



9 of 9 DOCUMENTS

**ERNIE BURNETT, et al., Plaintiffs, v. JEANNE MARIE ROWZEE, et al.,
Defendants.**

CASE NO. SA CV 07-641 DOC (ANx)

**UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF
CALIFORNIA**

2007 U.S. Dist. LEXIS 72931

**August 13, 2007, Decided
August 13, 2007, Filed**

SUBSEQUENT HISTORY: Claim dismissed by, Motion denied by, Application granted by, in part *Burnett v. Rowzee*, 2007 U.S. Dist. LEXIS 73295 (C.D. Cal., Aug. 28, 2007)

Related proceeding at *Mack-University LLC v. Halstead*, 2007 U.S. Dist. LEXIS 95098 (C.D. Cal., Sept. 25, 2007)

Related proceeding at *Dusky v. Bellasaire Invs.*, 2007 U.S. Dist. LEXIS 95501 (C.D. Cal., Dec. 4, 2007)

COUNSEL: [*1] For Ernie Burnett, Trustee of the Burnett Family Trust, U/D/T 10-13-1983, Kai W Adler, Luke Arnett, Michael Brackett, Eric Bradley, Jennifer Bradley, Enrique Campos, Tammy Campos, Mark Childers, Cherie Childers, Mike and Gwen Curtis Revocable Trust U/D/T 1-14-1999, Fifteen Morgan LLC, First Trust Co. of Onaga, Custodian F/B/O George C Kennedy, Anne Frank, Alan E Girdlestone and Dolores Girdlestone, Trustees of the Girdlestone Family 1989 Trust, Jason Glass, Dan Gluzman, Musia Gluzman, Fran Hargadon, Daniel Kechejian, Aline Kechejian, George C Kenney, James Kim, Fred Koeppe, Trustee of Koppe Trust, U/D/T 3-31-1997, Jeff Marsden, Christine Marsden, Robert B McDonald, Nigel Charles Page, Stephen Perebzkak, Eric Rasor, Laura Rasor, Mark R Sawusch, Ralph W Sheets, Spectrum Lending Group, Fakhri Taheri, John Taylor, Therapy Care Inc, Twelve Morgan LLC, Shirley Wagner, on behalf of themselves and all others similarly situated, Plaintiffs: Steven L

Krongold, LEAD ATTORNEY, Krongold Law Firm, Irvine, CA.

For James Richard Halstead, an individual, Susan Halstead, an individual, GAMEPLANJH LLC, a Nevada limited liability company, Gameplan Inc, an Arizona corporation, Defendants: David L Casterline, [*2] LEAD ATTORNEY, David L Casterline Law Offices, Hermosa Beach, CA.

Brooke Robbins Harvey, Defendant, Pro se, Prosper, TX.

For Brooke Robbins Harvey, Defendant: John H Carney, LEAD ATTORNEY, John H Carney & Associates, Dallas, TX; Scott M Schlegel, LEAD ATTORNEY, Law Offices of Scott M. Schlegel, San Diego, CA.

JUDGES: DAVID O. CARTER, United States District Judge.

OPINION BY: DAVID O. CARTER

OPINION

ORDER GRANTING PLAINTIFFS' MOTION TO DISQUALIFY C. TIMOTHY SMOOT BASED ON CONFLICT OF INTEREST

Before the Court is Plaintiffs' Motion to Disqualify

C. Timothy Smoot based on Conflicts of Interest ("Motion"). After considering the moving, opposing, and replying papers, the Court hereby GRANTS the Motion.

