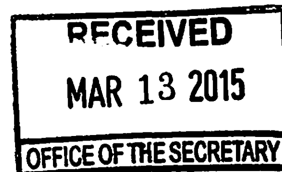
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of

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

Respondents.




# DIVISION OF ENFORCEMENT'S SUBMISSION IN RESPONSE TO THE COURT'S FEBRUARY 25, 2015 ORDER TO SHOW CAUSE

DIVISION OF ENFORCEMENT
Nancy A. Brown
Janna I. Berke
Securities and Exchange Commission
Brookfield Place, 200 Vesey Street
Suite 400
New York, New York 10281
(212) 336-1023 (Brown)
(212) 336-9144 (Berke)

Dated: March 12, 2015

# TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ........ iii

Preliminary Statement ........ 1

I. UNDER RULE 1.9, A LAWYER MAY NOT APPEAR IN A PROCEEDING INVOLVING HIS FORMER CLIENT IF HIS CURRENT AND FORMER CLIENTS HAVE MATERIALLY ADVERSE INTERESTS, UNLESS THE FORMER CLIENT GIVES HIS INFORMED CONSENT ........ 1

A. Kaplan Represented Kelly in a Matter Substantially Related to this One and Kelly's Interests Are Materially Adverse to Those of the Sands and SBAM ........ 2

B. To Satisfy Rule 1.9, Kelly's Consent Must Have Been Both Informed and Voluntary ........ 4

1. The Available Evidence Suggests that Kelly's Consent Was Not Adequately Informed ........ 6

2. Kaplan Has Not Shown that Kelly's Consent Was Voluntary ........ 8

II. KAPLAN'S DISCLOSURE OF KELLY'S VOICE MESSAGES TO THE SANDS OVER KELLY'S OBJECTION FURTHER CALLS INTO QUESTION KAPLAN'S IMPARTIALITY AMONG HIS CLIENTS ........ 9

A. In a Dispute Between a Lawyer and a Former Client Concerning Confidentiality, the Lawyer's Claim to Have No Confidential Information Is Insufficient ........ 9

B. In Kaplan's Hands, Kelly's Voice Mails to the Staff Were Confidential Information Kaplan Had a Duty Not to Disclose or Use to Kelly's Disadvantage ........ 10

1. The Voice Mails Were "Confidential Information" Under Rule 1.6 ........ 10

2. Rule 1.6 Prohibited Kaplan's Disclosure of the Voice Mails to the Sands without Kelly's Consent ........ 11

3. The February 18 Representation Letter Does Not Constitute Valid or Sufficient Consent ........ 12

III. SEVERING SBAM FROM THIS ACTION DOES NOT "RESOLVE THE CONCERNS" ........ 13

IV. OTHER POTENTIAL ISSUES SHOULD BE WEIGHED ........ 13

**Page**

V. THE INTEGRITY OF THESE PROCEEDINGS IS PARAMOUNT ....................................15

CONCLUSION ....................................................................................................................17

# TABLE OF AUTHORITIES

CASES

Page

Avra Surgical, Inc. v. Dualis Medtech GMBH, No. 13 Civ. 7863 (DLC), 2014 WL 2198598 (S.D.N.Y. May 27, 2014) .......... 9

Cardinale v. Golinello, 43 N.Y.2d 288 (1977) .......... 9

Celgene Corp. v. KV Pharm. Co., Civ. No. 07-4819 (SDW), 2008 WL 2937415 (D.N.J. July 29, 2008) .......... 5

CQS ABS Master Fund Ltd. v. MBIA Inc., No. 12 Civ. 6840 (RJS), 2013 WL 3270322 (S.D.N.Y. June 24, 2013) .......... 15, 16

Galderma Labs., LP v. Actavis Mid Atl. LLC, 927 F. Supp. 2d 390 (N.D. Tex. 2013) .......... 6

GEM HoldCo, LLC, v. Changing World Techs., L.P., 46 Misc. 3d 1207 (N.Y. Sup. Ct. 2015), appeal docketed, Index No. 650841/2013, Docket Entry 320 (Jan. 21, 2015) .......... 7

Government of India v. Cook, 569 F.2d 737 (2d Cir. 1978) .......... 3

Matter of Clarke T. Blizzard, No. 3-10007, 2002 WL 714444 (S.E.C. Apr. 24, 2002) .......... 15

Matter of John Thomas Capital Mgmt. Grp. LLC, File No. 3-15255, 2014 WL 5304908 (Initial Decision Oct. 17, 2014), review granted, Rel. No. 3978, 2014 WL 6985130 (Dec. 11, 2014) .......... 13

Matter of Morgan Asset Mgmt., Inc., No. 3-13847, 2010 WL 7765366 (Order Denying Mot. to Disqualify July 19, 2010) .......... 14

