

SECURITIES LITIGATION ADVISORY

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Court of Appeals of New York Issues Seminal Decision on Absolute Privilege Against Defamation Claims for Form U-5 Disclosures

The Court of Appeals of New York in *Rosenberg v. Metlife, Inc.*, ___ N.E.2d ___, 2007 WL 922920 (N.Y. Mar. 29, 2007), has just issued an important decision that protects NASD member firms from the burden and risk of vexatious defamation claims brought by terminated employees (associated or registered persons) based on statements made by the member firms on NASD employee termination notices (Form U-5). The court held that under New York law such statements are protected by an absolute privilege that immunizes firms from liability in defamation actions.

This decision should reduce firms' risk of suffering adverse results such as the \$3.1 million NASD arbitration award issued on or about March 21, 2007, to a former AllianceBernstein Holdings broker in a defamation case stemming from the market-timing scandal, or the ruling entered on or about March 28, 2007, by a U.S. district judge for the Southern District of New York confirming a \$14 million arbitration award against Merrill Lynch in favor of three former brokers who brought defamation claims after being terminated for their purported roles in market-timing schemes. Moreover, although defamation is a common law claim governed by state law, and most such claims are brought in NASD arbitration proceedings rather than in court, this decision has important implications for this area of the law throughout the country because of the generally recognized importance of New York law in the securities employment arena and the newly approved revised NASD Code of Arbitration Procedure (set to go into effect on April 16, 2007) that codifies and formalizes motion practice in NASD arbitration proceedings.

In *Rosenberg*, the plaintiff, a terminated Metlife financial service representative, brought a federal civil action against Metlife for damages for alleged employment discrimination, fraudulent misrepresentation, breach of contract and libel. With specific regard to the libel claim, the plaintiff alleged that Metlife's statements on the NASD Form U-5 filed after the plaintiff's dismissal were defamatory and made with malicious intent. After discovery, Metlife moved for summary judgment. The federal district court granted the motion as to the libel claim, holding that Metlife's statements on the Form U-5 were absolutely privileged.

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After a trial on the remaining claims, the plaintiff appealed to the Second Circuit, contending that the district court erroneously dismissed the libel claim. The Second Circuit concluded that the appeal presented an unsettled issue of New York law and certified to the Court of Appeals of New York the following question:

Are 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?

In the *Rosenberg* decision, the Court of Appeals of New York answered the question directly:

Statements made by an employer on a NASD employee termination notice are subject to an absolute privilege in a suit for defamation.

In reaching this conclusion, the court explained that statements made by a person in the discharge of some public or private duty, in the conduct of his own affairs, or in a matter where his interest is concerned, are protected by a qualified privilege and may not be the subject of a defamation action unless the plaintiff can prove that the declarant made the statement with malice, i.e., spite or a knowing or reckless disregard of a statement's falsity. However, when compelling public policy requires that the speaker be immune from suit, the law affords an absolute privilege. The absolute privilege generally is reserved for statements by individuals participating in a public function, such as executive, legislative, judicial or quasi-judicial proceedings.

The plaintiff argued that a qualified, but not absolute, privilege should attach to Form U-5 statements because the filing of a Form U-5 is too remote from the NASD's quasi-judicial functions to warrant the application of an absolute privilege. Metlife countered that an absolute privilege should apply because the filing of the Form U-5 is a preliminary step in a quasi-judicial process and because such a privilege best serves the public interest in encouraging full and truthful disclosure.

In answering the certified question, the court noted that it had previously indicated that the absolute privilege can extend to preliminary or investigative stages of a judicial or quasi-judicial process where compelling public interests are at stake. The court then concluded the NASD is a quasi-governmental entity because it is the only national securities association registered under the Securities Exchange Act of 1934 and has been delegated securities enforcement regulatory authority by the SEC.

Consequently, the court held that the NASD's regulatory regime serves a compelling public purpose comparable to that served by a bar association grievance committee responsible for investigating and administering disciplinary proceedings against attorneys. Indeed, the court determined that the regulation of registered brokers in the securities industry is of no less importance than the necessity of maintaining the high standards for the conduct of attorneys and that the Form U-5 plays a significant role in the NASD's self-regulatory (i.e., quasi-judicial) process.

Importantly, the court also noted that registered employees who are maliciously defamed on a Form U-5 are not wholly without remedy because they may commence an arbitration proceeding or court action to expunge any alleged defamatory language. Even so, the protection against large money damages awards should enable NASD member firms to more effectively fulfill the critical objectives of alerting the NASD to potential misconduct and protecting the investing public from unethical brokers, without fear of vexatious litigation.

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