I. BACKGROUND

This action is one of three related actions currently pending before this Court, involving a Ponzi scheme whereby Defendant Jeanne Rowzee and her co-conspirators allegedly bilked investors out of \$ 40 million by falsely representing that they were investing the money in Private Investments in Public Equity Securities ("PIPES"). Plaintiffs Ernie Burnett, Trustee of the Burnett Family Trust, U/D/T 10-13-1983, Kai W. Adler, Luke Arnett, Michael Brackett, Eric Bradley, Jennifer Bradley, Enrique Campos, Tammy Campos, [*3] Mark Childers, Cherie Childers, Mike and Gwen Curtis Revocable Trust U/D/T 1-14-1999, Fifteen Morgan, LLC, First Trust Co. of Onaga, Custodian F/B/O George C. Kenney, Anne Frank, Alan E. Girdlestone and Dolores Girdlestone, Trustees of The Girdlestone Family 1989 Trust, Jason Glass, Dan Gluzman, Musia Gluzman, Fran Hargadon, Daniel Kechejian, Aline Kechejian, George C. Kenney, James Kim, Fred Koeppe, Trustee of Koppe Trust, U/D/T 3-31-1997, Jeff Marsden, Christine Marsden, Robert B. McDonald, Nigel Charles Page, Stephen Perebzak, Eric Rasor, Laura Rasor, Mark R. Sawusch, Ralph W. Sheets, Spectrum Lending Group, Fakhri Taheri, John Taylor, Therapy Care, Inc., Twelve Morgan, LLC, and Shirley Wagner (collectively "Plaintiffs") are members of Harvest Income, LLC ("Harvest Income"),¹ which its founder Robert Harvey ("Harvey") used to solicit over \$ 7 million into the PIPES Ponzi scheme. In May 2007, the members of Harvest Income ousted Harvey after he settled claims that he violated federal and state securities law. The settlement agreement obligates Harvey to repay all of Plaintiffs' out of pocket losses totaling \$ 4 million. Prior to his ouster, Harvey was Harvest Income's sole manager. [*4] Plaintiff Ernie Burnett ("Burnett") is Harvest Income's current manager. Neither Harvest Income nor Harvey are parties to this action.

¹ While Plaintiffs are not all of the members of Harvest Income or all of the Harvest Income members who lost money in the PIPES Ponzi scheme, they are the majority of such members.

Plaintiffs filed this action on June 1, 2007. Plaintiffs now seek to disqualify C. Timothy Smoot ("Smoot") from representing Defendants James Halstead

("Halstead"), GamePlanJH, LLC, GamePlan, Inc., and Susan Halstead in this action based on conflicts of interest. Smoot is a sole practitioner. While both parties agree that Smoot provided legal services to Harvest Income, they dispute the proper characterization of these services. Plaintiffs allege that Smoot served as Harvest Income's corporate counsel from May 2005 through April 2007, whereas Smoot claims that he provided "limited legal services" to Harvest Income from October 2005 through February 2007. Opp'n 2:14-15; Decl. of C. Timothy Smoot P 10 ("Smoot Decl."). Smoot does not dispute that as counsel for Harvest Income, he drafted various business and corporate documents, including the Harvest Income Operating Agreement, [*5] Investor Suitability Questionnaire, opinion letters, and security agreements. Nor Smoot does Smoot dispute that he had access to all of Harvest Income's company and investor records.

In January 2007, while still acting as corporate counsel for Harvest Income, Smoot agreed to represent Harvey and Halstead in connection with claims arising out of the PIPES Ponzi scheme. Smoot drafted a "Multiple Representation Letter," in which he states that Halstead is a new client, but he has represented Harvey and various entities that he controls since 1999." Ex. 3 to Decl. of Steven L. Krongold ("Krongold Decl."). Smoot is also a registered agent for a number of Harvey-related companies. Ex. 4 to Krongold Decl. In the Multiple Representation Letter, Smoot admits that by representing Harvest Income, he has "a duty to its members separate from [his] duty to Mr. Harvey." Ex. 3 to Krongold Decl. Smoot further explains that by representing both Harvest Income and Harvey personally, "there is a potential for conflicts between [his] duty to Mr. Harvey and [his] duty to Harvest Income's members." *Id.* Finally, Smoot acknowledged that although he believed their interests were not in conflict in January 2007, [*6] Harvest Income's and Harvey's interests may diverge "particularly if Harvest Income members sue Mr. Harvey in relation to the PIPES investments. In that case, I may have to withdraw from representing both Mr. Harvey and Harvest Income." *Id.* Since Harvey was retaining Smoot to represent Harvey in his individual capacity, Harvey could not consent on behalf of Harvest Income; yet Smoot failed to get the consent of Harvest Income's members or a disinterested manager to the joint representation. Harvey and Halstead signed the Multiple Representation Letter on January 30, 2007. Thus, while Smoot obtained the consent of Harvey and Halstead to joint

representation, he did not obtain the consent of Harvest Income.

