argued that the State should not be able to use a “Lizzie Borden defense” (essentially the same as arguing that the State came to court with unclean hands since they voluntarily created the situation from which they were now seeking relief) to avoid paying its pension obligations. The same month the hit CBS television series, The Good Wife, discussed whether a client seeking relief in a civil lawsuit had unclean hands.

This paper seeks to explore the nature of the Clean Hands Doctrine (CHC), its roots, and its possible implications for governments in terms of public finance policymaking. As a necessary disclaimer, I am not an attorney, though I have studied the law extensively and have served as an expert witness or legal consultant in over two dozen cases involving local government. Thus, this paper presents an informed academic argument based on research and experience, but not a legal opinion or legal advice. Its focus is on the implications for public administrators of the implications of the clean hands doctrine, or an analogous concept, for public finance policymaking.

Motivation for the paper

My interest in the Clean Hands Doctrine as its application to public finance and public administration dates back more than twenty years to a major Tax Increment Financing case for which I was the plaintiff’s lead expert witness. I attempted to argue that the defendant had come to court with unclean hands, but my testimony on this point was denied when the judge upheld a defense objection which argued that I could not use the term “unclean hands” because I was not an attorney. I remained convinced of the appropriateness of the argument despite the judge’s legal ruling. My position was confirmed as on point several years later by the defense attorney who made the objection. Over the years, several other situations have continued to pique my ongoing interest in applying the Clean Hands Doctrine in public sector settings.

Brief fact patterns illustrative of potential Clean Hands Doctrine arguments against a public entity

Case I: Tax Increment Financing

A municipality has a long-standing policy against maintaining other than arterial streets (e.g., residential streets, streets in commercial areas off of state highways and major arterials). It qualifies a Tax Increment Financing area covering much of the village due to deficiencies in street condition and maintenance.

Case II: Highway Accidents and Failure to Maintain Road Conditions During a Snow/Ice Event

An Interstate highway is not maintained adequately during a snow/ice event. Multiple major accidents occur consecutively over a period of greater than one hour in a .25 mile stretch in one direction on the Interstate and are reported promptly by the state police. The state highway department seeks compensation from the drivers involved in the accidents for damage to guardrails that occurred as a result of at least one of the accidents.

Case III: Pension Underfunding
A governmental unit fails to pay the normal cost of pension obligations for a lengthy period of time and now seeks relief from its accumulated pension obligations despite constitutional guarantees of those pension benefits. Its argument is that its police powers allow it to avoid paying its past pension obligations regardless of any legal guarantees of the pension benefits.

**Case IV: Levee Failure in a Hurricane**

According to most accounts, the City of New Orleans “survived” (or at least had the appropriate infrastructure in place that was necessary to do so) the direct hit of Hurricane Katrina and its storm surge but levee failures created severe flooding and damage to the city. The failure of government to adequately inspect and to maintain the levee system was argued by some to be a proximate cause of much of the damage incurred in the city.

**Recognizing fact patterns for more plausible applicability of the Clean Hands Doctrine to government**

- *Negligence and unclean hands are not the same concepts*
- *Explicit, documented adverse actions increase the probability of unclean hands being provable*
- *Unclean hands is an equity concept; government must be seeking relief or favor of some kind in the proceedings (e.g., a TIF district, recompense for damages, relief from statutory or constitutional requirements)*

**Does the Clean Hands Doctrine Matter in Public Finance Policymaking?**

Whether the Clean Hands Doctrine matters in public finance policymaking requires analysis along several plausibly relevant dimensions including the following:

- Legal
- Ethical
- Fiduciary
- Bankruptcy
- Private vs. public sector organizations
- Generational factors including binding of future legislatures

**Legal dimensions**

The legal dimensions of the Clean Hands Doctrine are somewhat hazy and sometimes difficult to discern. As a part of my research, I contacted more than a dozen attorneys with whom I have worked in some capacity or are in my professional circles. I asked each about where the Clean Hands Doctrine fits into the taxonomy of law and where, if anywhere, the doctrine is taught in law school. Nearly all of these experienced attorneys, many of whom are litigators, simply offered a perplexed look and a sheepish answer of “I don’t know.” The consensus of our discussions was that it is a concept in either contracts or civil procedure. Notably, none of the attorneys mentioned torts. This remains a crucial issue as this is the most reliable path to finding relevant case law and legal principles to provide further guidance on circumscribing the Clean Hands Doctrine. Nevertheless, Herstein (2011) and Vukovic (2014) do offer some basic guidance.

