

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 2566 / April 22, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of

SANDS BROTHERS ASSET MANAGEMENT, LLC,
STEVEN SANDS,
MARTIN SANDS, AND
CHRISTOPHER KELLY

ORDER DENYING
CERTIFICATION OF RULING
FOR INTERLOCUTORY
REVIEW

Sands Brothers Asset Management, LLC (SBAM), requests that I certify to the Securities and Exchange Commission for interlocutory review the April 7, 2015, Order disqualifying Martin H. Kaplan, Esq., as SBAM's counsel.¹ The Division of Enforcement and Christopher Kelly filed responses to SBAM's request. Separately, Steven and Martin Sands (together, the Sands) request that I certify the April 7 Order for interlocutory review, or, alternatively, clarify its scope.

Procedural History

The Commission instituted this proceeding on October 29, 2014, against Respondents. The Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) alleges that: SBAM, a registered investment adviser, willfully violated Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-2 thereunder (custody rule) because, for fiscal years 2010 to 2012, it failed to undergo surprise audits or timely distribute audited financial statements to investors of pooled investment vehicles managed by SBAM as an alternative means of compliance with the custody rule; and the other Respondents willfully aided, abetted, and caused SBAM's violations. OIP at 1-2, 5-7.

On February 25, 2015, I ordered Kaplan to show cause why he should not be disqualified as SBAM's counsel. *Sands Bros. Asset Mgmt., LLC*, Admin. Proc. Rulings Release No. 2349, 2015 SEC LEXIS 702. I raised this issue because, among other reasons, Kaplan previously represented Kelly during at least part of the Division's investigation, but now, in SBAM's opposition to the Division's motion for summary disposition, is asserting as SBAM's main

¹ References to Kaplan in this Order should be understood to apply to both attorney Kaplan and the law firm Gusrae Kaplan Nusbaum PLLC.

defense that it was “Kelly’s failure to comport SBAM’s conduct with the Custody Rule” which prevented SBAM’s compliance. *Id.* at *2-5 (quoting SBAM Opp. at 6).

On April 7, after consideration of the parties’ responses, I disqualified Kaplan from representing SBAM in this proceeding. *Sands Bros. Asset Mgmt., LLC*, Admin. Proc. Rulings Release No. 2503, 2015 SEC LEXIS 1250. As more fully described in the April 7 Order, I found that: Kaplan had taken a position materially adverse to his former client Kelly in this proceeding; Kaplan had formulated a defense to pin the blame on Kelly, and even conveyed his view about Kelly’s responsibility to the Division in August 2013, well before he executed a February 2014 engagement letter with Kelly; and any purported conflict waiver in that letter was invalid because Kaplan knew at the time he executed the engagement letter that there was a conflict of interest, and he did not disclose that conflict to Kelly. *See id.* Given these circumstances, I ruled that Kaplan’s continued appearance as SBAM’s counsel would undermine the integrity and fairness of this proceeding. *Id.* at *17.

Standard for Certification

“A ruling submitted to the Commission for interlocutory review must be certified in writing by the hearing officer and shall specify the material relevant to the ruling involved.” 17 C.F.R. § 201.400(c). “The hearing officer shall not certify a ruling unless,” as relevant here, “(i) [t]he ruling involves a controlling question of law as to which there is substantial ground for difference of opinion; and (ii) [a]n immediate review of the order may materially advance the completion of the proceeding.” 17 C.F.R. § 201.400(c)(2).

Discussion

SBAM

First, SBAM fails to establish that the April 7 Order “involves a controlling question of law as to which there is substantial ground for difference of opinion.” 17 C.F.R. § 201.400(c)(2)(i).

SBAM primarily contends that the April 7 Order is wrongly premised on *SEC v. Csapo*, 533 F.2d 7 (D.C. Cir. 1976), and *Clarke T. Blizzard*, Investment Advisers Act of 1940 Release No. 2032, 2002 SEC LEXIS 3406 (Apr. 24, 2002). SBAM Request at 2. SBAM asserts that *Csapo* and *Blizzard* “are not controlling law” because a law judge’s 2010 Order – *Morgan Asset Management, Inc.*, Admin. Proc. Rulings Release No. 657, 2010 SEC LEXIS 2325 (July 19, 2010) – “significantly altered the standard of law for determining disqualification” and “controls.” *Id.* at 2-3. A law judge’s order, however, is not binding precedent on another law judge and cannot alter legal standards announced by the D.C. Circuit and the Commission.

