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Form U-5 Termination Notices — Absolutely or Qualifiedly Privileged?

On June 28, 2006, the United States Court of Appeals for the Second Circuit in *Rosenberg v. MetLife, Inc*. certified to the New York Court of Appeals the question whether statements made by an employer on an NASD employee termination notice (Form U-5) are subject to an absolute or a qualified privilege in a suit for defamation.[1] In declining to affirm the view of the United States District Court for the Southern District of New York—that statements made by employers on Forms U-5[2] enjoy an absolute privilege—the Court of Appeals held that New York law remains unsettled as to whether the privilege is absolute or qualified, and that resolution of the issue by the New York Court of Appeals was appropriate.

I. The Facts

Plaintiff Chiaskie Rosenberg ("Rosenberg") filed suit for employment discrimination against his former employer MetLife Inc., Metropolitan Life Insurance Co., and MetLife Securities, Inc., ("MetLife") in the United States District Court for the Southern District of New York.[3] In addition to claiming that MetLife wrongfully terminated him because he was a Hasidic Jew, Rosenberg also alleged libel, claiming that MetLife had made defamatory and malicious statements on the National Association of Securities Dealers U-5 form for employee termination.[4]

Rosenberg worked as a MetLife financial services representative from August 1997 to April 2003, primarily serving the Hasidic Jewish community in Brooklyn.[5] Beginning in 1998, MetLife launched an ongoing investigation into third-party payments on policy premiums.[6] MetLife audited and

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1 *Rosenberg* v. *MetLife, Inc.*, No. 05-4363-cv, 2006 U.S. App. LEXIS 16195 (2d Cir. June 28, 2006).

2 When a stock brokerage firm terminates an employee, it is required by the NASD to file a Form U-5, stating the reasons for termination. The form serves to protect new employers from hiring brokers who have violated industry regulations or policies, and the investing public. *See* Anne H. Wright, *Form U-5 Defamation*, 52 Wash. & Lee L. Rev. 1299 (1995).

3 *Rosenberg* v. *MetLife, Inc.*, 2005 U.S. Dist. LEXIS 2135 (S.D.N.Y. 2005).

4 *Id.*

5 *Id*. at *2.

6 *Id.* at *3.

closed down one of its agencies, the majority of employees of which were Hasidic Jews and where Rosenberg began his employment with MetLife. A few years later, MetLife audited another of its agencies, one to which Rosenberg had been transferred, and Rosenberg was questioned about several of his policies.[7] MetLife terminated Rosenberg's employment in April 2003, citing his handling of several policies and his allegedly false answers to questions regarding those policies.[8] MetLife listed the following reason for Rosenberg's termination on the U-5 form that it was required to file with NASD: "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."[9]

II. Procedural History

The United Stated District Court for the Southern District of New York (Rakoff, D.J.) granted defendant MetLife's motion for summary judgment on plaintiff Rosenberg's libel claim.[10] The district court held that Form U-5 statements are absolutely privileged under New York law.[11] Although plaintiff argued that the court was bound by *Fahnestock v. Waltman*[12] to apply a qualified privilege, the district court rejected this argument, maintaining instead that "[i]n light of the overwhelming authority in the New York courts, *Fahnestock*, and the Southern District cases that have applied it. . . [could] no longer be regarded as good law."[13]

The Court of Appeals agreed with the district court that *Fahnestock* and the qualified privilege applied therein did not govern plaintiff's case, though not because it was bad law.[14] Rather, *Fahnestock* was decided before New York courts had yet spoken on the question of absolute or qualified privilege for Form U-5 statements. Therefore, the arbitral panel's award of damages for defamation on a Form U-5 that was upheld in *Fahnestock* was not "manifestly contrary" to New York law.[15] However, the Court of Appeals disagreed with the district court's view that there was "overwhelming authority in the New York courts" for absolute privilege over Form U-5 statements, noting that the New York Court of Appeals had never addressed the issue; and the Appellate Division of the New York Supreme Court was divided.[16] The Court of Appeals viewed the question of whether New York law applies an absolute or qualified

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7 *Id.* at *6.

8 *Id.* at *7.

9 *Rosenberg* v. *MetLife, Inc.*, 2006 U.S. App. LEXIS 16195 at *5.

10 *Rosenberg* v. *MetLife, Inc.*, 2005 U.S. Dist. LEXIS 2135. The court denied summary judgment on plaintiff's employment discrimination claim.

11 *Id.* at *8-9.

12 *Fahnstock* v. *Waltman*, 935 F.2d 512 (2d Cir. 1991).

13 *Rosenberg*, 2005 U.S. Dist. LEXIS at *9, note 1.

14 *Rosenberg*, 2006 U.S. App. LEXIS at *8-9.

15 *Id.*

16 *Id.* at *15.

privilege to Form U-5 statements to be unresolved, and certified the question to New York's highest court.