The following day, January 31, 2007, Smoot sent a letter to all Harvest Income members, informing them that Harvest Income was the victim of a Ponzi scheme and claiming that he was acting on their behalf to recover assets lost in the scheme. Ex. 5 to Krongold Decl. The letter further asserted that it appeared that Rowzee "acted alone and that there is no larger conspiracy here." *Id.* Smoot informed the members that he had met with other investor groups who lost money in the PIPES Ponzi [*7] scheme and that he would meet with the other investors again to decide "whether we can work together as a group to recover what assets exist for the benefit of all investors, including Harvest Income investors." *Id.* He discouraged investors from filing suit, stating that "[i]t may be possible for the investor group to collect the assets that could otherwise be obtained in a successful lawsuit in a much shorter period of time and at far less expense that [sic] if lawsuits are filed." *Id.* Smoot closed the letter by making himself available to the members: "I am available to talk to any of you, simply call me. If you are represented by counsel or want to seek your own counsel, please do so and have your counsel call me." Smoot closed his January 31, 2007 letter to Harvest Income members stating that he would be representing Harvest Income at the upcoming investor group meeting. Ex. 5 to Krongold Decl.

In response to this letter, Smoot spoke directly with a number of Harvest Income members, including Mark Sawusch ("Sawusch") and George Kenney on February 1, Burnett on February 2, John Taylor on February 7 and Bob Bellano on February 8. On February 5, Smoot conferred with Ernie Burnett and [*8] "other Harvest Income investors," as well as Mike Curtis ("Curtis"). Ex. 2 to Krongold Decl. Smoot admits that he gave these investors information about the Ponzi and asked them questions about the PIPES Ponzi scheme, but asserts that he did seek or receive personal information from them. Smoot Decl. P 20. Smoot further states that he did not discuss representing any of them as their counsel and none of the Harvest Income members asked him to represent them individually. *Id.* Sawusch and Curtis, however, assert that they spoke to Smoot about the status of their investments and recovery efforts and that Smoot failed to disclose that he represented Halstead, who they later learned had raised significant sums of money for and has extensive ties to the PIPES Ponzi scheme. Decl.

of Mike Curtis P 5; Decl. of Mark Sawusch P 5. Sawusch and Curtis further state that if they had known that Smoot represented Halstead, they would not have contacted him or shared the information about their investments with him. *Id.* P 6. Burnett likewise asserts that Smoot did not tell him that he represented Halstead when they spoke on February 1, 2007 at which time he understood that Smoot was acting on behalf [*9] of Harvest Income and its members to recover funds. Decl. of Ernie Burnett ("Burnett Decl.") PP 4, 5. Nevertheless, Burnett was "uncomfortable dealing with Smoot due to his prior relationship with Harvey," so on February 4, 2007, Burnett sent Smoot an email, raising the issue of a potential conflict of interest and the need to secure separate representation for Harvest Income. *Id.* P 6; Ex. 1 to Burnett Decl.

In response to Burnett's email raising the conflict issue, Smoot withdrew as counsel for Harvest Income, arranging for Phillip Kimes ("Kimes") to take his place. Burnett Decl. P 7; Ex. 2 to Burnett Decl. Burnett later learned that Kimes had represented Harvey on unrelated matters and voiced his objection to Kimes, who eventually agreed to resign as well. Burnett Decl. P 8.

