

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: June 17, 2005

Attorney for two individual respondents prevented from cross-examining a former client and potentially disqualified from a disciplinary proceeding. Held, affirmed in part, remanded in part for further proceedings.

DECISION

Pursuant to NASD Procedural Rule 9280(c), respondents [Respondent 1] and [Respondent 2] (the "Respondents") have sought review of a Hearing Officer order preventing [Attorney A], the attorney for the Respondents, from cross-examining [RD], [Attorney A's] former client. After considering the motion, we affirm parts of the order's conclusions but remand the order to the Hearing Officer for further proceedings consistent with this opinion.

I. Procedural & Factual Background

In September 2002, NASD's Department of Market Regulation (the "Department") began an investigation of [Respondent Firm]. During the course of the investigation, the Department interviewed numerous employees of [Respondent Firm]. Among those interviewed were [RD], the Compliance Officer of [Respondent Firm] from October 2002 through July 2003, and [Respondent 2], a former broker at [Respondent Firm]. During those interviews, [Attorney A] represented both [RD] and [Respondent 2]. In October 2003, the Department filed a complaint against [Respondent Firm] and numerous individual respondents. While [RD], who still works in the securities industry, was not named as a respondent, the complaint included [Respondent 2] as an individual respondent. After the complaint was filed, [Attorney A] informed the Department that he would also be representing [Respondent 1], another named respondent.

On January 7, 2005, the Department filed a motion with the Hearing Officer seeking to disqualify [Attorney A] from representing the Respondents. The motion sought [Attorney A's] disqualification because the Department intends to call [RD] as a witness at the hearing, and the Department asserted that [RD] will testify against both [Respondents 1 and 2]. The Department argued that [Attorney A] will be faced with an insurmountable conflict: either he will breach his duty of confidentiality to his former client, [RD], during cross-examination or he will be unable to fulfill his obligation to represent zealously his current clients, the Respondents.

On January 21, 2005, the Respondents filed an opposition in which they raised two objections. First, the Respondents maintained that the Hearing Officer lacks jurisdiction to consider the issue or to disqualify [Attorney A]. Second, the Respondents asserted that the Department failed to meet its burden in demonstrating that [Attorney A] should be disqualified. Thereafter, the Department and the Respondents filed several competing briefs arguing over the application of legal authority and the appropriate remedy. Of note, on January 27, 2005, the Department submitted a copy of a letter from [RD] to [Attorney A] that refused to waive any conflict of interest, refused to waive attorney-client privilege, and severed [RD's] relationship with [Attorney A].

On March 24, 2005, the Hearing Officer issued her decision, which disqualified [Attorney A] from the proceeding unless both [Respondents 1 and 2] waived the conflict. The decision states that [Attorney A] would be disqualified unless [Respondents 1 and 2] submit sworn statements acknowledging that [Attorney A] would not be able to cross-examine [RD] and that if other respondents in the matter settle before the hearing, such that no other attorney is available to cross-examine [RD], the Hearing Officer may disqualify [Attorney A]. On March 31, 2005, the Respondents filed a "Motion of Appeal" of the Hearing Officer's decision.¹ As an exhibit to that motion, the Respondents attached written waivers from [Respondents 1 and 2]; however, neither of the waivers acknowledges that the Hearing Officer may disqualify [Attorney A] if other respondents in the matter settle before the hearing. The Department filed its response on April 6, 2005.

II. Discussion

A. Review of [Attorney A's] Motion

Pursuant to NASD Procedural Rule 9280(c), "[i]f an attorney for a Party . . . is excluded from a disciplinary hearing or conference, or any portion thereof, such attorney . . . may seek

¹ While it is captioned a "Motion of Appeal," NASD Procedural Rules provide that an attorney may seek review of an exclusion "by filing a motion to vacate with the National Adjudicatory Council." See NASD Procedural Rule 9280(c). Respondents in NASD disciplinary proceedings generally have no right to an interlocutory review of a Hearing Officer order. See NASD Procedural Rule 9148 (providing that, except under NASD Rule 9280, "there shall be no interlocutory review of a ruling or order issued by [a Hearing Officer or other adjudicator]"). Consequently, we consider the filing to be a motion by [Attorney A] to vacate the Hearing Officer's order.

review of the exclusion by filing a motion to vacate with the National Adjudicatory Council." The rule provides further that the National Adjudicatory Council (the "NAC") or the Review Subcommittee shall consider the motion, on the basis of the written record, on an expedited basis and promptly issue a written order. Because the Hearing Officer's order excludes [Attorney A] from cross-examining [RD]—and potentially excludes him from the entire proceeding—the NAC has jurisdiction to review the order on an interlocutory basis under NASD Procedural Rule 9280(c).