Mercado v. City of N.Y., No. 08 Civ. 2855 (BSJ)(HBP), 2010 WL 3910594 (S.D.N.Y. Sept. 30, 2010) .......... 8

Monzon v. United States, No. 13 Civ. 1943 (DLC), 2013 WL 4804095, at *4 (S.D.N.Y. Sept. 9, 2013) .......... 3-4

United States v. Oberoi, 331 F.3d 44 (2d Cir. 2003) .......... 16

United States ex rel. Stewart v. Kelly, 870 F.2d 854 (2d Cir. 1989) .......... 8, 14, 15

United States v. Quest Diagnostics, Inc., 734 F.3d 154 (2d Cir. 2013) .......... 16

Page

Wheat v. United States, 486 U.S. 153 (1988) .......... 15

STATUTES

Investment Advisers Act of 1940

Section 203(i), 15 U.S.C. § 80b-3(i)(1)(B)(2)(C)(i) .......... 13

COMMISSION RULES OF PRACTICE

Rule of Practice 111(d), 17 C.F.R. § 201.111(d) .......... 15

Rule of Practice 201(b), 17 C.F.R. § 201.201(b) .......... 13

RULES OF PROFESSIONAL CONDUCT AND OTHER AUTHORITIES

New York Rules of Professional Conduct, 22 NYCRR § 1200 et seq.

Rule 1.0, Terminology .......... 4, 11

Comment [6] .......... 4

Rule 1.6, Confidentiality of Information .......... 10, 11, 12

Comment [3] .......... 10

Rule 1.7, Conflict of Interest: Current Clients .......... passim

Comment [18] .......... 4-5

Comment [19] .......... 6, 11

Comment [21] .......... 12

Comment [22] .......... 5, 7

Comment [22A] .......... 12

Comment [29] .......... 5

Comment [29A] .......... 11

Comment [31] .......... 11, 16

**Page**

Rule 1.9, Duties to Former Clients ........................................ passim

Comment [3] ........................................ 3

Restatement (Third) of the Law Governing Lawyers

§ 121, Comment c ........................................ 3

§ 122, Comment b ........................................ 5

§ 122, Comment (c)(1) ........................................ 4

§ 132, Comment (d)(iii) ........................................ 9

Ass'n of the Bar of the City of N.Y., Eth. Op. 2006-01,
2006 WL 1662501, at *4 (Feb. 17, 2006) ........................................ 7-8

## Preliminary Statement

The Division of Enforcement ("Division") respectfully submits this Memorandum in response to the Court's February 25, 2015 Order to Show Cause on the issue of whether Mr. Kaplan ("Kaplan") and his firm should be disqualified. (Feb. 25, 2015 Order to Show Cause at 4.) ("The Division shall respond to Kaplan's submission by March 13, 2015.") The Court's Order showed concern that "[g]iven 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." (Id. at 2.)

The Division therefore makes this submission to supply the Court with relevant facts known to it and applicable legal principles. The Division's discussion, however, is limited by the fact that it is not privy to the confidential conversations that occurred between Kaplan and Kelly, between Kaplan and his then-clients Steven Sands and Martin Sands ("the Sands"), and between Kaplan and others who spoke on behalf of his current client, Sands Brothers Asset Management, LLC ("SBAM"), none of which is supplied by Kaplan. These facts may be dispositive to the Court's analysis of whether the conflict waiver, upon which Kaplan now relies, is valid.

## I. UNDER RULE 1.9, A LAWYER MAY NOT APPEAR IN A PROCEEDING INVOLVING HIS FORMER CLIENT IF HIS CURRENT AND FORMER CLIENTS HAVE MATERIALLY ADVERSE INTERESTS, UNLESS THE FORMER CLIENT GIVES HIS INFORMED CONSENT

Kaplan asserts that he should not be disqualified because Kelly has, by executing a conflicts of interest waiver, forfeited his right to object to Kaplan's continued representation of SBAM. (See Kaplan's Response to the ALJ's Order to Show Cause ("Kaplan Br.") at 1, 4-9; Affirmation of Martin H. Kaplan in Support of Submission on Order to Show Cause Relating to Disqualification of Martin H. Kaplan and Gusrae Kaplan Nusbaum, PLLC, affirmed March 5,

2015 ("Kaplan Aff."), Ex. A ("Representation Letter").) The Representation Letter that Kaplan now relies upon provided that "[y]ou [Kelly] explicitly agree that you will not seek to disqualify this firm from continuing to represent the Sands Entities, and/or the Individuals, should any conflict of interest develop." (Kaplan Aff., Ex. A at 2.)

