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

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 2503 / April 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of SANDS BROTHERS ASSET MANAGEMENT, LLC, STEVEN SANDS, MARTIN SANDS, AND CHRISTOPHER KELLY	DISQUALIFICATION ORDER

The Securities and Exchange Commission commenced this proceeding on October 29, 2014, with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) against Respondents, pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940. The OIP alleges that: Sands Brothers Asset Management, LLC (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 Martin H. Kaplan, Esq., of Gusrae Kaplan Nusbaum PLLC, to show cause why he should not be disqualified as SBAM's counsel.[1] *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 of Enforcement's motion for summary disposition, is asserting as SBAM's main 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).

[1] References to Kaplan in this Order should be understood to apply to both attorney Kaplan and the law firm. Indeed, an individual lawyer's conflicts are ordinarily imputed to his firm. *See* N.Y. Rule of Prof'l Conduct 1.10; *Kassis v. Teacher's Ins. & Annuity Ass'n*, 717 N.E.2d 674, 677 (N.Y. 1999).

Kaplan filed a response to the Order to Show Cause (Kaplan Resp.), along with an affirmation of Martin H. Kaplan (Kaplan Aff.), with an attached exhibit. Thereafter, the Division filed its response to the Order (Div. Resp.), along with a declaration of Division attorney Nancy A. Brown (Brown Decl.), with an attached exhibit. Christopher Kelly filed a reply to Kaplan's submission (Kelly Reply). Lastly, Kaplan filed a reply.

Background

During the investigation, Kaplan jointly represented Kelly, as well as Martin Sands and Steven Sands (together, the Sands), and SBAM for at least part of the time. In fact, Kaplan represents that during the investigation, beginning around 2012 and through the filing of the OIP, he "was the only counsel for all Respondents." Kaplan Resp. at 9. At the least, Kaplan appeared as Kelly's counsel when Kelly was called for investigative testimony in April 2013. Div. Ex. 6 at 6.[2] It appears that communications between Kaplan and Kelly were otherwise limited. Kaplan Aff. ¶¶ 19, 27, 37. In February 2014, Kelly executed a formal engagement letter with Kaplan. Brown Feb. Decl., Ex. 4.[3] In April 2014, the Division wrote to Kaplan, raising the concern that Kaplan may have an unresolved conflict of interest in jointly representing Respondents, as a result of voicemails that Kelly left with the Division. *Id.*, Ex. 6. Kaplan terminated his representation of Kelly shortly thereafter, and Kelly is currently pro se. Kelly Reply at 3.

Following the institution of this proceeding, I held a prehearing conference in December 2014, which the parties attended except Kelly.[4] At the conference, Kaplan represented both SBAM and the Sands. Tr. 3.[5] The Division stated that it had raised an issue with Kaplan that could potentially impact the integrity of the proceeding. Tr. 8. The Division indicated that as a result of the fact that Kaplan represented all Respondents in the investigation, "there may be because of that dual representation some issues of conflict that may permeate these proceedings, particularly if Mr. Kelly were to be called as a witness." Tr. 8-9. The Division explained that it would continue to discuss the issue with Kaplan to reach a resolution. Tr. 9.

After the Division filed its motion for summary disposition, Kaplan withdrew from representation of the Sands but remained as SBAM's counsel. About a week later, SBAM filed its opposition to the Division's motion. In its submission, SBAM does not dispute that it failed to timely distribute audited financial statements in accordance with the custody rule, but asserts that its failure was Kelly's fault. *See, e.g.*, SBAM Opp. at 6 ("The evidence presented at a

[2] This exhibit was submitted in support of the Division's motion for summary disposition.

[3] The cited declaration and exhibits were submitted in support of the Division's opposition to Kelly's motion for summary disposition.

[4] At the time, Kelly was discussing an offer of settlement with the Division, which subsequently did not materialize. *See Sands Bros. Asset Mgmt., LLC*, Admin. Proc. Rulings Release No. 2074, 2014 SEC LEXIS 4574 (Dec. 2, 2014).