II. LEGAL STANDARD

Disqualification of counsel is generally governed by state law, *In re County of Los Angeles*, 223 F.3d 990, 995 (9th Cir. 2000) and may arise where counsel has violated applicable standards of professional conduct, including conflicts of interest. *Pac. Harbor Capital, Inc v. Carnival Air Lines, Inc.*, 210 F.3d 1112, 1117 (9th Cir. 2000); *Trone v. Smith*, 621 F.2d 994, 999 (9th Cir. 1980). "Ultimately, [*10] disqualification motions involve a conflict between the clients' right to counsel of their choice and the need to maintain ethical standards of professional responsibility." *San Francisco v. Cobra Solutions, Inc.* ("Cobra Solutions"), 38 Cal. 4th 839, 846, 43 Cal. Rptr. 3d 771, 135 P.3d 20 (2006) (quoting *People ex rel. Dep't of Corps. v. SpeeDee Oil Change Sys., Inc.* ("SpeeDee"), 20 Cal. 4th 1135, 1145, 86 Cal. Rptr. 2d 816, 980 P.2d 371 (1999)). In resolving a motion to disqualify counsel, the Court should carefully examine the implications of counsel disqualification, including "a client's right to chosen counsel, an attorney's interest in representing a client, the financial burden on a client to replace disqualified counsel, and the possibility that tactical abuse underlies the disqualification motion." *SpeeDee*, 20 Cal. 4th at 1145; accord *Hitachi, Ltd. v.*

Tatung Co., 419 F. Supp. 2d 1158, 1161 (N.D. Cal. 2006). The Court must balance these considerations against "the need to maintain ethical standards of professional responsibility." *SpeeDee*, 20 Cal. 4th at 1145. "The paramount concern must be to preserve the public trust in the scrupulous administration of justice and the integrity of the bar." *Cobra Solutions*, 38 Cal. 4th at 846. Ultimately, the [*11] Court has the "primary responsibility of controlling the conduct of the attorneys who practice before it." *Erickson v. Newmar Corp.*, 87 F.3d 298, 303 (9th Cir. 1996). The decision to disqualify rests within the district court's discretion. *Trone*, 621 F.2d at 999.

III. DISCUSSION

In any attorney-client relationship, the attorney has two ethical duties to his clients -- a duty of confidentiality and a duty of undivided loyalty -- both of which play an important role in the conflict of interest rules governing attorneys. *Cobra Solutions*, 38 Cal. 4th at 846. California's Rules of Professional Conduct ("Rules") prohibit an attorney from representing clients whose interests potentially conflict without the informed written consent of each client. Rule 3-310(C). Additionally, "once a conflict has arisen between a corporation and one or more of its officers, directors or shareholders, corporate counsel may not simultaneously represent the corporation and the adverse officer, director or shareholder." *La Jolla Cove Motel & Hotel Apartments, Inc. v. Superior Court*, 121 Cal. App. 4th 773, 785, 17 Cal. Rptr. 3d 467 (2004). Thus, once the PIPES Ponzi scheme came to light, Smoot was required to get the informed written [*12] consent of both Harvey and Harvest Income to jointly represent them due to the potential and later actual conflict of interests. When, as here, an organization's consent to dual representation is required under *Rule 3-310*, the organization's consent "shall be given by an appropriate constituent of the organization other than the individual or constituent who is to be represented, or by the shareholder(s) or organization members." Rule 3-600(E). While Smoot successfully obtained Harvey's consent, he failed to obtain the informed written consent of Harvest Income because Harvey, as the individual to be represented, could not consent to Smoot's dual representation or waive the conflict on behalf of Harvest Income. Rather, Smoot was required to obtain the consent of a disinterested manager of Harvest Income or Harvest Income's members. *See Pringle v. La Chapelle*, 73 Cal. App. 4th

1000, 1006, 87 Cal. Rptr. 2d 90 (1999) (corporation's consent to dual representation must be given by someone other than jointly represented individual). Thus, because Smoot failed to obtain Harvest Income's consent, he violated California's Rules of Professional Conduct by representing Harvest Income, Harvey, and Halstead in regard [*13] to the PIPES Ponzi scheme.