Kaplan tacitly acknowledges, however, that absent Kelly's informed consent, Kaplan's representation of SBAM in this proceeding would run counter to New York Rule of Professional Conduct 1.9.[1] (Kaplan Br. at 4-5.) Under that Rule, "[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." (Emphasis added.) As explained below, it is beyond dispute that Kaplan formerly represented Kelly in the matter that is the focus of this proceeding and that Kelly's interests are materially adverse to the interests of the client that Kaplan is representing in the proceeding. The remaining issue for the Court is whether Kelly has provided *informed* consent to Kaplan's representation of SBAM in this proceeding. The Division submits that Kaplan has failed to carry his burden of showing that Kelly has given informed consent to Kaplan's representation of SBAM in this proceeding.

### A. Kaplan Represented Kelly in a Matter Substantially Related to This One and Kelly's Interests Are Materially Adverse to Those of the Sands and SBAM

There can be no dispute that the investigation leading to this proceeding – when Kaplan represented Kelly – is substantially related to the matter that is the focus of the current

---

[1] The New York Rules of Professional Conduct are found at 22 NYCRR §§ 1200 et seq. They are referred to hereinafter as the "Rules" or by an individual "Rule." The Comments to the Rules are available at http://www.nysba.org/WorkArea/DownloadAsset.aspx?id=50671.

proceeding.[2] See Rule 1.9, Comment [3] (matters that involve the same legal dispute are substantially related); see also Government of India v. Cook Indus., Inc., 569 F.2d 737, 739 (2d Cir. 1978) (finding substantial relationship where legal issues are "essentially the same").

Nor is there a dispute that Kelly's interests and SBAM's are today (and perhaps previously were) "materially adverse," since Kaplan's opposition on behalf of SBAM to the Division's Summary Disposition motion blames Kelly – and Kelly alone – for SBAM's admitted Custody Rule violations. (E.g., SBAM Opp'n to Div.'s Mot. for Summary Disposition at 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. . . . 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."); see also Answer of SBAM and the Sands, Second Affirmative Defense, at p. 4 ("Respondents reasonably relied upon SBAM's Chief Compliance Officer/Chief Operating Officer, Kelly, who was qualified, had extensive industry experience, is an attorney licensed to practice law in New York. Respondents were not aware of any red-flags which would have alerted them that Kelly was not functioning in the manner required by the SBAM's supervisory structure."); see generally Restatement (Third) of Law Governing Lawyers ("Restatement") § 121, comment (c)(i) & (c)(ii); Monzon v. United States, No. 13 Civ. 1943 (DLC), 2013 WL 4804095, at *4 (S.D.N.Y. Sept. 9, 2013) (finding

---

[2] Kaplan has not clearly addressed how long he represented Kelly. He acknowledges that he represented Kelly from the "commencement of the Commission's investigation in or around 2012." (Kaplan Br. at 9.) But he also maintains that the joint representation was not undertaken until "February 2014." (Kaplan Aff. ¶ 10.) Kaplan has not said whether he obtained conflict waivers in connection with representations undertaken prior to February 2014.

material adversity where "at too many junctures, the interests of" current and former clients "may be in conflict.").

Accordingly, Kaplan's continuation in this proceeding would seem to run counter to Rule 1.9 unless he establishes that he has obtained Kelly's informed consent, within the meaning of Rule 1.9(a), to Kaplan's representation of SBAM in this proceeding.

### B. To Satisfy Rule 1.9, Kelly's Consent Must Have Been Both Informed and Voluntary

Kaplan contends that the Representation Letter, dated February 18, 2014 and signed by Kelly on February 26, 2014, serves as Kelly's informed consent to Kaplan's representation of SBAM in this proceeding. The Representation Letter can serve as Kelly's informed consent within the meaning of Rule 1.9 only if it satisfies the standards of the Rule which requires the lawyer to obtain a client's consent that is adequately informed. Specifically, Kaplan must show that he had "communicated information adequate for [Kelly] to make an informed decision" and that he had "adequately explained to [Kelly] the material risks of the proposed course of conduct and reasonably available alternatives." See Rule 1.0(j) (defining "informed consent"). A lawyer who fails to inform the client of facts relevant to the client's understanding and evaluation of a conflict "assumes the risk that the client . . . is inadequately informed and the consent is invalid." See Rule 1.0(j), Comment [6]; see also Restatement § 122, Comment (c)(1); Rule 1.7[3], Comment [18] ("Informed consent requires that each affected client be aware of the relevant circumstances,

[3] Rule 1.7 governs conflicts of interest that may arise in the current joint representation of multiple clients. It governed Kaplan's behavior at the time the Representation Letter was signed.

including the material and reasonably foreseeable ways that the conflict could adversely affect the interests of that client.") [4]

Kaplan's discussions with Kelly had to be sufficiently specific so that Kelly could understand the reasonably foreseeable adverse consequences of the representations prior to waiving future conflicts of interest that might arise:

> The effectiveness of advance waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails. . . . The more comprehensive the explanation and disclosure of the types of future representations that might arise and the actual and reasonably foreseeable adverse consequences of those representations, the greater the likelihood that the client will have the understanding necessary to make the consent 'informed' and the waiver effective.