B. Hearing Officer Authority

The threshold issue we must address is whether an NASD Hearing Officer has the authority to disqualify an attorney from a disciplinary proceeding or otherwise limit the attorney's participation and, if so, under what circumstances. This issue is one of first impression for the NAC and Review Subcommittee. The Hearing Officer held that NASD Hearing Officers have the authority "to disqualify an attorney if necessary to maintain the integrity of the hearing process." We affirm this conclusion, not only because this authority is inherent in a Hearing Officer's power to maintain the integrity of the hearing process but also because NASD Procedural Rules explicitly grant a Hearing Officer the authority to disqualify lawyers for unethical or improper professional conduct and generally to regulate the course of a hearing.

In general, trial-level adjudicators have broad discretion over the conduct of parties and attorneys in adjudicated proceedings to preserve the integrity of the adversary process. See, e.g., Cole v. Ruidoso Mun. Schs., 43 F.3d 1373, 1383 (10th Cir. 1994) ("It is well established that ordinarily 'the control of attorneys' conduct in trial litigation is within the supervisory powers of the trial judge,' and is thus a matter of judicial discretion.") (citation omitted). Similarly, NASD has a statutory obligation to ensure that its procedures are fair, which includes ensuring that the adversary process is free from taint. Thus, the general proposition applicable to federal court litigation that the proceedings must be fair and free from taint applies to NASD disciplinary actions as well. NASD Hearing Officers exercise control over disciplinary hearings and must take action when appropriate to preserve the integrity of the adversary process.

In addition to the general obligation of Hearing Officers to ensure the integrity of litigated proceedings, like the Commission, NASD has adopted procedural rules regarding a Hearing Officer's powers that explicitly give Hearing Officers the authority to exclude attorneys for unethical or improper professional conduct during a proceeding. While the relevant NASD procedural rules adopt many of the same provisions as the Commission's Rules of Practice, they differ in important respects from the Commission rules. NASD Rule 9280 addresses similar issues as Rule 180(a)(1) of the Commission's Rules of Practice ("SEC Rule 180"), which provides that "[c]ontemptuous conduct by any person before the Commission or a hearing officer during any proceeding, including any conference, shall be grounds for the Commission or the hearing officer to: (i) exclude that person from such hearing or conference, or any portion thereof; and/or (ii) summarily suspend that person from representing others in the proceeding in which such conduct occurred for the duration, or any portion, of the proceeding." By contrast, NASD Rule 9280 is not limited to contemptuous conduct and provides that a Hearing Officer may also exclude an attorney under NASD Procedural Rule 9150(a), which states that a Hearing Officer may exclude an attorney "for contemptuous conduct under [NASD] Rule 9280 or

unethical or improper professional conduct in [a] proceeding."² Moreover, NASD Rule 9280(b) states that a Hearing Officer "may make such orders as are just in regard to a Party, an attorney for a Party, or other person authorized to represent others by [NASD] Rule 9141." Thus, unlike SEC Rule 180, NASD Rule 9280 extends the conduct that can lead to expulsion to include unethical and improper attorney conduct, which is in addition to contemptuous conduct.