[5] Citation (Tr.) is to the prehearing conference transcript.

hearing in this matter will demonstrate there was a clear and reasonable delegation of responsibility to Kelly as Chief Compliance Officer for all compliance matters and his authority as Chief Operating Officer empowered Kelly to oversee the audit process. . . . As Chief Compliance Officer, and as an attorney advising investment advisers on regulatory matters, Kelly was required to understand and had the ability to understand the Custody Rules as they applied to SBAM. . . . Kelly's failure to comport SBAM's conduct with the Custody Rule prevented SBAM employees, who were responsible for preparing valuations, from learning of the alternative methodology for distributing audited financial statements."), at 7 ("SBAM employees relied in good faith on Kelly's misinterpretation of the valuation and completeness requirement for the distribution of audited financials under the Custody Rule."), at 8 ("Slavin's testimony and reports will confirm that Kelly was unequivocally responsible and sufficiently empowered [to] effectuate the compliance program at SBAM.").

Discussion

Rule of Practice 111 provides the hearing officer with "the authority to do all things necessary and appropriate to discharge his or her duties," including "[r]egulating the course of a proceeding and the conduct of the parties and their counsel." 17 C.F.R. § 201.111(d). Further, Rule of Practice 103 provides that the "Rules of Practice shall be construed and administered to secure the just . . . determination of every proceeding." 17 C.F.R. § 201.103(a). The Commission has held that "[d]isqualification of counsel under Rule 111(d) would be appropriate if a conflict of interest is of sufficient magnitude to render the proceeding unjust." *Clarke T. Blizzard*, Investment Advisers Act of 1940 Release No. 2032, 2002 SEC LEXIS 3406, at *5 (Apr. 24, 2002).

In an administrative proceeding, a person is entitled to be represented by or appear through counsel pursuant to the Administrative Procedure Act, from which courts have implied the concomitant right to counsel of one's choice. *See* 5 U.S.C. § 555(b); *SEC v. Csapo*, 533 F.2d 7, 10-11 (D.C. Cir. 1976); *SEC v. Higashi*, 359 F.2d 550, 553 (9th Cir. 1966). However, "respondents in Commission proceedings do not enjoy an absolute right to counsel of their original choosing when[, for example,] a conflict of interest with that attorney threatens the integrity of Commission processes." *Trautman Wasserman & Co., Inc.*, Exchange Act Release No. 55989, 2007 SEC LEXIS 1408, at *15-16 (June 29, 2007). The presumption in favor of a person's chosen counsel "may be overcome not only by a demonstration of actual conflict but also by a showing of a serious potential for conflict." *Wheat v. United States*, 486 U.S. 153, 164 (1988).

The Commission has specifically cautioned:

> We have an obligation to ensure that our administrative proceedings are conducted fairly in furtherance of the search for the truth and a just determination of the outcome. Even the appearance of a lack of integrity could undermine the public confidence in the administrative process upon which our authority ultimately depends.

Clarke T. Blizzard, 2002 SEC LEXIS 3406, at *7. This concern cannot be addressed simply by a client's consent or waiver of conflicts of interest. *Id.* at *7-8 & n.10. "Rather, the issue is whether the Commission consents to the impact on its adjudicatory processes created by" the conflict. *Id.* at *7. This is consistent with the principle that some conflicts of interest are unwaivable; in other words, my "independent duty to assure a fair [hearing] may override such a waiver." *United States ex rel. Stewart v. Kelly*, 870 F.2d 854, 858 (2d Cir. 1989); *see Wheat*, 486 U.S. at 162-63 (a trial court may refuse waivers of conflicts of interest to ensure the adequacy of representation, to protect the integrity of the court, and to preserve the trial judge's interest to be free from future attacks over the adequacy of the waiver and the fairness of the trial).

Nonetheless, before disqualifying counsel, there must be "concrete evidence" that his appearance would undermine the integrity of the proceeding. *Csapo*, 533 F.2d at 11.[6] Here, there is not only concrete but clear evidence that Kaplan, in representing SBAM, has interests directly and materially adverse to his former client, Kelly, another respondent in this proceeding. Such conflict was not waived by Kelly, and, even if waived, I would have grave doubts about the integrity of this proceeding with Kaplan's continued appearance.

In his response, Kaplan primarily contends that by virtue of the February 2014 engagement letter, he provided Kelly with informed consent as to any potential conflict and Kelly effectively waived any disqualification of Kaplan under New York Rule of Professional Conduct 1.9. Kaplan Resp. at 3-9. That rule provides:

> A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client *unless the former client gives informed consent, confirmed in writing*.

N.Y. Rule of Prof'l Conduct 1.9(a) (emphasis added).