SBAM also contends that the April 7 Order “failed to use the appropriate standard of law for determining disqualification” as set forth in the law judge’s 2010 Order. SBAM Request at 3. SBAM, however, does not even attempt to explain what “standard” from the 2010 Order it believes controls or why such unidentified “standard” is at odds with the April 7 Order. In fact,

SBAM's request does not even identify what specific legal question warrants the Commission's review.

In any event, my independent review of the 2010 Order reveals no controlling legal question at odds with the April 7 Order. In the 2010 Order, the law judge ruled that the Division had at most shown *potential* conflict of interests which did not suffice to disqualify counsel; in doing so, the law judge favorably cited *Csapo* and applied *Blizzard*, which the law judge acknowledged is binding precedent. *Morgan Asset Mgmt., Inc.*, 2010 SEC LEXIS 2325, at *4-14, *26. Among other legal questions, the law judge ruled that conflict waivers were not per se prohibited under *Blizzard*, but subject to a balancing test. *Id.* at *12-13. The April 7 Order did not rule to the contrary. *See Sands Bros. Asset Mgmt., LLC*, 2015 SEC LEXIS 1250. Under "miscellaneous issues" in the 2010 Order, the law judge discussed "two post-*Blizzard* developments" relating to the applicability of criminal law cases to disqualification in administrative proceedings. *Morgan Asset Mgmt., Inc.*, 2010 SEC LEXIS 2325, at *24-28. The law judge's discussion, which was at most dicta, does not persuade me that there is a controlling legal question here warranting immediate review. *Cf. City of Anaheim*, Exchange Act Release No. 42140, 1999 SEC LEXIS 2421, at *3 (Nov. 16, 1999) (a legal question certified under Rule 400(c) must be one that "controls the outcome of th[e] proceeding"). Notably, the law judge did not address, and the 2010 Order has little bearing on, the central question here – whether a former client's consent to a purported conflict waiver was valid when he was not apprised that an *actual* conflict already existed.

SBAM asserts that the April 7 Order "adopted an overly broad interpretation of the duty of loyalty," and "ignored state law and standards underlying counsel and his firm's use of advanced conflict waivers to address standard conflict issues." SBAM Request at 3. To the contrary, the April 7 Order did not ignore relevant standards but applied the law on conflict waivers and informed consent to facts and issues at hand. *See Sands Bros. Asset Mgmt., LLC*, 2015 SEC LEXIS 1250, at *12 ("Even assuming that the engagement letter could be considered a conflict waiver, Kaplan failed to provide Kelly with the information required for Kelly to give informed consent, rendering any purported waiver invalid."); *id.* at *15-16 ("The totality of the evidence establishes that Kaplan knew at the time he executed the engagement letter that there was a conflict of interest, and he did not disclose that conflict to Kelly."). At bottom, SBAM challenges a "mixed question[] of law and fact," which is "inappropriate for certification." *Natural Blue Res., Inc.*, Exchange Act Release No. 74215, 2015 SEC LEXIS 441, at *8-9 (Feb. 5, 2015).

SBAM questions whether a law judge has the authority to sua sponte disqualify counsel even when, as here, I issued an Order to Show Cause directing Kaplan to address why he should not be disqualified; SBAM also questions whether there was even authority to issue the Order to Show Cause "in lieu of" a motion from the Division. SBAM Request at 3 & n.12. Although the Rules of Practice do not specify such authority in explicit terms, SBAM provides no support for the proposition that a law judge may disqualify counsel only upon a party's motion. The Commission has made clear that a law judge has the authority to disqualify counsel, emphasizing that Rule of Practice 111(d) "is broadly worded to permit the law judge to regulate the conduct of counsel in a proceeding," and stressing the "obligation to ensure that [Commission] proceedings are conducted fairly in furtherance of the search for the truth and a just

determination of the outcome.” *Clarke T. Blizzard*, 2002 SEC LEXIS 3406, at *5, *7. Indeed, the list of powers in Rule 111 “is illustrative, not exhaustive. The hearing officer is permitted to take any action necessary and appropriate to discharge his or her duties.” Rules of Practice, 60 Fed. Reg. 32738, 32748 (June 23, 1995). As such, it would be nonsensical for a law judge’s authority under Rule 111 and concomitant obligation to ensure the fairness of a proceeding to be entirely dependent on a party’s motion.