III. Rationale of the Court

In the absence of clear authority from the New York Court of Appeals on whether Form U-5 statements are absolutely privileged, the Second Circuit looked to decisions of the Appellate Division of the New York Supreme Court.[17] Only the First Department has spoken directly on the issue. That court applied an absolute privilege in *Herzfeld & Stern, Inc. v. Beck*,[18] and later reaffirmed that decision in *Cicconi v. McGinn, Smith & Co.*[19]

In *Herzfeld & Stern, Inc. v. Beck*, the First Department held that statements on a Form U-5 were subject to an absolute privilege because they were prepared in connection with a quasi-judicial proceeding.[20] Therefore, employer defendant Herzfeld & Stern was entitled to summary judgment dismissing plaintiff's defamation claim. More than ten years later, a three-member majority of the First Department reaffirmed *Herzfeld*'s absolute privilege in *Cicconi v. McGinn, Smith & Co.*,[21] a case in which the plaintiff unsuccessfully argued that *Herzfeld* was overbroad because not every Form U-5 led to quasi-judicial proceedings.

However, the Second Circuit found that the close split between the First Department's three-member majority and its two dissenting justices in *Cicconi* cast doubt on the propriety of an absolute privilege, noting that Justice Ellerin, who had joined the majority in *Herzfeld*, changed her mind in *Cicconi* and joined the dissent.[22] Justice Ellerin stated in *Cicconi* that *Herzfeld* was wrongly decided and that a qualified privilege would better serve the public and investors in light of employers' abuse of the absolute privilege in making distorted and false statements on Form U-5s for business reasons.[23] In addition to the First Department's internal split, other New York departments differed over absolute privilege.[24] The Second Department applied absolute immunity for statements made in the course of a quasi-judicial administrative investigation,[25] but the Fourth Department stated that it was far from clear that New York

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17 *Id.* at *10.

18 *Hertzfeld & Stern, Inc.* v. *Beck*, 572 N.Y.S. 2d 683 (1st Dep't. 1991).

19 *Cicconi* v. *McGinn, Smith & Co.*, 808 N.Y.S. 2d 604 (1st Dep't. 2005).

20 *Hertzfeld*, 572 N.Y.S. 2d at 691. The SEC investigated the broker upon receipt of the NASD Form U-5.

21 *Cicconi*, 808 N.Y.S. 2d at 607.

22 *Rosenberg*, 2006 U.S. App. LEXIS at *11.

23 *Cicconi*, 808 N.Y.S. 2d at 608.

24 *Rosenberg*, 2006 U.S. App. LEXIS at *11-12.

25 *Dunn* v. *Ladenburg Thalmann & Co., Inc.*, 259 A.D.2d 544 (2d Dept. 1999).

law required absolute immunity over Form U-5 statements in all circumstances.[26] The Third Department has not spoken on the matter.

The Second Circuit thus concluded that no lower New York court holding compelled a decision in favor of either an absolute or qualified privilege.[27] In addition, questions of state public policy were appropriate for the New York Court of Appeals to decide: how to protect candid disclosure of brokers' conduct and also provide a remedy for employers' bad faith statements and "blackballing" of former employees.[28] Because a definitive answer would resolve the litigation,[29] the Second Circuit certified the issue to the New York Court of Appeals.

IV. Significance of Decision

Whether statements made in a Form U-5 are privileged on a qualified or absolute basis is a contested issue in the securities industry.[30] Supporters of an absolute privilege argue that an absolute privilege over statements made by securities brokerages on Forms U-5 protects the public from unscrupulous brokers; that is, while firms are required by regulators to disclose reasons for termination, they are more likely to be candid when immune from defamation suits, or liability to other firms that hire their former employees.[31] Proponents of a qualified privilege assert that disclosure is adequately assured by a qualified privilege under which Form U-5 statements are unprotected only upon a showing that the employer's statements were made in bad faith.[32] The Second Circuit takes no position in *Rosenberg* on the merits of these policy arguments. Its decision, however, to certify the question to New York's Court of Appeals may suggest skepticism of an absolute privilege as a viable rule over Form U-5 statements.[33]

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26 *Spasiano* v. *1717 Capital Management Co.*, 1 A.D.3d 902 (4th Dept. 2003). The Fourth Department in *Spasiano* cited conflicting decisions in *Fahnestock* and *Hertzfeld* to conclude that New York law was not "well-defined" concerning absolute or qualified privilege of Form U-5 statements. *But see* note 7, *supra*, for the Second Circuit's alternative reading of *Fahnestock.*

27 *Rosenberg*, 2006 U.S. App. LEXIS at *12.

28 *Id.* at *16-17.

29 *Id.* at *17.

30 *Acciardo* v. *Millennium Secs. Corp.*, 83 F.Supp. 2d 413, 419 (S.D.N.Y. 2000).

31 *See* Michael Siconolfi, "Blackballing" of Brokers is Growing on Wall Street, Wall St. J., Feb. 27, 1998, at C1. *See also Baravati* v. *Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 708 (7th Cir. 1994); *Acciardo*, 83 F.Supp. 2d at 419.

32 *See Dawson* v. *New York Life Insurance Co.*, 135 F.3d 1158, 1164 (7th Cir. 1998); *Baravati*, 28 F.3d at 708.

33 *See Rosenberg*, 2006 U.S. App. LEXIS at *10. The majority there states that Appellate Division decisions should not be disregarded in ascertaining state law unless the court is "*convinced* by other persuasive data that the highest court of the state would decide otherwise" (quoting *West* v. *Am. Tel. & Tel. Co.*, 311 U.S. 223, 237 (1940), emphasis added).

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Charles A. Gilman at (212) 701-3403 or cgilman@cahill.com, Jonathan I. Mark at (212) 701-3100 or jmark@cahill.com or John Schuster at (212) 701-3323 or jschuster@cahill.com