As a threshold matter, New York attorney ethical rules such as Rule 1.9 may "provide guidance" in determining disqualification. *Monzon v. United States*, Nos. 13-cv-1943, 99-cr-157, 2013 WL 4804095, at *3 (S.D.N.Y. Sept. 9, 2013). However, a tribunal's "primary concern is with the integrity of the adversary process, not the enforcement of the ethical rules." *Am. Int'l Grp., Inc. v. Bank of Am. Corp.*, 827 F. Supp. 2d 341, 345 (S.D.N.Y. 2011).

---

[6] In *Csapo*, the D.C. Circuit upheld a district court's order conditioning enforcement of a Commission subpoena upon the respondent's right to be accompanied by attorneys of his choice during questioning. 533 F.2d at 8. The district court found, and the appeals court agreed, that the Commission failed to produce any "concrete evidence" of misconduct to justify excluding counsel. *Id.* The appeals court held that "before the SEC may exclude an attorney from its proceedings, it must come forth . . . with 'concrete evidence' that his presence would obstruct and impede its investigation." *Id.* at 11. Although the present proceeding is not a Commission investigation, I apply the same "concrete evidence" standard in assessing a conflict that may undermine the integrity of the proceeding, which is a distinct and separate concern from obstructing and impeding an investigation.

There is no dispute that Kaplan formerly represented Kelly during at least part of the investigation, and that the present proceeding is, as a practical matter, the same. SBAM, Kaplan's current client, has interests that are materially adverse to Kelly. In fact, SBAM's central defense is that Kelly is at fault for its custody rule violations. *See* SBAM Opp. at 6-8. Remarkably, Kaplan represents that: "Any argument relating to allocating responsibility for compliance with the Custody Rule is not a matter that involves SBAM, and thus [Kaplan] should not be disqualified on the basis of an argument it will not raise." Kaplan Aff. ¶ 40. This representation is squarely contradicted by Kaplan's brief submitted on SBAM's behalf. *See, e.g.*, SBAM Opp. at 8 ("Kelly was unequivocally responsible . . .").

The engagement letter that Kaplan relies upon informed Kelly that potential conflicts of interest may arise due to Kaplan's joint representation of Kelly, SBAM, and the Sands; and provided as follows: "You explicitly agree that you will not seek to disqualify this firm from continuing to represent [SBAM] and/or the [Sands] should any conflict of interest develop or should it become necessary or desirable for you to obtain other counsel." Kaplan Aff., Ex. A at 1-2. The letter further stated: "To the extent any privileged information provided by you prior to today has been shared with [SBAM] and/or the [Sands] prior to today, you agree that you will not assert such sharing of information as a basis for disqualification of this firm." *Id.* at 3.

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. *See* N.Y. Rule of Prof'l Conduct 1.0(j) ("'Informed consent' denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated information adequate for the person to make an informed decision, and after the lawyer has adequately explained to the person the material risks of the proposed course of conduct and reasonably available alternatives.") & cmt. 6 ("A lawyer need not inform a client or other person of facts or implications already known to the client or other person; nevertheless, a lawyer who does not personally inform the client or other person assumes the risk that the client or other person is inadequately informed and the consent is invalid.").

The engagement letter stated that Kaplan believed his firm could adequately represent all Respondents, and that his firm had "not found any apparent conflict of interest that would serve to prevent us from undertaking such representation." Kaplan Aff., Ex. A at 2. Further, Kaplan represents that at the time the OIP was filed, all Respondents "had a unified defense" and he did not believe there was a conflict. Kaplan Aff. ¶ 29.

However, 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. In an August 2013 telephone call, Kaplan told the Division that he ascribed SBAM's late distribution of its audited financials to the fact that the chief compliance officer did not understand the custody rule. Brown Decl. ¶¶ 2-3. Kaplan added that the Sands relied on the chief compliance officer and noted his view that "the only issue was how responsibility for the late delivery of the financial statements should be allocated."[7] *Id.* ¶ 3. This conversation came

[7] These circumstances seemingly call into question whether any client communications with Kaplan related to allocating responsibility would be confidential or privileged. *Cf. In re Grand*

on the heels of Kaplan representing Kelly during his April 2013 investigation testimony, and Kaplan said nothing during the August 2013 conversation to lead the Division to believe that he was not representing Kelly. *Id*. ¶ 4; Div. Ex. 6 at 6. When he signed the engagement letter, Kelly was not aware of Kaplan's strategy to attribute fault to him. Kelly Reply at 3. Accordingly, Kelly could have not provided informed consent to any conflict waiver. N.Y. Rule of Prof'l Conduct 1.7 cmt. 18 ("Informed consent requires that each affected client be aware of the relevant circumstances, including the material and reasonably foreseeable ways that the conflict could adversely affect the interests of that client.").

