

# CLIENT ALERT

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### Form U-5 Defamation Claims Barred In New York

New York securities industry employers received welcome news recently when the State's highest court held that statements in Form U-5 employee termination notices are subject to an absolute privilege. The holding on this previously unsettled legal issue, in *Rosenberg v. MetLife, Inc.*, 2007 NY Slip Op. 2627 (N.Y. Mar. 29, 2007), means that employees cannot prevail on defamation claims based upon statements made by an employer in a Form U-5.

#### Form U-5

Member firms of the National Association of Securities Dealers ("NASD") are required to complete and file with the NASD a termination notice, known as a Form U-5, within thirty days of the voluntary or involuntary departure of a "registered representative" from his or her employment. The employer is also required to provide a copy of the Form U-5 to the former employee. A registered representative is an employee of an NASD member firm who advises clients on which securities to buy and sell, and who receives a percentage of the commission income generated.

In the Form U-5, the employer must explain the reasons for the termination. The form also contains several disclosure questions addressing whether the employee was the subject of customer complaints, criminal charges, or an internal review for violating investment-related rules. If so, the employer is required to complete a corresponding disclosure reporting page to explain the nature of the allegations.

#### The Facts

In 1997, plaintiff Chaskie Rosenberg began his employment with defendant MetLife, Inc. ("MetLife"), as a financial service representative. After three internal audits

regarding possible speculative insurance practices and money-laundering implicated Rosenberg, MetLife terminated his employment.

MetLife filed a Form U-5 in which it explained the reason for Rosenberg's discharge as follows: "AN INTERNAL REVIEW DISCLOSED MR[.] ROSENBERG APPEARED TO HAVE VIOLATED COMPANY POLICIES AND PROCEDURES INVOLVING SPECULATIVE INSURANCE SALES AND POSSIBLE ACCESSORY TO MONEY LAUNDERING VIOLATIONS." The Form U-5 also stated that Rosenberg had been under an internal review for violating investor-related rules.

#### The Lawsuit

Rosenberg filed an action in the U.S. District Court for the Southern District of New York against MetLife asserting, among other things, claims of employment discrimination and libel. He alleged that MetLife had terminated his employment because he was a Hasidic Jew. He further alleged that MetLife's statements on the Form U-5 were defamatory. Following discovery, MetLife filed a motion for summary judgment.

#### The District Court

The district court granted MetLife's motion in part, dismissing Rosenberg's libel claim. The court held that MetLife's statements on the Form U-5 were absolutely privileged. Following a trial on the remaining causes of action, the jury found MetLife not liable for discrimination. Rosenberg appealed the dismissal of the libel claim.

#### The Second Circuit

On appeal, Rosenberg argued that the district court had erred in holding that statements on a Form U-5 are absolutely privileged. The U.S. Court of Appeals for the Second Circuit concluded that Rosenberg's argument

presented an unsettled issue of New York law and certified the following question to the New York State Court of Appeals: “[a]re statements made by an employer on an NASD employee termination notice (“Form U-5”) subject to an absolute or qualified privilege in a suit for defamation?”

### The Court Of Appeals

Before the New York State Court of Appeals, Rosenberg argued that only a qualified, not an absolute, privilege attaches to Form U-5 statements. Rosenberg contended that the filing of a Form U-5 is too remote from the NASD’s quasi-judicial functions to justify application of an absolute privilege. He also contended that one of the purposes of the form is to provide companies with background information about prospective employees, which is not a quasi-judicial function. MetLife responded that an absolute privilege should apply because filing a Form U-5 is a preliminary step in a quasi-judicial process and an absolute privilege best serves the public interest in encouraging complete and truthful disclosure.

In deciding the issue, the Court first considered the difference between a qualified and an absolute privilege. According to the Court, statements protected by a qualified privilege are not actionable unless the plaintiff can establish that the declarant made the statement with malice. The Court explained that a communication is typically subject to a qualified privilege when it is made by someone pursuant to his or her public or private legal or moral duty or in the conduct of his or her own affairs.

The Court explained that an absolute privilege completely immunizes the declarant in a defamation action. According to the Court, an absolute privilege typically applies only to communications made by participants in a “public function, such as

executive, legislative, judicial or quasi-judicial proceedings.” The purpose of affording absolute privilege to certain statements is to ensure that one’s own personal interest in avoiding a civil action does not adversely affect his or her discharge of a public function. Moreover, the absolute privilege does not only apply to statements made during the course of judicial and quasi-judicial proceedings, but also to preliminary or investigative stages of the process, as long as the statements are material and pertinent to the questions at issue.

The Court then considered the public purpose served by the NASD’s regulatory regime for the securities industry. The Court explained that the NASD is a “quasi-governmental entity” and is “the primary regulator of the broker-dealer industry.” According to the Court, although the U.S. Securities and Exchange Commission (“SEC”) has the authority to regulate the NASD’s members, most of the day-to-day regulation is delegated to the NASD.

The Court explained that “investigation and adjudication of suspected violations of the SEC’s laws and regulations as well as the NASD’s own rules” are among “the NASD’s central responsibilities.” The Court further explained that the Form U-5 “plays a significant role in the NASD’s self-regulatory process.” Upon receiving a Form U-5, the NASD investigates terminations for cause in order to determine whether the employee violated any securities rules. The form is often the first indication that the NASD receives of possible misconduct. As such, the “Form U-5 can be viewed as a preliminary or first step in the NASD’s quasi-judicial process.”

The Court explained that the “public interests implicated by the filing of Forms U-5 are significant,” because the form alerts the NASD to potential misconduct and enables it to

investigate, sanction and deter misconduct. In this way, the NASD is able to protect the investing public from unethical brokers. The Court explained that “[a]ccurate and forthright responses on the Form U-5 are critical to achieving these objectives.” Finally, the Court noted that a remedy exists for employees who are defamed in a Form U-5, because they may initiate an arbitration proceeding or court action to expunge the defamatory language.

### Conclusion

The *Rosenberg v. MetLife, Inc.* decision is clearly a victory for New York employers in the securities industry. Employers must be aware, however, that although Form U-5 statements may not form the basis for a defamation claim, they may still be used as evidence in other actions. For instance, if the reason for an employee’s termination set forth in a Form U-5 is inconsistent with the reason that the employer provided elsewhere, the Form U-5 may constitute evidence of pretext in a discrimination case. Thus, care must still be taken when completing a Form U-5.

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