BEFORE THE

REVIEW SUBCOMMITTEE OF THE

NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Market Regulation, Complainant, vs. [Respondent Firm], et al., Respondent.	DECISION Complaint No. CMS040165 Dated: September 30, 2005

Attorney for two individual respondents disqualified from a disciplinary proceeding. Held, findings and disqualification affirmed.

DECISION

Pursuant to NASD Procedural Rule 9280(c), attorney [Attorney A] seeks review of a Hearing Officer order disqualifying [Attorney A] from participating in a disciplinary proceeding as counsel for [Respondent 1 and Respondent 2]. After considering both [Attorney A's] motion to vacate the Hearing Officer's order and the response of the Department of Market Regulation (the "Department"), we affirm the Hearing Officer's findings and affirm the disqualification of [Attorney A] from the proceedings below.[1]

I. Procedural Background

[1] [Attorney A] inaccurately styled his motion as a "Motion of Appeal" filed by [Respondents 1 and 2]. As we noted in our previous decision, Rule 9280(c) makes clear that, after an attorney is disqualified, the attorney—not his clients—may file a motion to vacate with the National Adjudicatory Council (the "NAC"). We treat [Attorney A's] filing as a motion to vacate the Hearing Officer's disqualification order. *See* NASD Procedural Rule 9280(c).

The issue of [Attorney A's] potential disqualification is now before us for the second time. On June 17, 2005, we issued a decision (the "Remand Order") affirming in part and remanding in part a Hearing Officer's March 24, 2005 order preventing [Attorney A] from cross-examining [RD], [Attorney A's] former client, during a disciplinary proceeding concerning [Respondents 1 and 2's] alleged misconduct. In the Remand Order, we directed the Hearing Officer to determine whether [Attorney A's] continued representation of [Respondents 1 and 2] would result in a material conflict and, in making this determination, to consider certain relevant facts and circumstances.[2]

On June 21, 2005, the Hearing Officer issued an order allowing both parties to file briefs addressing the facts and circumstances identified in the Remand Order to determine whether a material conflict existed. The order required that any briefs be filed by July 8, 2005. [Attorney A] states that, on June 27, 2005, [Respondents 1 and 2] filed a motion (the "First Motion") requesting that the Hearing Officer modify the briefing schedule to require that the Department file its brief first and thus allow [Respondents 1 and 2] an opportunity to respond to the Department's brief.[3] The First Motion stated that [Respondents 1 and 2] "at this time would be [sic] able to properly brief or respond to the disqualification issue, since they do not know what factual or legal basis the Department will now contend supports a conclusion of disqualification." The First Motion also asserted that "the Department has never previously made a proffer as to what specific testimony it intends to elicit from [RD]; or how it is material to the case."[4] The record indicates that, while [Respondents 1 and 2] served the First Motion on the parties, it was not filed with the Office of Hearing Officers.[5]

On July 5, 2005, [Respondents 1 and 2] filed a second motion to modify the briefing schedule (the "Second Motion") because the Hearing Officer had not yet ruled on the First Motion. The Second Motion included an additional request that the briefing schedule be extended to accommodate [Attorney A's] vacation schedule such that briefs would be due on

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[2] The facts underlying the Department's motion to disqualify [Attorney A] are discussed at length in the Remand Order. Consequently, we need not repeat them here.

[3] The record indicates that before filing the First Motion, [Respondents 1 and 2]sent a letter to the Office of Hearing Officers requesting that the briefing schedule be modified. This letter was rejected on procedural grounds, and [Attorney A] represents that he received the notification of the rejection on June 25, 2005.

[4] As discussed more fully below, we find [Attorney A's] contention that the Department failed to proffer "what specific testimony it intends to elicit from [RD]" to be without merit. *See infra* note 10.

[5] [Attorney A] included as exhibits to his motion to vacate the motions and briefs filed with the Hearing Officer relevant to the issue of his disqualification. Among these are copies of both the First Motion and delivery confirmation information regarding the service of the First Motion. The fax confirmation sheet [Attorney A] included in the exhibit does not include the Office of Hearing Officers' fax number.

