

This Order has been published by NASD's Office of Hearing Officers and should be cited as OHO Order 05-31 (CMS040165).

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF MARKET REGULATION

Complainant,

v.

Respondent Firm,

Respondent 1,

Respondent 2, et al.,

Respondents.

Disciplinary Proceeding
No. CMS040165

Hearing Officer – SNB

**ORDER ON REMAND FROM THE NATIONAL ADJUDICATORY COUNCIL
GRANTING COMPLAINANT'S MOTION TO DISQUALIFY COUNSEL FOR
RESPONDENTS 1 AND 2**

This Order on Remand from the National Adjudicatory Council (the "NAC") relates to the Department of Market Regulation's (the "Department") January 6, 2005 motion to disqualify David Schrader and Schrader and Schoenberg ("Schrader"), counsel for Respondents 1 and 2. The Department argues that Schrader cannot represent Respondents 1 and 2 zealously, while also maintaining the confidences of his former client who is expected to testify against Respondents 1 and 2. The Hearing Officer's original order disqualified Schrader unless Respondents 1 and 2 chose to meet certain conditions designed to address the conflict. The NAC rejected this approach, and remanded the Order with instructions for the Hearing Officer to determine whether a material conflict exists and, if it does, to disqualify Schrader. For the reasons set forth below, under the standards outlined in the NAC's order, the Hearing Officer has determined to disqualify Schrader.

I. Procedural and Factual Background

Schrader initially represented Respondent 1, a former broker with Respondent Firm, as well as _____, Respondent Firm's former Director of Compliance, during on-the-record interviews preceding the filing of the Complaint in this matter. Schrader now represents Respondents 1 and 2;¹ he no longer represents _____. The Department plans to call _____ to testify in this matter in support of its claims against Respondents 1 and 2. The Department proffered that _____ will testify that he told Respondent 2 that his conduct was illegal, but that Respondent 2 ignored the advice and continued to sell unregistered securities. In addition, _____ will testify that he called to Respondent 1's attention customer complaints, but that Respondent 1 ignored him.

The Department moved to disqualify Schrader who, it claimed, has an insurmountable conflict because he cannot simultaneously fulfill his responsibility to represent Respondents 1 and 2 zealously, while maintaining the confidences of _____ who will be testifying against them.² In support of its motion, the Department included a letter from _____ asserting that he did not waive any conflict arising from Schrader's representation of him, and that his discussions with Schrader are covered by the attorney-client privilege and therefore should remain confidential. Respondents opposed the motion, claiming that _____ waived the conflict during his on-the-record testimony; and that the Department had not established that _____'s interests are materially adverse to Respondents or that confidential information was

¹ Schrader did not represent Respondent 2 during the investigation in this matter.

² See, e.g., New York Disciplinary Rules, which prohibit a lawyer from using confidences or secrets of the former client (DR 5-108) and require a lawyer to represent his or her client zealously (DR7-101).

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exchanged. Finally, Respondents asserted that, assuming a conflict exists, disqualification will result in substantial prejudice and, thus, other less burdensome remedies should be used.³

On March 24, 2005, the Hearing Officer issued her order which permitted Schrader to continue representing Respondents if: 1) Schrader did not cross-examine _____; and 2) Respondents provided a sworn statement demonstrating a waiver based upon full disclosure of the potential conflict. The Hearing Officer required that Respondents expressly acknowledge 1) that Schrader would be unable to cross-examine _____; and 2) that, if the other Respondents settled prior to hearing thereby leaving no other attorney to cross-examine _____, the Hearing Officer might disqualify Schrader at that time.

On June 17, 2005, the Review Subcommittee of the NAC issued its order remanding the matter to the Hearing Officer for further proceedings.⁴ The NAC determined that the Hearing Officer's approach was impermissible, insofar as it sought to remove the possibility of a material conflict. Instead, the NAC instructed the Hearing Officer to examine the record to determine whether a material conflict exists, and if it does, to disqualify Schrader.

II. Discussion

The NAC's Decision specified three items for the Hearing Officer to consider in determining whether a material conflict exists such that Schrader should be disqualified:

³ The NAC's Order forecloses the possibility of a remedy short of disqualification.

⁴ Respondents also argued that the Hearing Officer did not have jurisdiction to disqualify an attorney. In her March 24, 2005 Order, the Hearing Officer found that jurisdiction existed, and the NAC affirmed this finding in its June 17, 2005 Order. Therefore, Respondents' jurisdictional argument is not part of the remand.

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- The scope of Schrader's representation of _____ (and the likelihood that Schrader obtained confidential information) and _____'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 Schrader's current clients – particularly given _____'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 Schrader'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.⁵

This order addresses each of these in turn.

A. The scope of Schrader's representation of _____ and _____'s anticipated testimony

The NAC directed the Hearing Officer to consider the scope of Schrader's representation of _____, and whether confidential communications resulted from that representation. It is undisputed that Schrader represented _____ in three document productions and two days of on-the-record testimony in the investigation leading to the filing of NASD's Complaint against Respondents. Schrader asserts that he received no confidential information in connection with this representation. However, _____ disagrees and asserts that his communications with Schrader were confidential and subject to the attorney-client privilege.⁶ Where, as here, there is a dispute between the attorney and the former client as to whether the client disclosed confidential information, the Hearing Officer cannot resolve the dispute by inquiring into the specific content of attorney-client communications. Rather, she must determine

⁵ NAC Remand Order, at 8.