Moreover, once the interests of Harvey, Harvest Income and Halstead became adverse, Smoot could not simultaneously represent them. *Cobra Solutions*, 38 Cal. 4th at 846 ("An attorney who seeks to simultaneously represent clients with directly adverse interests in the same litigation is automatically disqualified" since an attorney cannot maintain his or her duty of loyalty to each client under these circumstances.). Nor may an attorney switch sides during litigation because the duty to preserve client confidences survives the termination of the attorney's representation. *Id.* Even after Smoot's representation of Harvest Income ended, he could not represent Harvey or Halstead without Harvest Income's consent because an attorney may not represent the adversary of his former client without the informed written consent of the former client. *Id.* at 847. If the attorney fails to obtain the former client's consent, the former client may disqualify the attorney from representing his adversary by showing that a "substantial relationship" exists between the current and former representation. *Id.*

Here, Smoot represented Harvey, Halstead, and Harvest Income in relation to [*14] the PIPES Ponzi scheme at issue in this action. Thus, because the subject matter is identical, there is a substantial relationship between Smoot's prior representation of Harvest Income and his present representation of Halstead. Moreover, the interests of Harvest Income, whose members lost millions of dollars in the PIPES Ponzi scheme, clearly diverge from those of Harvey and Halstead, who have been accused of conspiring with Rowzee to defraud investors, including Harvest Income's members, through the PIPES Ponzi scheme. Accordingly, given the divergence of interests between Harvey/Halstead and Harvest Income, Harvest Income could disqualify Smoot from representing Harvey or Halstead. The issue, however, is more complicated because it is not Harvest Income, but rather its members who seek to disqualify Smoot. The question is, thus, whether the members of Harvest Income are Smoot's former clients or should be treated as such even if they are not technically former clients for

purposes of the conflict of interest and disqualification of counsel rules.

Plaintiffs argue that as individual members of Harvest Income, they should be able to disqualify Smoot because he breached his duty of [*15] loyalty to them by engaging in the unsanctioned representation of conflicting interests. Plaintiffs seek to step into the shoes of Harvest Income, the entity, which could disqualify Smoot from representing Halstead if it were the plaintiff. Plaintiffs contend that the result should be no different when the individual members of Harvest Income are the plaintiffs because "[t]he attorney for a corporation represents it, its stockholders and its officers in their representative capacity." *Meehan v. Hopps*, 144 Cal. App. 2d 284, 290, 301 P.2d 10 (1956). The Halsteads argue, in response, that as corporate counsel for Harvest Income, Smoot "in nowise represent[ed] the [members] personally." *Id.* ("It would be a sorry state of affairs if when a controversy arises between an attorney's corporate client and one of its officers he could not use on behalf of his client information which that officer was required by reason of his position with the corporation to give to the attorney."). Yet, the rule that an attorney can represent a corporation in a dispute against a former officer from whom he received confidential information is inapposite and unhelpful here as Smoot is not trying to represent Harvest Income [*16] against Harvey or its other members. Instead he is representing a third party, who allegedly conspired with Rowzee and Harvey in duping the members of Harvest Income and others to invest in the PIPES Ponzi scheme, against the members of his former corporate client Harvest Income. While an attorney representing a corporation does not represent its stockholders merely because the attorney's actions on the corporation's behalf benefit the stockholders, *Skarbrevik v. Cohen, England & Whitfield*, 231 Cal. App. 3d 692, 703, 282 Cal. Rptr. 627 (1991), an attorneys' work on behalf of a corporation and its stockholders, should preclude that attorney from representing clients with interests adverse to the corporation and its stockholders where as here the interests of the corporation and the members are the same, regardless of whether the corporation or its stockholders are parties to the lawsuit. The specific facts of this case support the conclusion that Smoot should be disqualified from representing the Halsteads and GamePlan based on his prior representation of Harvest Income and its members.

The interests served by preventing attorneys from

accepting representation adverse to former clients, i.e. protecting [*17] and enhancing the professional attorney-client relationship, are implicated in this case even if Harvest Income's members were not technically Smoot's clients because Smoot led them to believe that he was working on behalf of Harvest Income and its members to recover their investments.