July 12 rather than July 8. On July 6, the Hearing Officer issued an order denying the Second Motion, which stated, as grounds for denial, that [Respondents 1 and 2] had waited almost two weeks to file the Second Motion.[6] The following day, [Respondents 1 and 2] filed a motion for reconsideration in which they set forth a chronology of the filings to demonstrate that, contrary to the Hearing Officer's assertions, [Respondents 1 and 2] had not delayed in filing their motion. That same day, the Hearing Officer granted the request to extend the deadline for the filing of briefs until July 12, 2005. While the Hearing Officer extended the filing date, she did not modify the briefing schedule to permit [Respondents 1 and 2] to file their brief after the Department's brief had been filed.[7] On July 13, 2005, together with their brief, [Respondents 1 and 2] filed a motion for leave to file a reply brief, which was denied by the Hearing Officer on July 15, 2005. The Hearing Officer's order stated that [Respondents 1 and 2] "have presented no new facts which would demonstrate good cause to grant the motion."

On August 22, 2005, the Hearing Officer issued a decision disqualifying [Attorney A] from the proceedings below. After considering the factors outlined in the Remand Order, the Hearing Officer determined that a material conflict existed and that, consequently, [Attorney A] must be disqualified. On August 29, 2005, pursuant to NASD Procedural Rule 9280(c), [Attorney A] filed a motion to vacate seeking the NAC's review of the order.

II. Discussion

[Attorney A's] motion to vacate raises two types of concerns that we must address. First, [Attorney A] challenges the procedural fairness of the proceedings below.[8] Second, [Attorney A] challenges the Hearing Officer's determination that the Department demonstrated that [Attorney A] should be disqualified. We address each of these in turn.

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[6] In the order denying the Second Motion, the Hearing Officer stated that "[[Respondents 1 and 2] refer to this as a supplemental motion and make reference to an initial motion to modify the briefing schedule. The Office of Hearing Officers did not receive an initial motion and can only infer that [[Respondents 1 and 2 are] referring to a letter dated June 21, 2005 sent to the Office of Hearing Officers on this issue."

[7] The Hearing Officer's order again notes that "[Respondents 1 and 2] indicate that they served or sent their original motion to modify the briefing schedule to the Office of Hearing Officers on June 27, 2005[; however,] [r]espondents offered no evidence to substantiate this, and the Office of Hearing Officers has no record of having received it."

[8] [Attorney A] also requests that a new Hearing Officer be assigned to the proceedings because of the Hearing Officer's alleged "significant bias" against [Respondents 1 and 2]. Pursuant to NASD Procedural Rule 9148, the only issues appropriate for interlocutory review are disqualifications under Rule 9280. If [Respondents 1 and 2] wishes to move for the Hearing Officer's disqualification, that remedy lies within the procedural framework of NASD Procedural Rule 9233, not as part of a motion to vacate under Rule 9280.

A. Procedural Issues

[Attorney A] contends that by requiring the contemporaneous filings of briefs, and subsequently refusing to allow [Respondents 1 and 2] to file a reply to the Department's brief following the Remand Order, the Hearing Officer violated principles of "fundamental fairness."[9]

The Securities Exchange Act of 1934 (the "Exchange Act") requires that NASD develop procedures to ensure that its disciplinary proceedings are conducted fairly. *See* Exchange Act § 15A(b)(8). [Attorney A] argues that the Hearing Officer violated NASD Procedural Rule 9146 by failing to permit [Respondents 1 and 2] to file a reply brief. We disagree. Rule 9146 provides that a party in an NASD disciplinary proceeding has fourteen days in which to file a response to a motion; however, this provision is inapposite to the briefing schedule ordered by the Hearing Officer following our remand. Here, the only "motion" at issue was the Department's initial January 6, 2005 motion to disqualify [Attorney A], which the Respondents responded to on January 20, 2005. After the Review Subcommittee remanded the Hearing Officer's March 24, 2005 decision, neither party was entitled to any filing. Nonetheless, the Hearing Officer permitted—but did not require—the parties to file supplemental briefs to address the issues raised in the Remand Order. After these supplemental briefs were filed, the Hearing Officer considered, and ultimately denied, [Respondents 1 and 2's] request to file a reply brief because she found that they "presented no new facts which would demonstrate good cause to grant the motion."[10] In doing so, the Hearing Officer did not violate any aspect of NASD's Procedural Rules or any of the fairness requirements imposed by the Exchange Act.[11]

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[9] [Attorney A] also contends that [Respondents 1 and 2's] due process rights were violated. However, NASD is not a state actor, and constitutional due process rights do not attach in NASD disciplinary hearings. *See, e.g.*, *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 161-63 (2d Cir. 2002); *Desiderio v. Nat'l Ass'n of Secs. Dealers, Inc.*, 191 F.3d 198, 206-07 (2d Cir. 2002).