Rule 1.7, Comment [22].

And Kelly's consent had to be voluntary. "'[W]here dual representation is sought to be justified on the basis of the parties' consents,'" such consents must be "'knowing, intelligent and voluntary.'" Celgene Corp. v. KV Pharm. Co., Civ. No. 07-4819 (SDW), 2008 WL 2937415, at *4 (D.N.J. July 29, 2008) (quotations omitted); see also Restatement § 122, Comment b ("Client consent must also, of course, be free of coercion.").

Finally, Kaplan – not Kelly or the Division – today bears the burden of showing that Kelly's consent was both informed and voluntary. "Where the fact, validity or propriety of client

---

4 Kaplan's brief does not squarely address whether the Sands and SBAM gave their own informed consent to conflicts of interest that might arise as a result of Kaplan's joint representation. See Kaplan Br. at 6 ("As part of Kaplan's representation of each of the individual Respondents, Kelly executed Engagement Letters, which contained the Conflict Waiver and the individual Respondents expressly agreed that they would share confidential information with each other and SBAM."). Thus the staff does not know whether the requirement that "each affected client gives informed consent" in writing was fulfilled. Rule 1.7 (b)(4) (governing conflicts of interest in joint representations) and Comment [29] ("A lawyer should consult with each client concerning the implications of the common representation, including the advantages and the risks involved, and the effect on the attorney-client privilege, and obtain each client's informed consent, confirmed in writing, to the common representation.")

consent is called into question, the lawyer has the burden of establishing that the client's consent was properly obtained in accordance with the Rule." Rule 1.7, Comment [19]; see also Galderma Labs., LP v. Actavis Mid Atl. LLC, 927 F. Supp. 2d 390, 398 (N.D. Tex. 2013) (with regard to the burden of proof on informed consent, it is "the attorney's burden to show a reason why the court should allow the otherwise impermissible dual representation.").

### *1. The Available Evidence Suggests that Kelly's Consent Was Not Adequately Informed*

Neither the Representation Letter nor Kaplan's Brief provides sufficient information to substantiate Kaplan's contention that Kelly was appropriately informed, within the meaning of Rule 1.9, before signing the Representation Letter. The evidence available to date indicates that Kelly's consent was not informed. Indeed, the Representation letter appears to contain little more than standard language. It does not reflect the unique facts of Kelly's situation that Kaplan was required to explore with Kelly as a prerequisite to obtaining informed consent.[5]

Nor does the Representation Letter address the litigation strategy that Kaplan appears to have already adopted: that his defense of SBAM would be based on blaming Kelly. In a call with the staff on August 7, 2013, Kaplan confirmed that SBAM had not distributed audited financial statements for its managed funds within the time frame set out by the Custody Rule. He further stated – much like he ultimately argued in opposition to Summary Disposition – that SBAM and the Sands had relied on SBAM's compliance officer and the compliance officer had not understood the Custody Rule. He added his view that the only issue here was how responsibility for the late delivery of the financial statements should be allocated. (Declaration

---

[5] For example, the Representation Letter does not identify any of the Rules of Professional Conduct that govern the representation at issue, referring only generically to the "Code of Professional Responsibility For Lawyers." Notably, in 2009, New York replaced the Code with the New York Rules of Professional Conduct.

of Nancy A. Brown in Support of the Division's Submission in Conjunction with the Court's February 25, 2015 Order, executed March 12, 2015 ("Brown March Decl."), ¶ 2.)

Thus, by February 18, 2014, when Kaplan presented Kelly with the Representation Letter, Kaplan must have foreseen the likelihood that Kelly's interests in any subsequent proceeding would be adverse to those of his other clients, the Sands and SBAM. The Representation Letter, itself, makes no specific mention of that foreseeable conflict. To the contrary, the letter states that "[b]ased upon our review of the file to date, we have not found any apparent conflict of interest that would serve to prevent us from undertaking such representation." (Kaplan Aff., Ex. A at 2.) In light of this representation, the Representation Letter, standing alone, does not demonstrate that Kaplan fulfilled his obligation to Kelly to ensure that his consent was informed.[6]

Thus Kaplan must rely on something other than the Representation Letter to carry his burden under Rule 1.9. Kaplan's submission provides no evidence on the question. Nowhere does Kaplan inform the Court about any discussions or other communications with Kelly on this topic. He gives no assurance that his communications to Kelly were comprehensive or that he disclosed the potential conflicts that might arise or the adverse consequences to Kelly of those conflicts. Rule 1.7, Comment [22].[7]

---

6 This is why Kaplan's reliance on GEM HoldCo, LLC, v. Changing World Techs., L.P., 46 Misc. 3d 1207 (N.Y. Sup. Ct. 2015), appeal docketed, Index No. 650841/2013, Docket Entry 320 (Jan. 21, 2015) (Kaplan Br., passim) is so misplaced. In GEM, when the lawyer obtained the prospective waiver, the conflict had not yet arisen.

