April 2007

CLIENT ALERTS

EPSTEIN BECKER & GREEN, P.C.

Resurgens Plaza
945 East Paces Ferry Road
Suite 2700
Atlanta, Georgia 30326-1380
404.923.9000

150 North Michigan Avenue
35th Floor
Chicago, Illinois 60601-7553
312.499.1400

Lincoln Plaza
500 N. Akard Street
Suite 2700
Dallas, Texas 75201-3306
214.397.4300

Wells Fargo Plaza
1000 Louisiana
Suite 5400
Houston, Texas 77002-5013
713.750.3100

1875 Century Park East
Suite 500
Los Angeles, California 90067-2506
310.556.8861

Wachovia Financial Center
200 South Biscayne Boulevard
Suite 2100
Miami, Florida 33131
305.982.1520

Two Gateway Center
12th Floor
Newark, New Jersey 07102-5003
973.642.1900

250 Park Avenue
New York, New York 10177-1211
212.351.4500

One California Street
26th Floor
San Francisco, California 94111-5427
415.398.3500

One Landmark Square
Suite 1800
Stamford, Connecticut 06901-2681
203.348.3737

1227 25th Street, N.W.
Suite 700
Washington, DC 20037-1175
202.861.0900

WWW.EBGLAW.COM

ALERT: New York Court Rules That Absolute Privilege Applies To Statements Made on Forms U-5

The New York Court of Appeals, on March 29, 2007, issued a decision that clarifies an important area of New York law, holding that an employer's statements on a Uniform Termination Notice for Securities Industry Registration, also known as Form U-5, are protected by an absolute privilege in defamation lawsuits.

The decision, *Rosenberg v. MetLife, Inc.*,___N.E.2d_, 2007 WL 922920 (N.Y.), 2007 N.Y. Slip Op. 02627, resolves a split among the New York Appellate Divisions on whether such statements are protected by an absolute or a qualified privilege. An absolute privilege applies without consideration of motive or bad faith and provides an employer with immunity from a defamation suit. A qualified privilege leaves the door open to such suits, since immunity applies only if the statement was made in good faith.

In *Rosenberg*, a terminated broker claimed that statements made by his former employer, MetLife, on a Form U-5 were defamatory and made with malicious intent. Specifically, MetLife said that Rosenberg's employment was terminated because he appeared to have violated company policies and procedures involving speculative insurance sales and was a possible accessory to money laundering violations.

What is a Form U-5?

Upon the termination of a registered representative's employment, the National Association of Securities Dealers (NASD) requires member firms, including broker-dealers, investment advisers, and issuers of securities, to complete and file a Form U-5 within 30 days of dismissal, and to provide a copy of the form to the employee. Among other information, the U-5 calls for the employer to disclose the reason for the employee's termination. The firm must also update the Form U-5 if it later learns of any additional information that should have been included. Filing is mandatory and firms are subject to penalties for non-compliance.

Although a firm's duty to prepare an accurate Form U-5 should not, in theory, expose the firm to liability (since there can be no liability for a truthful statement), the more unfavorable the statements on Form U-5, the more likely the statements will be challenged by an action for defamation. Whether or not statements made on a Form U-5 are protected from such suits, by either an absolute or qualified privilege, is a matter of state law. Courts have generally agreed that employers must be provided some form of protection or immunity, since otherwise, they would have an incentive to be less candid on Forms U-5. However, courts have disagreed about the appropriate standard for such immunity.

The *Rosenberg* Case

In *Rosenberg*, the plaintiff filed a complaint in the United States District Court for the Southern District of New York, alleging libel, among other things, over MetLife's statements on the Form U-5. The district court held that under New York law, statements made on a Form U-5 are "absolutely privileged." On appeal, Rosenberg argued that a qualified, not an absolute, privilege attached to statements made on a Form U-5. The United States Court of Appeals for the Second Circuit, noting that New York law was unsettled on whether absolute or qualified immunity applied to statements on a Form U-5, certified the following question to New York State's highest court, the New York Court of Appeals: "[a]re statements made by an employer on a Form-U-5 subject to an absolute or qualified privilege?"