[10] As noted above, [Attorney A] contends that the Department never proffered facts to support its motion to disqualify. [Attorney A] argues that, because of this, he should have been permitted to file a reply brief to address these issues. We disagree. In its original motion to disqualify, the Department proffered that, "[a]mong other things, [RD] will testify about his unsuccessful efforts to get [Respondent 2] to respond to customer complaints regarding sales fraud and penny stocks and about [Respondent 1's] improper sale of more than 58,000 shares of stock in defiance of [RD's] express warnings that the sales appeared to violate the securities laws." In the supplemental briefing that took place before the Hearing Officer issued her initial order on March 24, 2005, the Department reiterated this: "As described in the Motion to Disqualify, [RD] will testify that he told Respondent [1] that his conduct was illegal, but [Respondent 1] ignored the advice and continued to sell unregistered securities. [RD] also called [Respondent 2's] attentions [sic] to customer complaints, which [Respondent 2] ignored." [Attorney A's] effort to claim that he had no knowledge of the factual basis of the Department's disqualification motion as it related to [RD's] anticipated testimony is simply not credible.

Consequently, we dismiss [Attorney A's] claim that the Hearing Officer's handling of the process was deficient and deprived [Respondents 1 and 2] of a fair process.

B. The Hearing Officer's Decision

In the Remand Order, we set forth both the appropriate analysis for Hearing Officers to use when determining whether to disqualify an attorney from an NASD disciplinary proceeding and several specific factors for the Hearing Officer to consider in this case. After a review of the Hearing Officer's order, we find that she properly weighed the considerations, and we affirm her disqualification of [Attorney A]. [Attorney A's] motion to vacate raises a host of issues regarding the Hearing Officer's decision; however, for the reasons described below, we reject each of them.

First, [Attorney A] claims that the Hearing Officer "erroneously did not require the Department to submit any competent evidence (let alon[e] ANY evidence) as to any of the purported facts from which the Hearing Officer made her factual conclusion." [Attorney A] notes that the Department did not submit excerpts from [RD's] on-the-record testimony to substantiate their proffers, instead relying only on "bald conclusory statements as to [RD's] anticipated testimony." In fact, the Department submitted a sworn declaration from the compliance examiner who investigated the case, and the declaration included specific statements regarding [RD's] on-the-record testimony, the documents produced by [RD] through [Attorney A], and their relevance to the Department's case. Moreover, the Department's motion is premised upon [RD's] *expected* testimony; as it is impossible to know with certainty what an individual's testimony may ultimately include, it is certainly reasonable for the Hearing Officer to rely on a sworn declaration from the examiner to infer what [RD's] anticipated testimony is likely to be.

Second, [Attorney A] argues that the Department "failed to satisfy the initial threshold issue to show that [Attorney A] represented [RD] in a substantially related matter in which the interest[s] of [RD] were *materially adverse*." (Emphasis in original.) We find, however, that the matters involving [Attorney A's] representation of [RD], Respondent 1, and Respondent 2] are substantially related given that [RD's] anticipated testimony is focused on [Respondent 1 and Respondent 2's] alleged misconduct. *See* Model Rules of Prof'l Conduct R. 1.9, cmt. 3 (2004) ("Matters are 'substantially related' for purposes of this Rule if they involve the same transaction or legal dispute."). The Hearing Officer found that a material adversity of interest existed because, if the direct testimony of [RD], as a currently registered person, were to be discredited during cross-examination, [RD's] testimony could subject him to disciplinary action. In addition, [RD's] career and reputation are subject to harm under these circumstances. *Cf. Selby v. Revlon Consumer Prods.*, 6 F. Supp. 2d 577, 581 (N.D. Tex. 1997) (stating that business reputation "should factor into the risk analysis" of whether to prevent an attorney from deposing

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[11] Moreover, [Attorney A] was able to address any issues raised in the Department's supplemental brief in his motion to vacate.

a former client). We agree with the Hearing Officer's analysis and conclusion that this case presents materially adverse interests in a substantially related matter.