“The unclean hands doctrine is an equitable defense that allows a defendant to defeat the plaintiff’s claim against them... The unclean hands defense is only available in claims involving equitable forms of relief...that involve the court ordering the defendant to perform some sort of action...[E]xamples of equitable remedies are injunctions and specific performance. The clean
clean hands argument is not available in cases resulting in legal damages....[U]nclean hands is a form of ‘affirmative defense’.... The defendant has the burden of both raising the defense in court and proving it.” (Vukovic, 2014)

Vukovic specifically references contract law in his explanation of the nuances of the Clean Hands Doctrine.

In contrast, Herstein (2011) takes on the challenging task of formulating the normative theory of the Clean Hands Doctrine, noting that the doctrine is antithetical to many other legal concepts including relatively unfettered access to possible judicial relief regardless of past behavior.

“...[I]t is surprising that the clean hands defense (CHD) has attracted so little jurisprudential reflection. The formulation of the clean hands maxim is well-known: ‘He who comes into equity must come with clean hands.’ [e.g., Johnson v. Yellow Cab Transit Co., 321 U.S. 383, 387 (1944)]....What is the CHD normatively for or about?...A normative theory of the CHD is especially desirable considering that in the law, denying the right to be heard is an anomalous response to wrongdoing.” (Herstein, 2011, p. 1)

At this point, by all accounts, there is no reason to believe that a governmental unit would be immune to a CHD defense in action where an equity outcome is being sought by the government. Tort immunity would not typically be applicable as it is the governmental unit seeking relief rather than defending itself against legal action. Furthermore, even in tort actions, the immunity of government has not been absolute (citations from laptop) Nevertheless, legal dimensions are unlikely to be the major drivers of any kind of policy or practice response on the part of government as any statutory or constitutional requirements to which a government might be subject are few and far between (if they exist at all).

More traction for awareness and consideration of the CHD by public finance policymakers comes in the realms of ethical, fiduciary, financial, and general organizational structure and theory.

**Ethical Dimensions**

Public and non-profit managers, board members, and elected officials all have ethical responsibilities related to the performance of their duties and the responsibilities of their position. Included in this ethical responsibility is the notion that these individuals have an obligation to avoid doing harm through their failure to uphold their responsibility to carry out their legal and ethical responsibilities. For elected officials, their legal responsibilities as board members are typically not as defined as they are for other boards of directors (e.g., in Illinois there are statutes outlining the responsibility of both for-profit and not-for-profit board members, but not for public elected officials).

In terms of the CHD, this means that these individuals have a responsibility to allocate sufficient resources to meet their legal responsibilities as outlined in legislation including ordinances, resolutions, and policies duly adopted by the appropriate legislative body. In practice, some flexibility may be given on a temporary basis in the short-term, but the long-term responsibilities remain. Failure to provide adequate funding to meet contractual responsibilities (especially if overt, documentable, and long-term) may open the government to the repercussions of the Clean Hands Doctrine if they seek relief (i.e., enter into an equity proceeding) from their obligations to pay the accumulated past obligations. This has been an issue in recent disagreements over pension and OPEB funding responsibilities.

**Fiduciary Dimensions**
Peddle (2014) addresses the fiduciary responsibilities of local elected officials and notes the potential conflict between duty to the organization and duty to taxpayers that can occur. A broad description of fiduciary duties from Peddle (2014) follows.

**Fiduciary duties**

Fiduciary responsibility is an overarching concept that describes the duties of board members. BoardSource, a preeminent resource organization for building effective nonprofit boards, defines the legal responsibilities of nonprofit boards more explicitly as duty of care, of loyalty, and of obedience. (e.g., see [http://www.boardsource.org/Knowledge.asp?ID=3.364](http://www.boardsource.org/Knowledge.asp?ID=3.364), accessed 3-2-14)  Duty of care refers to the responsibility to be informed of the organization’s activities, participate in collective decisions in good faith using the care of an ordinary prudent person in similar circumstances. Part of this responsibility is the duty to raise questions about items that seem unclear or questionable. Duty of care has been a major indictment of fiduciaries in many high profile cases including Enron, WorldCom, and accusations of research misconduct at Johns Hopkins University. Duty of loyalty “requires board members to exercise their power in the interest of the organization and not in their own interest or interest of another entity, particularly one in which they have formal relationship. When acting on behalf of the organization, board members must put the interests of the organization before their personal and professional interests.” (Loftis, 2009, Resource #3) This duty is the foundation of the thesis of this paper: duty to the organization. Duty of obedience primarily relates to ensuring the organization functions within the law and in compliance with its mission. All of these duties have come under substantially more scrutiny since the enactment of the Sarbanes-Oxley Act of 2002. (Loftis, 2009) These duties have been codified in many states, with common law providing legal foundations for these duties in every state, according to BoardSource.