Both the lawyer and the client should expect that the lawyer will use every skill, expend every energy, and tap every legitimate resource in the exercise of independent professional judgment on behalf of the client and in undertaking representation on the client's behalf. That professional commitment is not furthered, but endangered, if the possibility exists that the lawyer will change sides later in a substantially related matter. Both the fact and the appearance of total professional commitment are endangered by adverse representation in related cases. From this standpoint it matters not whether confidences were in fact imparted to the lawyer by the client. The substantial relationship between the two representations is itself sufficient to disqualify.

Trone, 621 F.2d at 998-99. Here, Smoot did not merely change sides in a substantially related matter, he sought to simultaneously represent both sides [*18] in the PIPES Ponzi scheme when on January 30, 2007, while still representing Harvest Income, he undertook the representation of Harvey and Halstead, individuals implicated in the PIPES Ponzi scheme as recruiters, who convinced Harvest Income's members and others to invest in the scam. Moreover, on January 31, 2007, Smoot informed Harvest Income's members that he was acting on their behalf to recover the assets lost in the PIPES Ponzi scheme without informing them that he was simultaneously representing Harvey and Halstead. Thus, Harvest Income's members mistakenly thought that Smoot was acting in their best interests when they contacted him to discuss their investments at the beginning of February 2007 in response to his letter. At this time, Smoot attended meetings with other investors who had lost money in the PIPES Ponzi scheme purportedly on behalf of Harvest Income. He further drafted a settlement agreement with Rowzee and began to

identify recoverable assets. Smoot even actively discouraged Harvest Income members from filing lawsuits, advising them that it was in their best interests to pursue a settlement with Rowzee. Whether or not Smoot's conduct established an actual attorney-client [*19] relationship with the members of Harvest Income, by claiming to represent the interests of Harvest Income and its members and purportedly acting on their behalf to recover the funds they invested in the PIPES Ponzi scheme, he impliedly agreed not to accept representations adverse to Harvest Income's interests. *See Responsible Citizens v. Superior Court*, 16 Cal. App. 4th 1717, 1733, 20 Cal. Rptr. 2d 756 (1993). Despite these representations, Smoot had already undertaken representation of Harvey and Halstead, whose interests were adverse from those of Harvest Income and its members. Under these circumstances, Plaintiffs reasonably believed that Smoot was representing their interests as members of Harvest Income and it is improper for him to represent the Halsteads, whose interests are adverse to those of Harvest Income and its members. Given Smoot's direct communications with Harvest Income's members and his failure to obtain Harvest Income's informed consent as to the joint representation of Harvey, Halstead, and Harvest Income in relation to the PIPES Ponzi scheme, he cannot continue to represent one of these clients, when the interests of the members of his former client Harvest Income, who were lead to [*20] believe that Smoot was acting solely in their best interests, are adverse to his

current clients. As Harvest Income's attorney, Smoot had access to all members files, which included copies of checks, wire transfers, spreadsheets, completed investor questionnaires, emails and other correspondence to and from members, and tax documents. Thus, in his role as Harvest Income's attorney, Smoot obtained confidential information from its members. The mere technicality that Plaintiffs are members of Harvest Income, rather than the entity itself, does not justify condoning Smoot's ethical violations by allowing him to continue to represent the Halsteads in this action against the members of Harvest Income who he previously claimed to be helping. As the Ninth Circuit has observed: "[f]iduciary obligations and professional responsibilities may warrant disqualification of counsel in appropriate cases even in the absence of a strict contractual attorney-client relationship." *Trone*, 621 F.2d at 1002. The conflict of interest in this case mandates Smoot's disqualification.

IV. DISPOSITION

For the reasons set forth above, Plaintiffs' Motion to Disqualify C. Timothy Smoot is GRANTED.

IT IS SO ORDERED.

DATED: [*21] August 13, 2007

DAVID O. CARTER

United States District Judge