In Clarke T. Blizzard, the Commission considered a similar issue: whether an Administrative Law Judge ("ALJ") has the authority to disqualify a respondent's attorney when the attorney also represented individuals whom the Commission's Department of Enforcement intended to call as witnesses at the hearing. See Clarke T. Blizzard, Investment Advisers Act Rel. No. 2032, 2002 SEC LEXIS 1087 (Apr. 24, 2002). The Commission held that an ALJ has the authority to disqualify attorneys in these circumstances; however, the Commission concluded that the source of that authority was Rule 111(d) of the Commission's Rules of Practice, which grants ALJs general powers, rather than SEC Rule 180.³

For the reasons discussed above, we affirm that part of the Hearing Officer's order concluding that NASD Hearing Officers have the authority to disqualify attorneys in disciplinary proceedings for conflicts of interest or otherwise limit their participation. This power is based on their general authority to regulate the course of a proceeding and their obligation to ensure that proceedings are conducted fairly and with integrity and on NASD Rule 9280, which incorporates NASD Rule 9150.⁴

C. Disqualification and Exclusion of Schrader

As described more fully below, we hold that, in resolving an attorney disqualification motion, Hearing Officers must determine whether the representation at issue gives rise to a material conflict. This determination should be informed by national ethical standards of attorney conduct and the effect that the attorney's continued representation could have on the proceedings. In reaching this conclusion, we have considered multiple authorities, including the fairness requirements of Section 15A of the Securities Exchange Act of 1934 (the "Exchange Act"), applicable Commission precedent, and federal case law. Because our opinion requires a different analysis than that performed by the Hearing Officer, we remand the order to the Hearing Officer to determine, consistent with this opinion, whether a material conflict exists. If,

² NASD Procedural Rule 9150(a) (emphasis added).

³ Rule 111(d) of the Commission's Rules of Practice provides that ALJs have the authority to "regulat[e] the course of a proceeding and the conduct of the parties and their counsel." NASD Procedural Rule 9235, which is modeled on this rule, gives NASD Hearing Officers broad authority to "regulat[e] the course of the hearing." See NASD Procedural Rule 9235(a)(2).

⁴ In addition to giving Hearing Officers the power to regulate the course of a hearing, NASD Rule 9235 also provides generally that a Hearing Officer has the authority "to do all things necessary and appropriate to discharge his or her duties." NASD Procedural Rule 9235(a).

on remand, the Hearing Officer determines that a material conflict is present, [Attorney A] must be disqualified.

1. Exchange Act Requirements & Commission Precedent

As a state actor, the Commission is required to ensure that its administrative proceedings are conducted in accordance with respondents' constitutional rights. By contrast, NASD is required by statute to ensure that its disciplinary procedures are fair.⁵ The Exchange Act requires that NASD rules "provide a fair procedure for the disciplining of members and persons associated with members." Exchange Act § 15A(b)(8). While one requirement is grounded in the Constitution and another is based in legislation, we nonetheless agree with the Commission 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." Blizzard, 2002 SEC LEXIS 1087, at *6. Thus, maintaining the integrity and fairness of disciplinary proceedings is the primary concern when deciding whether to disqualify a respondent's attorney.

The Commission's decision in Blizzard is instructive. In that case, an attorney for one of the respondents also represented five other individuals whom the SEC Division of Enforcement intended to call as witnesses. Blizzard, 2002 SEC LEXIS 1087, at *1. The attorney submitted written consents to the joint representation from both the respondent and the witnesses. Id. at *2. Despite these waivers, the Commission held that, because of the "serious potential for prejudice to the integrity of the proceeding," the attorney could not represent the respondent while simultaneously representing any witnesses who may be called to testify against the respondent. Id. at *9. In reaching its decision, the Commission noted that its concerns "cannot be addressed by the consent of [the attorney's] clients to his representation of them. Rather, the issue is whether the Commission consents to the impact on its adjudicatory processes created by [the attorney's] multiple representation." Id. at *6. While, in Blizzard, the attorney's representation of a respondent and multiple witnesses was ongoing, the applicable ethical duty of confidentiality protects former clients, not just current clients. See Model Rules of Professional Conduct, Rule 1.9, Comment [1] ("After termination of a client-lawyer relationship, a lawyer has certain continuing duties with respect to confidentiality and conflicts of interest and thus may not represent another client except in conformity with [Model Rule 1.9]."); cf. Swidler & Berlin v. United States, 524 U.S. 399 (1998) (holding that the attorney-client privilege remains after the death of a client).