Third, [Attorney A] argues that his previous representation of [RD] "was very limited in nature and did not provide [Attorney A] access to confidential information." In support of this contention, [Attorney A] submitted a sworn declaration to the same effect. The declaration acknowledges that [Attorney A] prepared [RD] for his on-the-record interview and was involved in [RD's] production of documents to NASD. [Attorney A] asserts that his involvement in preparing [RD] for, and representing [RD] during, testimony was limited to explaining the process to [RD] and objecting to certain questions during his on-the-record testimony. [Attorney A] also states that his services in the document production amounted only to serving as a "pass-through" for documents. As the Hearing Officer correctly noted, the adjudicator's role in determining disqualification motions is not to parse the attorney's former representation to determine whether, in fact, the attorney was actually privy to confidential and privileged information and whether that information is at risk. Rather, the adjudicator's proper role is to determine whether there is a reasonable possibility that such information was exchanged.[12] *See, e.g., State Farm Mut. Auto. Ins. Co. v. Red Lion Med. Ctr.*, 2003 U.S. Dist. LEXIS 6600, at *6 (E.D. Pa. Mar. 27, 2003).

Contrary to [Attorney A's] arguments, the presumption is that, if the matters are substantially related, confidential information was received. *See* Restatement (Third) of the Law Governing Lawyers § 132, cmt. d(iii) (2000) ("When the prior matter involved litigation, it will be conclusively presumed that the lawyer obtained confidential information about the issues involved in the litigation."); *see also Lott v. Morgan Stanley Dean Witter & Co. Long-Term Disability Plan*, 2004 U.S. Dist. LEXIS 25682, at *4 n.1 (S.D.N.Y. Dec. 23, 2004) ("The Court will assume that during the course of the former representation confidences were disclosed to the attorney bearing on the subject matter of the representation. It will not inquire into their nature and extent.") (quoting *Emle Indus., Inc. v. Patentex, Inc.*, 478 F.2d 562, 570 (2d Cir. 1973)); New York State Bar Ass'n Committee on Professional Ethics, Opinion 628 (1992) ("Where there is such a substantial relationship, the law presumes that the lawyer obtained confidences and secrets in the prior representation relevant to the current or proposed representation. Whether that presumption is rebuttable by the lawyer seeking to undertake the new representation is open to serious debate.") (citations omitted). Moreover, and contrary to [Attorney A's] assertions, in those cases where a lawyer wishes to claim that his or her prior representation was minor, "[t]he lawyer bears the burden of persuasion as to that issue and as to the absence of opportunity to acquire confidential information." Restatement (Third) of the Law Governing Lawyers § 132, cmt. h (2000). We agree with the Hearing Officer that [Attorney A] has not met that burden. By

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[12] [Attorney A] cites two cases in support of his argument that there must be a showing that specific confidential information was communicated to the lawyer. *See Raiola v. Union Bank of Switzerland*, 230 F. Supp. 2d 355 (S.D.N.Y. 2002); *Nomura Secs. Int'l, Inc. v. Hu*, 658 N.Y.S.2d 608 (N.Y. App. Div. 1997). Neither of these cases stands for the proposition [Attorney A] advances, and, although [Attorney A] cites them, he makes no attempt to explain how either of the cases supports his claim.

[Attorney A's] own admission, he was involved in preparing [RD] for testimony and producing documents on his behalf. Under those circumstances, and given [RD's] written refusal to waive the conflict or attorney-client privilege and his objection to being cross-examined by [Attorney A], we find it highly unlikely that [RD] and [Attorney A] did not discuss confidential issues germane to these proceedings. *See* Model Rules of Prof'l Conduct R. 1.9, cmt. 3 (2004) ("A conclusion about the possession of [confidential] information may be based on the nature of the services the lawyer provided the former client and information that would in ordinary practice be learned by a lawyer providing such services."). In addition, the preservation of client confidences is not the sole concern when deciding disqualification motions. We must also consider the duty of loyalty a lawyer owes to his or her former clients. *See Selby*, 6 F. Supp.2d at 582 (quoting *In re American Airlines*, 972 F.2d 605, 619-20 (5th Cir. 1992)). And, perhaps most importantly, we must protect the integrity of NASD's disciplinary process.