7 For the same reasons, Kaplan has also not provided sufficient evidence to support the conclusion that in February 2014 he "reasonably believe[d] that [he would] be able to provide competent and diligent representation to each affected client" as was required by Rule 1.7(b)(1). If a disinterested lawyer "'would conclude that any of the affected clients should not agree to the [multiple] representation under the circumstances, the lawyer involved should not ask' for the advance waiver" because the conflict is not consentable. Ass'n of the Bar of the City of N.Y.,

In sum, Kaplan knew by August 2013, that he was at least considering assigning responsibility to Kelly for SBAM's failings, and in light of the silence of his submission on what he and Kelly discussed about the import and ramifications of the waiver, Kaplan has failed to carry his burden of showing that he has obtained Kelly's informed consent to his representation of SBAM in this proceeding. See generally United States ex rel. Stewart v. Kelly, 870 F.2d 854, 857 (2d Cir. 1989) (refusing to give weight to a defendant's consent to waive an attorney's conflict of interest where "it was not at all clear that [such] consent was knowing" because "[t]he record is incomplete on this question."); Mercado v. City of N.Y., No. 08 Civ. 2855 (BSJ)(HBP), 2010 WL 3910594, at *8 (S.D.N.Y. Sept. 30, 2010) (requiring defendants to submit new declarations to the court waiving counsel's conflicts of interest, because the declarations submitted "do not acknowledge and expressly agree to waive the personal defenses that they will forfeit as a result of this joint representation").

### 2. *Kaplan Has Not Shown that Kelly's Consent Was Voluntary*

In any event, even if Kaplan did provide the information and counseling to which Kelly was entitled, Kelly's voice mails to the staff indicate that the consent he gave may not have been voluntary. On his February 18, 2014 voice mail to the staff (the same date of Kaplan's Representation Letter), Kelly suggests that the Sands had threatened to fire him if he did not cooperate with their defense in connection with the investigation. "I also promise I will look for another job so the Sands' threats to fire me if I don't go along – whatever that means – will be mooted." (Declaration of Nancy A. Brown In Support of the Division's Opposition to Kelly's Motion for Summary Disposition, executed February 12, 2015 ("Brown Feb. Decl."), Ex. 2 (Feb. 18, 2014 Voice Mail).) Kelly has not offered further detail for the Court about the circumstances

---

Eth. Op. 2006-01, 2006 WL 1662501, at *4 (Feb. 17, 2006) (internal citations omitted) (cited in Kaplan Br. at 5).

in which that threat was made, but if he understood that his acquiescence to Kaplan's defense of all of Respondents – including Kaplan's plan to blame him for the violations – was a condition of his continued employment, then any purported consent given by Kelly was not voluntary.

## II. KAPLAN'S DISCLOSURE OF KELLY'S VOICE MESSAGES TO THE SANDS OVER KELLY'S OBJECTION FURTHER CALLS INTO QUESTION KAPLAN'S IMPARTIALITY AMONG HIS CLIENTS

### A. In a Dispute Between a Lawyer and a Former Client Concerning Confidentiality, the Lawyer's Claim to Have No Confidential Information Is Insufficient

Kaplan's assertion that he obtained no confidential information about Kelly during his representation of him is not dispositive on the issue before the Court under Rule 1.9(a). Indeed, as courts have noted, whether confidential information was exchanged or not is irrelevant to Rule 1.9(a) because that subsection reflects the lawyer's duty of loyalty to former clients, a duty that is independent and distinct from the lawyer's duty to preserve confidentiality. E.g., Avra Surgical, Inc. v. Dualis Medtech GMBH, No. 13 Civ. 7863 (DLC), 2014 WL 2198598, at *4 (S.D.N.Y. May 27, 2014) (rejecting lawyer's claim that he should not be disqualified because no confidential information was exchanged between him and his former client as irrelevant, and holding that it was the lawyer's "duty of loyalty that prevents him from representing" his current client); Cardinale v. Golinello, 43 N.Y.2d 288, 295-296 (1977) ("it is no answer that the lawyer did not in fact obtain any confidential information in connection with the first employment. . . . [T]he first client is entitled to freedom from apprehension and to certainty that his interests will not be prejudiced in consequence of representation of the opposing litigant by the client's former attorney."); accord Restatement § 132, comment (d)(iii).

