

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

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 2349 / February 25, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of

SANDS BROTHERS ASSET MANAGEMENT, LLC, ORDER TO SHOW CAUSE
STEVEN SANDS,
MARTIN SANDS, AND
CHRISTOPHER KELLY

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. The OIP alleges that: Sands Brothers Asset Management, LLC (SBAM), willfully violated Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-2 thereunder because, for three years, it failed to timely distribute audited financial statements to investors of pooled investment vehicles managed by SBAM; and the other Respondents willfully aided, abetted, and caused SBAM's violations. OIP at 1-2, 7.

The Division of Enforcement and Christopher Kelly each filed a motion for summary disposition. Oppositions to the Division's motion were filed by: Kelly, who is pro se; SBAM, which is represented by attorney Martin Kaplan of Gusrae Kaplan Nusbaum PLLC¹; and Martin Sands and Steven Sands (collectively, the Sands), who are represented by Mayer Brown LLP. The Division filed an opposition to Kelly's motion. Lastly, the Division and Kelly filed reply papers.

Background and Discussion

During the investigation, Kaplan jointly represented Kelly, SBAM, and the Sands for at least some period of time, including at Kelly's April 2013 investigative testimony. Div. Opp., Brown Feb. Decl. ¶¶ 3, 8 & Ex. 4; Berke Decl., Ex. P at p. 6.² In February 2014, Kelly executed

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

² These cited declarations and exhibits were submitted in support of the Division's opposition to Kelly's motion for summary disposition.

a formal engagement letter with Kaplan. Brown Feb. Decl., Ex. 4. In April 2014, the Division wrote to Kaplan, raising the concern that Kaplan may have an unresolved conflict of interest in jointly representing Respondents. *Id.*, Ex. 6. The Division said it appeared that Kelly may have interests in the investigation that are divergent from, and potentially adverse to, the Sands and SBAM, because: on one hand, Kaplan had represented to the Division that the Sands relied on Kelly in connection with the late audits; and on the other hand, Kelly had left unsolicited voicemails with the Division stating his belief that he had no responsibility for the late audits and that his “confidential” voicemails should not be shared with the Sands. *Id.* It appears that Kaplan terminated representation of Kelly shortly thereafter, and Kelly has since been pro se.

Following the institution of this proceeding, I held a prehearing conference on December 2, 2014, which the parties attended except Kelly.³ At the conference, Kaplan represented both SBAM and the Sands. The Division said that it had raised an issue with Kaplan that could potentially impact the integrity of the proceeding. Tr. 8.⁴ 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. In its submission, SBAM does not dispute that it failed to timely distribute audited financial statements, but asserts that it was Kelly’s responsibility, as the firm’s chief compliance officer, to ensure compliance with such requirement. *See, e.g.*, SBAM Opp. at p. 6 (“The evidence presented at a 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.”), p. 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.”), p. 8 (“Slavin’s testimony and reports will confirm that Kelly was unequivocally responsible and sufficiently empowered [to] effectuate the compliance program at SBAM.”).

Given Kaplan’s prior representation of Kelly in the investigation, and that SBAM’s defense seeks to establish that Kelly was responsible for the alleged violation, a potential issue regarding the integrity of this proceeding may arise. Kaplan is likely privy to privileged information regarding Kelly, and it remains to be seen how Kaplan will effectively establish

³ At the time, Kelly was discussing an offer of settlement with the Division, which subsequently did not materialize.

⁴ Citation (Tr.) is to the prehearing conference transcript.

SBAM's defense, let alone examine Kelly at any hearing in this matter, without potentially implicating a conflict with his former client. See *United States v. Quest Diagnostics Inc.*, 734 F.3d 154, 167-68 (2d Cir. 2013) ("We have . . . previously found it necessary to dismiss counsel who had themselves committed no ethical violation, on the basis that confidences . . . could have been revealed to them that would prejudice a party in litigation." (alteration brackets and internal quotation marks omitted)); *United States ex rel. Stewart v. Kelly*, 870 F.2d 854, 857 (2d Cir. 1989) (finding that a serious potential conflict of interest existed where "[t]here was no guarantee that [the client's] interests could be served without vigorous cross-examination of [a former client of that attorney] in a manner wholly inconsistent with the [former client's] interests"); cf. N.Y. Rules of Prof'l Conduct 1.6, 1.9.

In its opposition to Kelly's motion, the Division asserts that Kelly agreed to waive any conflict with Kaplan, citing the February 2014 engagement letter executed by Kelly.⁵ See Div. Opp. at 24 (citing Brown Feb. Decl., Ex. 4). The engagement letter 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." Brown Feb. Decl., Ex. 4 at p. 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 p. 3. Although the letter may preclude Kelly from moving to disqualify Kaplan in this proceeding, nothing in the letter appears to wholly waive conflicts of interest. But even if Kelly did waive any conflict, my "independent duty to assure a fair [hearing] may override such a waiver." *Kelly*, 870 F.2d at 858; cf. *Wheat v. United States*, 486 U.S. 153, 163 (1988). Indeed, the Commission has cautioned that "[e]ven 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*, 55 S.E.C. 650, 653-54 (2002).

Ruling

As a result, I ORDER Kaplan to show cause by March 6, 2015, why disqualification is not appropriate. Kaplan should address, if practicable: whether Kelly's engagement letter actually waived any conflict of interest; whether Kaplan has privileged information about Kelly that could be used by SBAM against Kelly, and whether Kelly waived any claim against such use; the degree to which such privileged information has already been shared with SBAM and the Sands; the scope of SBAM's defense as it relates to Kelly, and the anticipated scope of Kaplan's examination of Kelly at any hearing in this matter, if Kelly is called to the stand; whether Kaplan plans to limit his examination of Kelly to curtail a potential conflict of interest with his former client, and how that scenario would not conflict with his duties in representing

⁵ The Division acknowledges that it is not in a position to know whether such waiver was appropriate under Kaplan's ethical obligations to Kelly and his other clients. Div. Opp. at 24. The Division states that it may have to bring this issue for my resolution should Kelly take the stand. *Id.* An earlier resolution, however, would be more efficient.

SBAM; and any other issues that may be appropriate. If Kaplan anticipates that his response will contain confidential or otherwise privileged information, he should seek a protective order.

The Division shall respond to Kaplan's submission by March 13, 2015. Kelly and the Sands may, but are not required to, respond to Kaplan's submission by March 13, 2015. Kaplan's reply is due March 18, 2015.

Cameron Elliot
Administrative Law Judge