2. Material Conflict

When resolving attorney disqualification motions in civil litigation—a more apt analogy to NASD disciplinary proceedings than criminal proceedings—federal courts generally consider both the "ethical rules announced by the national profession . . . considered 'in light of the public

⁵ NASD is not a state actor; consequently, constitutional protections do not attach in NASD disciplinary proceedings. 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. 1999).

interest and the litigants' rights" as well as the local rules of the district court.⁶ See Cole, 43 F.3d at 1383 (quoting In re Dresser Indus., Inc., 972 F.2d 540, 543 (5th Cir. 1992)); see also Scattered Corp., 53 S.E.C. 948, 959 (1998) ("We look primarily to both the American Bar Association's Model Rules of Professional Conduct and the American Law Institute Restatement (Third) of the Law: The Law Governing Lawyers, rather than Illinois state law, for a national standard appropriate to a federal agency.") (citing Dresser Indus., Inc., 972 F.2d 540). While the ethical rules are "persuasive authority," they frame the analysis rather than dictate a particular result.⁷ See Skidmore v. Warburg Dillon Read L.L.C., 2001 U.S. Dist. LEXIS 6101, at *6 (S.D.N.Y. May 10, 2001) ("[A]lthough the various ethical codes that have been promulgated are highly persuasive authority, . . . our decision must ultimately be guided by the goal of a trial process that lacks any hint of a taint.") (citations omitted). Thus, it is impossible to establish a bright-line rule for disqualification; the facts surrounding the former and current representations are essential in reaching any decision. See Dresser Indus., Inc., 972 F.2d at 543-44 ("[S]tandards such as the ABA canons are useful guides but are not controlling in adjudicating [disqualification] motions. The considerations we relied upon in [an earlier case] were whether a conflict has (1) the appearance of impropriety in general, or (2) a possibility that a specific impropriety will occur, and (3) the likelihood of public suspicion from the impropriety outweighs any social interests which will be served by the lawyer's continued participation in the case.") (citations omitted). When determining disqualification motions, Hearing Officers should look to the national standard analysis employed by federal courts for guidance in determining whether a material conflict exists.⁸

⁶ Some courts also require that the party seeking disqualification establish that "an actual attorney-client relationship existed between the moving party and the opposing counsel." See Cole, 43 F.3d at 1384. We concur with the Hearing Officer's conclusion that, in an NASD disciplinary action, the Department has standing to move for disqualification. Moreover, on the facts of this case, [RD] has, without formally joining the Department's motion, clearly indicated his objection to being cross-examined by Schrader.

⁷ Many state ethical codes include a provision stating that the ethical rules should be used as authority only in disciplinary actions and that "the purpose of the rules can be subverted when they are invoked by opposing parties as procedural weapons." Florida Rules of Professional Conduct, Preamble (adopting the language in the ABA Model Rules of Professional Conduct); see also, e.g., D.C. Rules of Professional Conduct, Scope (4) ("[N]othing in the Rules . . . is intended to confer rights on an adversary of a lawyer to enforce the Rules in a proceeding other than a disciplinary proceeding. A tribunal presented with claims that the conduct of a lawyer appearing before that tribunal requires, for example, disqualification of the lawyer and/or the lawyer's firm may take such action as seems appropriate in the circumstances, which may or may not involve disqualification.").

⁸ In a case such as this, Rule 1.9 of the ABA's Model Rules of Professional Conduct ("Model Rule 1.9"), which governs a lawyer's duties to former clients, is instructive. Model Rule 1.9(a) provides that "[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." Thus, "[Model] Rule 1.9 expressly forbids an attorney: (1) from appearing in a substantially related matter; (2) in which the interests of the