Thus, absent an informed and voluntary waiver, Kelly was entitled to Kaplan's continued loyalty, even after Kaplan's representation of him ended, and even if he had provided him with no confidential information at all.

### B. In Kaplan's Hands, Kelly's Voice Mails to the Staff Were Confidential Information Kaplan Had a Duty Not to Disclose or Use to Kelly's Disadvantage

Contrary to Kaplan's assertions in his brief, Kelly's voicemails to the staff (Brown Feb. Decl., Exs. 1-3, 5) were confidential information that, absent Kelly's informed consent, Kaplan had a duty to withhold from the Sands. Kaplan's decision to share the voice messages with the Sands appears to have been inconsistent with his obligations to Kelly under Rule 1.6.

#### *1. The Voice Mails Were "Confidential Information" Under Rule 1.6*

Kaplan assumes that if Kelly's voice mails were not required to be treated as confidential information in the Division's hands, they were also not confidential once he obtained them from the Division in April 2014. (Kaplan Br. at 10.) Kaplan fails to distinguish the obligations of Division staff from his own ethical obligations to Kelly under Rule 1.6. The Division explained in its letter to Kaplan why it disclosed the voice mails to him. (Brown Feb. Decl. Ex. 6.) The staff's disclosure to Kaplan did not relieve Kaplan of his own separate ethical obligations to Kelly under Rule 1.6.

Rule 1.6 defines "confidential information" as "information gained during or relating to the representation of a client, *whatever its source*, that is (a) protected by the attorney-client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential." (Emphasis added.) In other words, a lawyer's duty of confidentiality applies not only to information protected by the attorney-client privilege. Rule 1.6 and Comment [3]. The voice mails satisfy both (b) and (c) of the definition: It should

have been apparent to Kaplan that disclosure of the tapes to the Sands would be detrimental to Kelly, as Kelly alleges that it was. According to Kelly, the disclosures resulted in the Sands' immediate decision to put Kelly on unpaid leave and to withdraw his indemnification. (See Kelly Mot. for Summary Disposition at 5.) Kelly had asked that the information be kept confidential, a request he made in the voicemails themselves. The Division made that request clear to Kaplan when it sent the voice mails to him in April. (Brown Feb. Decl., Ex. 6, at 1-2 ("The potential conflict becomes even more apparent in light of the fact that the unsolicited voice mails that Mr. Kelly left with the staff strongly suggest that he does not want the content of his voice mails to be shared with Steven Sands or Martin Sands.").) Accordingly, the tapes of the voice mails were "confidential information" within the meaning of Rule 1.6.[8]

### 2. *Rule 1.6 Prohibited Kaplan's Disclosure of the Voice Mails to the Sands without Kelly's Consent*

Rule 1.6 prohibits a lawyer from "knowingly reveal[ing] confidential information, as defined in this Rule, or us[ing] such information to the disadvantage of a client or for the advantage of the lawyer or a third person, unless. . . the client gives informed consent as defined in Rule 1.0(j)." A lawyer's duty of confidentiality to a client who requests that certain information be kept confidential from other clients applies even when the lawyer represents clients jointly in a matter. See Rule 1.7, Comment [31] ("At the outset of the common representation . . . the lawyer should advise each client that . . . the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other."). As discussed above at Point I.B, Kaplan bears the burden of showing that he obtained

---

8 Thus, Rule 1.6 imposes special responsibilities on Kaplan to retain the confidentiality of the voice mails that did not apply to the Division. As previously explained, the Division had no similar confidentiality restrictions, and it was careful to disclose them only to Kelly's lawyer. (Div. Opp'n to Kelly's Mot. for Summary Disposition ("Div. Opp'n") at 22-24.)

Kelly's informed and voluntary consent to share his confidential information with the Sands. Id., Comment [19]. As between Kelly and the Sands, Kaplan owed a duty to remain impartial between his commonly represented clients.' Id., Comment [29A].

Thus, contrary to Kaplan's assertions, Rule 1.6 prohibited his disclosure of the voice mails to the Sands in April without Kelly's current consent.

### 3. *The February 18 Representation Letter Does Not Constitute Valid or Sufficient Consent*

For all the reasons provided above, Kaplan has not satisfied his burden to establish that the Representation Letter reflected Kelly's informed and voluntary consent to disclosure of the voice messages.

In addition, the situation in April presented significantly different issues that Kaplan was required to consider and potentially additional disclosure obligations for Kaplan to satisfy under Rule 1.6. To be sure, the letter states that "you expressly agree that any information you provide to us . . . may be made available to the Sands Entities," but that agreement, even if effective at the time it was signed, cannot relieve a lawyer of his ongoing duty to represent each affected client with competence and diligence. See Rule 1.7(b)(1) and Comment [22A] ("Even if a client has validly consented to waive future conflicts, the lawyer must reassess the propriety of the adverse concurrent representation under paragraph (b) when an actual conflict arises. If the actual conflict is materially different from the conflict that has been waived, the lawyer may not rely on the advance consent previously obtained"); cf. Rule 1.7, Comment [21] ("A client who has given consent to a conflict may revoke the consent").

