

NEWS & DEVELOPMENTS

Lawyer Cannot Discharge Client's Claim Based on Funds Stolen by Lawyer

In a recent decision, the Ninth Circuit Court of Appeals held that a debtor-attorney could not use the unclean hands doctrine to render dischargeable a former client's claim based on the lawyer's misappropriation of funds entrusted to him by the former client. See [Northbay Wellness Group, Inc. v. Beyries](#), No. 13-17381 (9th Cir. June 5, 2015). The creditor was a medical marijuana dispensary, and the debtor acted as counsel to the creditor and served on its board of directors. In the ordinary course of its business, the creditor engaged in cash sales, including as depository institutions were not permitted to accept business from marijuana dispensaries under applicable federal regulations. The creditor entrusted certain cash funds to the lawyer, and the lawyer later diverted a portion of those funds to himself. The lawyer filed his bankruptcy petition after the creditor obtained a judgment against him for the amount of the diverted funds. The bankruptcy court (later affirmed by the district court) accepted that claims based on misappropriation ordinarily are not dischargeable. However, it also concluded that the creditor had engaged in the unlawful sale of marijuana, the doctrine of unclean hands therefore applied to preclude the creditor's claim in the bankruptcy case and its debt was dischargeable.

The Ninth Circuit reversed. It held that the bankruptcy court abused its discretion in applying the doctrine of unclean hands solely based on the fact that the creditor had engaged in wrongful activity. Here, the debtor-attorney participated in the alleged wrongful conduct and also misappropriated the funds on which the creditor's claim was based. Under these circumstances, the lower court was required to weigh the parties' respective alleged wrongdoing before deciding whether the unclean hands doctrine should be applied. Moreover, the Ninth Circuit held that the public interest in holding attorneys to high ethical standards also compelled a different result than that reached by the lower court. On this basis, the Ninth Circuit concluded and held that "the doctrine of unclean hands cannot prevent recovery of funds stolen from a client by his or her lawyer."

Keywords: bankruptcy and insolvency litigation, discharge, unclean hands, medical marijuana

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