The Hearing Officer also must consider the extent to which client waivers—both current and former—are relevant to the determination. The Hearing Officer held that, provided other counsel was available during the hearing to cross-examine [RD], the Respondents' waiver of [Attorney A's] conflict was sufficient to allow him to continue to serve as their counsel. The Hearing Officer gave no particular weight to the fact that [RD], [Attorney A's] former client, did not waive the conflict.⁹ We find that the Hearing Officer afforded too much weight to criminal cases in which courts have noted that "whether the current client is willing to limit his right to cross-examine the former client to avoid disclosure of information obtained during his lawyer's prior attorney-client relationship" is a relevant consideration. United States v. Castellano, 610 F. Supp. 1137, 1147 (S.D.N.Y. 1985); see also United States v. Gotti, 9 F. Supp. 2d 320, 324 (S.D.N.Y. 1998) ("A waiver by the current client alone will obviate the need for disqualification, unless the 'conflict is so egregious that no rational defendant would knowingly and voluntarily desire the attorney's representation.'") (citations omitted). While the current client's consent is a relevant consideration, it is not dispositive, and a court need not accept the consent if it does not cure the conflict. See State Farm, 2003 U.S. Dist. LEXIS 6600, at *9-10 ("[The current client's] recognition and waiver of this potential conflict does not cure the 'serious potential for conflict.' [The lawyer's] former clients . . . do not consent to [the lawyer's] continued representation of [the current client] and filed this motion."). Indeed, the Restatement (Third) of the Law Governing Lawyers (the "Restatement") requires a waiver by both the former client and the current client to cure any such conflict. Specifically, the Restatement provides that "[u]nless both the affected present and former clients consent to the representation . . . , a lawyer who has represented a client in a matter may not thereafter represent another client in the same or a substantially related matter in which the interests of the former client are materially adverse."¹⁰ As noted above, in Blizzard, the Commission agreed that a waiver by the clients does not end the inquiry, and the true issue to be resolved is whether the adjudicator consents to the impact the conflict may have on the proceeding. In sum, waivers should not be dispositive and should never be sufficient,

current client are materially adverse to the former client; (3) unless the former client consents to the representation after consultation." Selby v. Revlon Consumer Prods., 6 F. Supp. 2d 577, 579 (N.D. Tex. 1997) (citing In re American Airlines, 972 F.2d 605, 615 & n.2 (5th Cir. 1992)); see also Cole, 43 F.3d at 1384.

⁹ One factor courts have assessed in determining whether material adversity of interests exist when an attorney cross-examines a former client is whether the attorney's questioning could expose the former client to liability, however remote the possibility, or could inure to the detriment of the former client. See Selby, 6 F. Supp. 2d at 581 (holding that an attorney could not depose a former client because it would present a "slight risk" of liability for the former client); State Farm Mut. Auto. Ins. Co. v. Red Lion Med. Ctr., 2003 U.S. Dist. LEXIS 6600, at *7-10 (E.D. Pa. Mar. 27, 2003) (disqualifying an attorney after finding that "[a]lthough [the attorney] may not directly divulge confidential information related to his representation of [his former clients], they have no protection against counsel's use of such information in framing cross-examination questions or advice to his remaining client").

¹⁰ Restatement (Third) The Law Governing Lawyers § 132 (2000).

standing alone, to cure the conflict. Rather, Hearing Officers should consider client waivers in determining whether a material conflict exists.

III. Conclusion

We affirm the Hearing Officer's conclusion that she has the authority to disqualify an attorney from participating in an NASD disciplinary proceeding in appropriate circumstances. With respect to the conclusions regarding whether [Attorney A] should be disqualified, we remand the Hearing Officer's order to determine whether a material conflict exists such that the conflict would taint the disciplinary proceeding. On remand, the Hearing Officer should consider all relevant facts and circumstances, including an examination of:

- The scope of [Attorney A's] representation of [RD] (and the likelihood that [Attorney A] obtained confidential information) and [RD's] anticipated testimony to determine whether the clients have a materially adverse interest and whether the matters are substantially related;
- Whether the waivers of the potential conflict by [Attorney A's] current clients—particularly given [RD's] objections and refusal to waive conflicts and attorney-client privilege—are sufficient to cure the conflict in light of the existing ethical standards established by the national profession and interpreted by federal courts; and
- Whether [Attorney A's] continued representation of the Respondents results in any potential for degrading the integrity of the disciplinary proceeding or creates potential prejudice to the Respondents.

After a consideration of the relevant factors, if the Hearing Officer determines that a material conflict exists, [Attorney A] should be disqualified.

For the Review Subcommittee
of the National Adjudicatory Council,

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