The conflict facing Kaplan in April 2014 was materially different -- involving sharing confidences over one client's objections, and based on a new set of facts -- than the conflict he

faced in February. That situation required his reassessment and potentially a new consent from Kelly. There is no evidence that Kaplan even considered these issues.

## III. SEVERING SBAM FROM THIS ACTION DOES NOT "RESOLVE THE CONCERNS"

Kaplan's footnoted suggestion that this proceeding be severed with respect to SBAM under Rule of Practice 201(b) does not "resolve the concerns raised in the ALJ's Order." (Kaplan Br. at 2 n.5.) Even if the only issue left to resolve against SBAM was the appropriate "penalty" (id.)[9], resolution of it undoubtedly involves consideration of SBAM's defense: "that Kelly was responsible for the alleged violation." (Kaplan Br. at 2.) Factors in any penalty analysis will include whether SBAM's conduct involved "deliberate or reckless disregard of a regulatory requirement." 15 U.S.C. § 80b-3(i)(1)(B)(2)(C)(i). Since an entity can only act through its principals, Kelly's and the Sands' conduct is directly relevant to that analysis. Matter of John Thomas Capital Mgmt. Grp. LLC, File No. 3-15255, 2014 WL 5304908, at *25 (Initial Decision Oct. 17, 2014), review granted, Rel. No. 3978, 2014 WL 6985130 (Dec. 11, 2014).[10]

## IV. OTHER POTENTIAL ISSUES SHOULD BE WEIGHED

Other potential issues, not addressed in Kaplan's submission, threaten to disrupt any further proceedings in this matter and should be considered now.

In his motion for Summary Disposition, Kelly claims that he consulted with Kaplan as to issues relating to the Custody Rule. (See Kelly Br. at 10-11 (noting "Kelly discussed custody matters with the Gusrae Firm"; "[t]he legal component with respect to custody matters was

---

9 It is not. The Division has also sought revocation of SBAM's registration, and, if appropriate, a Cease-and-Desist Order. (Div. Mot. for Summary Disposition at 26-30, 30-31.)

10 These matters can be addressed on Summary Disposition in light of the Respondents' failure to adduce any evidence to raise a material issue of fact. (Div. Reply Br. at 1-12.) Unlike severance, disposition of SBAM's liability and the appropriate remedy would "resolve the concerns" with Kaplan's continued representation of SBAM.

handled by the Gusrae Firm, Cohen & Wolf, and other outside counsel").) The Division maintains that evidence of such conversations should be precluded from any hearing (and can be disregarded by the Court on Summary Disposition) because Kelly has not properly asserted an advice of counsel defense (Div. Opp'n at 17-19), nor made the production of the evidence needed to mount such a defense. But if the Court were to allow Kelly to assert such a defense in the future, Kaplan might be called by Kelly or the Division as a percipient witness to the advice sought and given. In that event, Kaplan's disqualification would likely be appropriate under Rule 3.7(a), which counsels that "[a] lawyer shall not act as advocate before a tribunal in a matter in which the lawyer is likely to be a witness on a significant issue of fact . . . ." Furthermore, if the propriety of Kaplan's advice became an issue, withdrawal would additionally be necessary because it could create a conflict of interest between Kaplan and either his current client, SBAM, or his former clients, Kelly or the Sands. Rule 3.7, Comment [1].

Similarly, if the Court determines that Kaplan should continue to represent SBAM in the proceeding, in light of Kaplan's duties to his former client, Kelly, under Rule 1.9 discussed above, it should give due consideration to the question of whether Kaplan should be allowed to cross examine Kelly on behalf of SBAM at any hearing. At least one Judge has suggested that it could be appropriate for a respondent to retain independent counsel for the purpose of cross-examining witnesses who were formerly represented by his counsel. See Matter of Morgan Asset Management, Inc., No. 3-13847, 2010 WL 7765366, at *9 (Order Denying Mot. to Disqualify July 19, 2010); see generally United States ex rel. Stewart, 870 F.2d at 857 (discussing the conflict involved where lawyer must vigorously cross examine former client).