Before disqualifying Kaplan as SBAM’s counsel, I issued an Order to Show Cause, seeking the position of all parties on various questions about Kaplan’s conflict of interest, including whether there was a valid conflict waiver. Kaplan had two opportunities – in an initial response and a reply brief – to address the relevant issues and submit evidence or declarations. Kaplan’s initial response demonstrates that he fully understood the issues at stake, as he addressed conflicts with former clients under New York Rule of Professional Conduct 1.9(a) and whether there was a valid conflict waiver. With his reply brief, Kaplan had the opportunity to respond to the Division and Kelly’s submissions. He did not dispute the fact that he told the Division in August 2013 that the Sands had relied on SBAM’s chief compliance officer and that he ascribed responsibility for SBAM’s custody rule failures to Kelly. *Compare* Brown Decl. ¶¶ 2-4 *with* Kaplan Reply.² Nor did he dispute the fact that Kelly was not made aware of an actual conflict. In these circumstances and contrary to SBAM’s suggestion, the opportunity to be heard through written submissions sufficed, and nothing established the need for oral argument.

Second, immediate review is more likely to delay rather than “materially advance the completion of the proceeding.” 17 C.F.R. § 201.400(c)(2)(ii). SBAM asserts that “Kaplan represented SBAM for nearly a decade and is familiar with SBAM’s complex business structure and the facts and circumstances of the instant matter.” SBAM Request at 3. The actual issues in this matter, however, are not complex. SBAM conceded that it violated the custody rule in its opposition to the Division’s motion for summary disposition. SBAM Opp. at 3. Kaplan’s experience with SBAM does not, in and of itself, establish that other counsel could not just as effectively advocate for SBAM. Kaplan already withdrew from representing the Sands, who are now represented by new counsel. It is thus unlikely that immediate review – even if such review were to conclude before the June 8, 2015, date by which SBAM shall retain new counsel, and even if Kaplan was reinstated as SBAM’s counsel – would materially advance this proceeding’s completion.³

² The cited declaration was submitted by the Division in response to the Order to Show Cause.

³ Even if the disqualification is incorrect, it can be effectively reviewed and remedied by the Commission, upon appeal from an initial decision, by vacatur and remand. *Natural Blue Res., Inc.*, 2015 SEC LEXIS 441, at *15; *see Mohawk Indus., Inc. v. Carpenter*, 558 U.S. 100, 107 (2009) (even though a ruling “may burden litigants in ways that are only imperfectly reparable by appellate reversal,” that scenario “has never sufficed” to warrant immediate interlocutory review (citation omitted)). And contrary to SBAM’s contention, there is nothing extraordinary about the April 7 Order warranting immediate review. *See In re Bushkin Assocs., Inc.*, 864 F.2d 241, 244 (1st Cir. 1989) (“Nothing about a disqualification order distinguishes it from the run of pretrial judicial decisions that affect the rights of litigants yet must await completion of trial court proceedings for review. Because a disqualification order will rarely, if ever, represent a final rejection of a claim of fundamental right that cannot effectively be reviewed following

The Sands

The Sands request certification of the April 7 Order on the basis that the Commission or the law judge on potential remand may “clarify the scope of evidence, allegations, and conduct relevant to the issue of Kaplan’s disqualification.” Sands Mem. at 1-2. Alternatively, they move for clarification of the scope of the April 7 Order’s rulings and findings. *Id.* at 2. Specifically, they take issue with the April 7 Order’s finding that “there is concrete evidence that prior to executing the engagement letter, Kaplan had already colluded with the Sands to formulate a defense that would pin the blame on Kelly.” *Sands Bros. Asset Mgmt., LLC*, 2015 SEC LEXIS 1250, at *13. They suggest that this finding implicates due process concerns that “defendants receive ‘adequate notice of the charges’ against them and ‘an opportunity to defend against those charges’ before a disposition is rendered.” Sands Mem. at 1 (citation omitted).

On its face, the Sands’ request does not involve a controlling legal question. Moreover, it is plain that the April 7 Order did not dispose of any “charges” or impose any sanction against the Sands, nor did it expand their potential liability beyond the scope of the OIP. The OIP does not allege that the Sands colluded with Kaplan to pin the blame on Kelly, and I intend to give the Sands a full and fair opportunity to address this issue once SBAM has retained new counsel (or determined to proceed without retained counsel). Thus, there is no discernable basis for certification or clarification.

Ruling

Accordingly, SBAM’s request for certification of the April 7 Order is DENIED, and the Sands’ request for certification of the April 7 Order, or, alternatively, clarification is DENIED. SBAM’s request for a stay is DENIED as moot.

SO ORDERED.

Cameron Elliot
Administrative Law Judge

judgment on the merits, the remedy of vacating the final judgment and remanding for a new trial seems plainly adequate should petitioner’s concerns of possible injury ultimately prove well-founded. Therefore, disqualification orders can be reviewed as effectively on appeal of a final judgment as on an interlocutory appeal.” (internal quotation marks, citations, and alteration brackets omitted)).