Because the fiduciary responsibilities of local government elected officials remain murky at best, my conclusions consist of speculation since the issue has not been determined in any “on point” cases of which I am aware—informed speculation, but speculation nevertheless.

My research supports the notion that the fiduciary duties of non-profit board members logically transfer to elected officials even in the absence of statute or case law. Thus, the notion of unclean hands would appear to be a logical threat to board actions in which one could reasonably argue that the board has violated its fiduciary duties, thereby creating the very situation from which the government is seeking relief. It should be noted that there is some overlap between the argument on ethical dimensions and that on fiduciary dimensions, but they are separated by the notion that fiduciary duties offer more in the way of guidance from statutes and case law in other arenas.

**Bankruptcy**

While the case of Detroit receiving relief from its creditors, including employee pensions and pension funds, has received much attention, it remains a special case. Most states do not allow their local governments to file for bankruptcy, and even those that do only allow a filing under relatively restricted conditions and only after going through several steps to avoid a bankruptcy filing. Detroit was able to “avoid” its obligations for pensions despite a fairly strong state
constitutional guarantee of those benefits because state law became essentially irrelevant when the litigation moved into the realm of bankruptcy which is the purview of the federal courts. In this situation, employee pensions became simply another unsecured debt and the employees just another creditor in the bankruptcy proceedings.

Could an unclean hands argument be made by creditors in a bankruptcy proceeding? While this is an empirical question, based on cases where creditors were able to successfully argue for their debts not being part of the discharge process, as well as cases where debtors deliberately increased their debt prior to filing for bankruptcy seeking discharge or reorganization of their debt, I would suspect that the courts would be amenable to considering an unclean hands argument. However, the outcome of that argument and its effect on the terms of the bankruptcy plan/settlement remains unclear.

**Sectoral Dimensions**

Governments have various types and levels of immunity from legal action. Other types of organizations typically to do not, at least not in terms of the breadth and depth that governmental units have.

The immunity factor is much larger in terms of negligence arguments, but could become relevant to some courts with respect to the CHD. This deserves further research.

**Intergenerational Dimensions**

Should a legislative body be able to commit future legislatures and future generations to pay the costs, or a portion of the costs, for a long-term item such as pensions, OPEB, or long-lived capital? Increasingly, there is a clamor that the answer to this question should be no and that we need to get out of these historic arrangements which are now viewed as too costly.

While there are multiple elements to the analysis of this issue, I will address one. Many governments seeking relief from pension and OPEB obligations have failed to fund the normal costs of these benefits over time. Now, they not only owe the normal costs each year but are also on the hook for the accumulated pension and OPEB actuarial costs to make up for the missed or inadequate payments. Had the normal costs (the annual amount owed to meet that year’s new obligations) been funded each year, the costs of any catch-up due to changes in market conditions would be both nominal and able to be spread over several years with little noticeable impact on a unit’s budget.

This notion is currently under Supreme Court review in Illinois, so we will know more about the judiciary’s view of this issue in the state where public pensions are generally the most poorly funded in the United States.

**Recommendations and Next Steps**
The Clean Hands Doctrine is an important consideration in public policymaking and in public finance policymaking in particular. The appropriate dimensions of consideration of the CHD require further research, especially in terms of identifying and applying relevant case law (or confirming the lack of such).

For public administrators, the major take away of this paper is to be aware of the Clean Hands Doctrine and its implications for public financial management. At minimum, finance professionals need to be well versed in the implications of failing to meeting the obligations of government for the delivery of goods and services, and honoring the terms of contractual agreements as well as statutory and constitutional responsibilities. It is the duty of public managers to ensure that elected officials are aware of their legal, ethical, and fiduciary responsibilities, as well as the potential consequences of not meeting those responsibilities in a timely, effective, and compliant manner.

Much more can be written once the Illinois pension clause/pension reform case is fully adjudicated, but signals are that legislative bodies will be held more directly accountable for their past actions on a strict liability basis. The argument that governments can circumvent their responsibilities by claiming absolute police powers (or at least using their police powers to default on long-standing obligations) does not seem to be resonating in the legal system.

More research will follow to extend and expand the arguments in this paper to include more legal analysis and more longitudinal treatment of the Clean Hands Doctrine.
References


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