## V. THE INTEGRITY OF THESE PROCEEDINGS IS PARAMOUNT

In determining whether disqualification is appropriate, courts "balance a client's right freely to choose his counsel against the need to maintain the highest standards of the profession." CQS ABS Master Fund Ltd. v. MBIA Inc., No. 12 Civ. 6840 (RJS), 2013 WL 3270322, at *8 (S.D.N.Y. June 24, 2013) (quotations omitted). The client's right to counsel of his choosing is not "an absolute right," and may be "outweighed by the necessity of ensuring that our administrative proceeding is conducted with a scrupulous regard for the propriety and integrity of the process." Matter of Clarke T. Blizzard, No. 3-10007, 2002 WL 714444, at *2 (S.E.C. Apr. 24, 2002) (disqualifying counsel under Rule of Practice 111(d) where counsel's concurrent representation of respondent and potential witnesses who could testify against respondent created "serious potential for prejudice to the integrity of the proceeding"); see generally Wheat v. United States, 486 U.S. 153, 164 (1988) (denying defendant counsel of his choice where a serious potential conflict of interest existed).

This is especially so where a "serious potential for conflict" of interest exists, Wheat, 468 U.S. at 164, and "it is hard to conceive of a conflict of interest between clients that would not be serious." United States ex rel. Stewart, 870 F.2d at 857. Disqualification may be appropriate even in the face of a knowing waiver where there is the potential for a serious conflict. See Wheat, 468 U.S. at 160-62; United States ex rel. Stewart, 870 F.2d at 858; Blizzard, 2002 WL 714444, at *2 (noting that the Commission's concern regarding the appearance of lack of judicial integrity "cannot be addressed by the consent of [counsel's] clients to his representation of them").

"Disqualification is not a sanction, but a remedy that seeks to avoid prejudice to the party whose confidences have been revealed and, in so doing, promote the integrity of our justice system." United States v. Quest Diagnostics, Inc., 734 F.3d 154, 168 n.21 (2d Cir. 2013).

If the Court determines that Kaplan's conduct merits disqualification, then SBAM's right to freely choose its counsel must bow to the "public's interest in the outcome." CQS ABS Master Fund, 2013 WL 3270322, at *8 (S.D.N.Y June 24, 2013) (quoting United States v. Oberoi, 331 F.3d 44, 51 (2d Cir. 2003).) Although Kaplan claims that if he is disqualified, SBAM will suffer prejudice, imposing "a significant and unfair hardship on SBAM," owing to Kaplan's extensive knowledge and experience derived from his representation of SBAM since 2006 (Kaplan Br. at 3), those concerns cannot trump the interests of the integrity in the process and Kelly's right to a fair proceeding. Indeed, the risk that Kaplan might have to withdraw from representing any of the jointly-represented clients is a risk that Kaplan should have fully explained to each of the clients, including SBAM. See Rule 1.7, Comment [31]. In any event, Kaplan's prediction of prejudice appears overstated; as SBAM concedes, the only matters left with regard to it in this action are remedies, and in light of the fact that the Sands – SBAM's control persons – have already retained new counsel, they apparently feel comfortable with different representation, despite their history with Kaplan. Kaplan offers no reason why SBAM would be singularly disadvantaged by retaining new counsel if the Sands have already concluded that they are not.

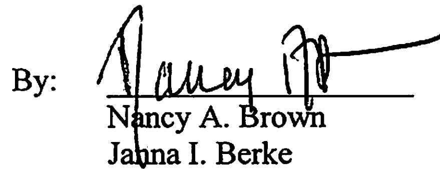
## CONCLUSION

As noted above, the Division submits this memorandum in order to aid the Court in its determination as to whether Kaplan and his firm can continue to represent SBAM.

Dated: New York, New York
March 12, 2015

Respectfully submitted,

DIVISION OF ENFORCEMENT

By: 

Nancy A. Brown
Janna I. Berke

Securities and Exchange Commission
Brookfield Place, 200 Vesey Street
Suite 400
New York, New York 10281
(212) 336-1023 (Brown)
(212) 336-9144 (Berke)

CERTIFICATE OF SERVICE

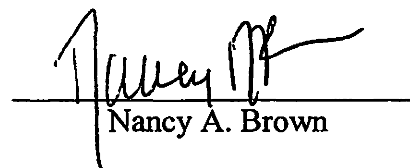
I hereby certify that I caused copies of the Division's Submission in Response to the Court's February 25, 2015 Order to Show Cause, and the Declaration of Nancy A. Brown dated March 12, 2015, to be served on the following this 12th day of March 2015, in the manner indicated below.

Via UPS Overnight

Christopher Kelly, Esq.
[redacted]
(Pro Se)

Martin Kaplan, Esq.
Gusrae Kaplan Nusbaum PLLC
120 Wall Street
New York, NY 10005
(Counsel for Respondent SBAM)

Matthew Rossi, Esq.
Mayer Brown LLP
1999 K Street, N.W.
Washington, D.C. 20006-1101
(Counsel for Respondents Steven Sands and Martin Sands)



Nancy A. Brown