Fourth, [Attorney A] argues that [RD] consented to the conflict at the time of his on-the-record testimony. In support of this contention, [Attorney A] cites to the transcript of [RD's] on-the-record interview. We find that, for at least two reasons, any consent by [RD] at that time is inapposite to the issue now before us. First, the circumstances under which [RD] gave his purported consent are no longer relevant. [RD] could not consent to a conflict between [Attorney A's] representation of [RD] and [Respondent 1] because [Attorney A] was not [Respondent 1's] counsel at the time.[13] *See* Model Rules of Prof'l Conduct R. 1.7, cmt. 18 (2004) ("Informed consent requires that each affected client be aware of the relevant circumstances and of the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client."). [RD's] own statement relied upon by [Attorney A] confirms that any consent was made based on the relationships that existed at the time of the interview. When [Attorney A] asked [RD] to affirm on the record that he consented to [Attorney A's] multiple representations, [RD] responded: "*At this time*, I don't have any opposition or feel that there's any conflict . . . ." (Emphasis added.) Moreover, at the time [Attorney A] represented [RD] for his testimony, [Attorney A's] representation, by his own admission, was limited to the investigative testimony. [Attorney A] stated on the record that his representation "with the various people that are involved in this proceeding is solely limited to representing them in connection with the investigatory interviews, which is the sole scope." There is simply no evidence in the record that [RD] consented to the conflict with respect to [Respondent 1] or that [RD] expected any consent to have preclusive effect regardless of subsequent events. Second, even if [RD] had consented to the conflict, he subsequently revoked his consent. *See* Model Rules of Prof'l Conduct R. 1.7, cmt. 21 (2004) ("A client who has given consent to a conflict may revoke the consent and, like any other client, may terminate the lawyer's

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[13] [Attorney A] included sworn declarations from both [Respondent 1 and Respondent 2]with his brief filed with the Hearing Officer after the Remand Order was issued. We note that [Respondent 2's] declaration includes the following: "I am also unaware at this time of any facts or circumstances to which [RD] has first hand knowledge which are adverse to my interests. [RD] was not employed at [Respondent Firm] at the time of the alleged securities transactions the subject of this case." The declaration of [Respondent 1], whom [Attorney A] did not represent during [RD's] on-the-record testimony, contains no such statement.

representation at any time."). Thus, [Attorney A] would have us extend [RD's] contingent statement into an unalterable waiver of conflicts as to both [Respondent 1 and Respondent 2] after the Department has filed its complaint. We refuse to do so.

Finally, [Attorney A] argues that his disqualification will significantly prejudice [Respondents 1 and 2] and adversely affect the proceeding.[14] In support, [Attorney A] offered sworn declarations from both [Respondent 1 and Respondent 2]. Each respondent states that the disqualification of [Attorney A] will result in financial hardship if he is forced to hire another attorney and pay legal fees to have that attorney begin the representation anew (and noting that each has already paid fees to [Attorney A] for his work on the cases to date). In addition, [Respondents 1 and 2] note that [Attorney A's] disqualification will deprive them of their counsel of choice.[15] While we are sympathetic to these concerns, they are present whenever the disqualification of an attorney is at issue and are not unique to this case. [Respondents 1 and 2's] preference to be represented by an attorney with a material conflict is not preeminent. We agree with the Commission's conclusion in *Clarke T. Blizzard* that "[h]ere, the right to counsel of one's choice is outweighed by the necessity of ensuring that our administrative proceeding is conducted with a scrupulous regard for the propriety and integrity of the process." *Clarke T. Blizzard*, Investment Advisers Act Rel. No. 2032, 2002 SEC LEXIS 1087, at *11 (April 24, 2002).

[Attorney A's] motion to vacate is denied.

III. Conclusion

In the Remand Order, we instructed the Hearing Officer to determine whether [Attorney A's] continued representation of [Respondents 1 and 2] presented a material conflict, and we set forth certain issues for the Hearing Officer to consider in making such a determination. We find that the Hearing Officer correctly and properly applied the criteria set forth in the Remand Order, and for the reasons set forth above, we affirm her decision to disqualify [Attorney A] from the proceedings below. Consequently, the motion to vacate is denied.[16]

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[14] [Attorney A] also argues that it was error for the Hearing Officer to fail to consider less drastic remedies. In the Remand Order, we instructed the Hearing Officer to disqualify [Attorney A] if she found that a material conflict existed.

[15] We note that respondents have no right to counsel in NASD disciplinary proceedings. *See, e.g., Falcon Trading Group, Ltd.*, 52 S.E.C. 554, 559 (1995), *aff'd*, 102 F.3d 579 (D.C. Cir. 1996); *Sheen Fin. Res., Inc.*, 52 S.E.C. 185, 192 (1995) ("[R]espondents in NASD disciplinary proceedings do not have either a constitutional or a statutory right to the assistance of counsel.").

[16] We have also considered and reject without discussion all other arguments advanced by the parties.

For the Review Subcommittee
of the National Adjudicatory Council,

Alan B. Lawhead
Vice President, NASD Regulation, Inc.