⁶ Compare Affidavit of David A. Schrader filed on July 12, 2005, with January 19, 2005 letter from _____ to Schrader, filed on January 27, 2005.

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whether there is a reasonable possibility that confidential information was exchanged.

See State Farm Mutual Auto Ins. Co. v. Red Lion Med. Ctr., 2003 U.S. Dist. Lexis 6600, at *6 (E.D. Pa. Mar. 27, 2003).⁷ Given the scope of Schrader's representation of _____, the Hearing Officer finds a reasonable possibility that confidential communications occurred.

The NAC also directed the Hearing Officer to consider _____'s anticipated testimony, and whether the clients have a material adversity of interests. Consistent with the NAC's guidance, the Hearing Officer must examine whether the attorney's representation "could expose the former client to liability, however remote the possibility; or could inure to the detriment of the former client." NAC Remand Order, at 7, n.8, citing *Selby v. Revlon Consumer Products*, 6 F. Supp. 2d 577, 579 (N.D. Tex., 1997)(holding that disqualification is appropriate even if there is a small probability that the former client will be affected). See *National Medical Enterprises v. Godbey*, 924 S.W. 2d 123, 133 (Tex. 1996)(stating that the former client "is not likely to be struck by lightning in the pending case, even though he is in the midst of a severe thunder storm, but he is entitled to object to being forced by his former lawyer to stand under a tree while the storm rages on.")

The Department proffers that _____ will testify that he told Respondent 2 that his conduct was illegal, but Respondent 2 ignored the advice and continued to sell

⁷ While Respondents claim that there must be a showing that specific confidential information was communicated to the lawyer, the cases cited in support are distinguishable or otherwise do not support that proposition. In *Nomura Securities International, Inc., v. David Hu*, 240 A.D. 2d 249; 658 N.Y.S.2d 608 (App. Div. 1st Dept. 1997) the court held that when a petitioner fails to demonstrate the existence of adverse interests or a substantial relationship between the proceedings, *then* a showing of specific confidential information must be made. Here, there can be no dispute that the matters are substantially related, and, for reasons discussed herein, adverse interests are also present. In *Raiola v. Union Bank of Switzerland*, 230 F. Supp. 2d 355 (S.D.N.Y. 2002), among other things, Respondent offered no evidence that confidential information was conveyed.

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unregistered securities. _____ is also expected to testify that he called to Respondent 1's attention customer complaints, but that Respondent 1 ignored him. This testimony is clearly adverse to Respondents, and it creates a strong incentive for them to discredit _____'s testimony. If Respondents succeeded in doing so, it is possible that _____ would be subject to disciplinary action. At a minimum, _____'s career and reputation might be harmed if he were found to have given false testimony. Accordingly, the Hearing Officer finds that there is a clear material adversity of interests.

Finally, the NAC directs an inquiry as to whether Schrader's prior representation of _____ substantially relates to this matter. It cannot be disputed that the matters are substantially related, since Schrader represented _____ in the investigation that gave rise to the charges against Respondents in this proceeding.

B. Waivers by Respondents 1 and 2, and _____'s refusal to provide a waiver

The NAC has also directed the Hearing Officer to consider "whether waivers of the potential conflict by Schrader's current clients - particularly given _____'s objections and refusal to waive conflicts and the attorney-client privilege - are sufficient to cure the conflict in light of existing ethical standards established by the national profession and interpreted by the courts."⁸

As the NAC observed, both Rule 1.9 of the ABA's Model Rules of Professional Conduct ("Model Rule 1.9") and the Restatement (Third) of the Law Governing Lawyers § 132 (2000) require a waiver by both the former client and the current client to cure a conflict arising from representation in a substantially related matter, where the interests of the former client are materially adverse. *See, also, Selby v. Revlon Consumer*

⁸ NAC Remand Order, at 8.

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Products, 6 F. Supp 2d 577, 579 (N.D. Tex. 1997). While Respondents appear to have waived the conflict,⁹ _____ has not done so.¹⁰ Under these circumstances, the waivers by Respondents alone do not cure the conflict.

C. Integrity of the Proceeding and Potential for Prejudice to Respondents

Finally, the NAC directed the Hearing Officer to consider whether Schrader's continued representation of the Respondents results in any potential for degrading the integrity of the proceedings or creating potential prejudice to Respondents. Because Schrader may be called upon to choose between maintaining confidential information of his former client and representing Respondents zealously, the Hearing Officer finds that there is a potential for degrading the integrity of the disciplinary proceeding. Moreover, to the extent Schrader chooses to maintain his former client's confidence, Respondents would not receive the zealous representation to which they are entitled. Therefore, the Hearing Officer finds there is potential prejudice to Respondents.

⁹ On March 31, 2005, Respondents 1 and 2 filed sworn statements waiving the conflict.

¹⁰ Respondents argue that _____ waived the conflict when Schrader represented both _____ and Respondent 1 in connection with the OTRs. However, a waiver must be based upon full disclosure, and there is no evidence that _____ anticipated and agreed to waive the sort of conflict that has arisen in this proceeding. And, even assuming that _____ implicitly waived the conflict as to Respondent 1, Schrader was not representing Respondent 2 at that time. Thus, _____ did not have notice that his confidences could later be used to zealously represent Respondent 2.

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III. Conclusion

Based on a consideration of the factors enumerated by the NAC, the Hearing Officer finds that a material conflict exists, and, therefore, Schrader must be, and hereby is, disqualified from representing Respondents in this proceeding.

SO ORDERED.

Sara Nelson Bloom
Hearing Officer

Dated: August 22, 2005