The Court of Appeals answered the question, adopting the broadest form of immunity—an absolute privilege. The Court's decision was based on the Form U-5's compulsory nature, its role in the NASD's quasi-judicial process and the protection of public interests.

In reaching its holding, the Court noted that when a compelling public policy requires that the speaker be immune from suit, the law affords an absolute privilege, while statements fostering a lesser public interest are subject only to a qualified privileged. The Court explained that the absolute privilege generally is reserved for communications made by individuals participating in a public function, such as legislative or judicial proceedings, to ensure that such persons' fear of a civil action do not have an adverse impact upon the discharge of their pubic function.

The Court reasoned that the public interests implicated by the filing of Forms U-5 are significant, since they play a significant role in the NASD's self-regulatory process. The form is designed to alert the NASD to potential misconduct, and to enable the NASD to investigate, sanction, and deter misconduct by its registered representatives. The NASD's actions ultimately benefit the general investing public, which faces the potential for substantial harm if exposed to unethical brokers. The Court emphasized that accurate and forthright responses on the Form U-5 are critical to achieving these objectives.

As a result of the *Rosenberg* decision, New York employees are no longer entitled to monetary damages resulting from Form U-5 defamation claims when such claims are brought in court. Although California follows the absolute privilege rule, other states do not. Courts applying Tennessee, Illinois, Oklahoma, North Carolina, Michigan and Florida law have granted Form U-5 statements qualified, rather than absolute, immunity. It is also important to note that New York employers may be subject to the qualified (and not the absolute) privilege in federal cases where other states' laws apply. Still other jurisdictions, such as New Jersey, have not yet decided this issue. Such states may, however, look to New York law on financial services industry matters and adopt the absolute privilege, as they have in the past with respect to other issues surrounding the financial industry.

Other Recent Defamation Claims in the Financial Industry

A week before the *Rosenberg* decision, on March 21, 2007, an NASD arbitrator found Alliance Capital Management LP and related Alliance companies liable for defaming the claimant, a former AllianceBernstein broker, after the employer made public statements about the broker. *See Schaffran v. Alliance Capital Management, LP, et al.*, 2007 WL 1001079, (N.A.S.D.) 04-06498. *Schaffran*, however, differs form the *Rosenberg* decision in at least two significant ways. First, the forum in that case was an NASD arbitration, not a court of law. Although arbitrators are afforded wide discretion, an arbitration award may be vacated if it is rendered in "manifest disregard of the law." In other words, arbitration decisions will generally be upheld, except if the arbitrator knew the law, yet refused to apply it, or if the law ignored by the arbitrator was well defined, explicit, and clearly applicable to the case. Second, the *Schaffran* case did not involve a Form U-5. Rather, when the claimant's employment was terminated, his firm made public statements about him and another employee. Although the *Schaffran* case was decided prior to *Rosenberg*, the holding in *Schaffran* would not necessarily have changed if issued post-*Rosenberg*, since the public policy basis for the absolute privilege surrounding statements made on Forms U-5 simply does not apply in connection with allegedly defamatory public statements.

What Remedies Remain Available to Terminated Employees?

Although terminated registered employees can no longer bring valid defamation claims based on statements made on their U-5s, those employees who believe they have been maliciously defamed on a Form U-5 may commence an arbitration proceeding or court action to expunge any alleged defamatory language. Accordingly, and as always, employers must remember to be honest and forthright in their disclosures on employees' Forms U-5. Finally, employers are reminded to keep their comments within the context of the Form U-5, since republishing comments outside of the U-5 context may lead to the loss of the absolute privilege.

* * *

If you have any questions regarding the *Rosenberg* and similar decisions, please contact David Jacobs at 310/557-9517, djacobs@ebglaw.com or Susan Gross Sholinsky at 212/351-4789, sgross@ebglaw.com.

Anna Cohen, an Associate in the Labor and Employment practice in the Firm's New York Office, contributed to this Client Alert.

* * **