Additionally, Kaplan's decision to turn over Kelly's voicemails to the Sands calls into question Kaplan's impartiality toward his former client, and strongly suggests that he had ongoing, divided loyalties. In his reply, Kelly represents that he did not know about Kaplan's divided interests or notice any red flags of a possible conflict. Kelly Reply at 5. Kelly did suggest in one of his voicemails to the Division that the Sands threatened to fire him "if [he] don't go along – whatever that means . . . ." Brown Feb. Decl., Ex. 2. But there is no indication that the threat pertained to the Sands' defense strategy to pin the blame on Kelly, and the threat was vague in any event. Moreover, to extent that Kelly's statement could be construed to mean that he was threatened to go along with the Sands' defense to pin the blame on him otherwise he would be fired, Kelly's decision to execute the conflict waiver would not have been voluntary and would not be valid. *See* Restatement (Third) of Law Governing Lawyers § 122 cmt. b (2000) ("Client consent must also, of course, be free of coercion.").

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. Kaplan avers that no client confidences were exchanged between him and Kelly, and Kelly appears to confirm that he had limited contact with Kaplan. However, that Kaplan arguably does not actually possess or did not actually obtain confidential information about Kelly is not necessarily dispositive to the disqualification question. Rule 1.9(a) precludes Kaplan's representation of Kelly, irrespective of confidentiality. *See AVRA Surgical, Inc. v. Dualis MedTech GmbH*, No. 13-cv-7863, 2014 WL 2198598, at *3-4 (S.D.N.Y. May 27, 2014). By taking a position in this proceeding that is in direct conflict with his former client's interests, it is "no answer that [Kaplan] did not in fact obtain any confidential information in connection with" his representation of Kelly. *Cardinale v. Golinello*, 372 N.E.2d 26, 30 (N.Y. 1977). This is because separate from a duty of not disclosing client confidences, Kaplan owes a duty of loyalty to his former client, which he has breached. *See Tekni-Plex, Inc. v. Meyner & Landis*, 674 N.E.2d 663, 666 (N.Y. 1996) ("Attorneys owe fiduciary duties of both confidentiality and loyalty to their clients."). In such circumstances, Kaplan's continued appearance in this action undermines the integrity and fairness of this proceeding.

It does not appear that finding new counsel would be particularly burdensome for SBAM. Kaplan claims that disqualification "would impose a significant and unfair hardship on SBAM" because his "knowledge and experience would be difficult to replicate since Kaplan has

---

Jury, 475 F.3d 1299, 1305 (D.C. Cir. 2007) ("Attorney-client communications are not privileged if they 'are made in furtherance of a crime, fraud, *or other misconduct*.'" (quoting *In re Sealed Case*, 754 F.2d 395, 399 (D.C. Cir. 1985)) (emphasis added)).

represented SBAM in various matters since 2006 and thus has since acquired special knowledge and experience with respect to representing SBAM." Kaplan Resp. at 3. But the fact that an attorney has a longstanding relationship with a client does not, in and of itself, show that the task of finding new counsel would impose a hardship sufficient to outweigh concerns about the integrity of this proceeding. It is common in administrative proceedings for a respondent to change counsel after the investigation has concluded. *See* 17 C.F.R. § 201.323 (official notice). In fact, Mayer Brown LLP has already taken over representation of the Sands. Given that the defenses of SBAM and the Sands appear aligned, it is at least conceivable that Mayer Brown would not have a conflict taking on such joint representation. Nonetheless, that is an issue for those parties to decide.

Ruling

I ORDER that Martin H. Kaplan, Esq., and Gusrae Kaplan Nusbaum PLLC, are DISQUALIFIED from representing Sands Brothers Asset Management, LLC, in this proceeding. SBAM shall have until June 8, 2015, to retain new counsel.

_____

Cameron Elliot
Administrative Law Judge