Client Advisory

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New York's Highest Court Clarifies U-5 Immunity

On March 29, 2007, the New York Court of Appeals, New York's highest court, issued an important decision clarifying the level of protection afforded to securities industries employers with respect to liability stemming from statements made on an employee's Form U-5 ("U-5"). In Rosenberg v. MetLife, Inc., Metropolitan Life Ins. Co. and Metlife Securities, Inc.,[1] the Court held that statements made by employers on a U-5 are absolutely privileged. What this means is that an employee may not bring a defamation action against his former employer for statements made on a U-5, even if those statements are false and were made with malice. As discussed below, because of the important role U-5's play in the National Association of Securities Dealers ("NASD") regulation of securities professionals, the Court of Appeals rejected the proposition that such statements should enjoy only a qualified privilege.

Background

Chaskie J. Rosenberg is a Hasidic Jew who was employed by MetLife between August, 1997 and 2003.[2] Rosenberg, who was registered with the NASD, initially worked out of MetLife's All-Boro office in Brooklyn, New York selling insurance and other wealth management products. Rosenberg concentrated his sales efforts on the Hasidic community in the area of Brooklyn in which his office was located.

The Hasidic community to which Rosenberg directed his sales efforts apparently participated in the "Hasidic institution of Gemach, or free loan society, in which individuals pay into a shared fund that lends out money on an as needed basis to those [who suffer financial hardship]."[3] In 1998, MetLife began an inquiry into sales practices at the All-Boro office because it learned that premiums on certain life insurance policies sold from the All-Boro office were being paid with third party checks. That concern led MetLife to believe that life insurance policies were being sold "as a form of speculative insurance (in which a policy does not protect an insurable interest but rather serves as a form of investment for a third party)."[4]

MetLife's inquiry turned into a full blown audit of the All-Boro office and in March, 2000 Metlife made the decision to close that office. Rosenberg and several other MetLife representatives then transferred to another MetLife office located at Shore Road in Brooklyn. In 2002, MetLife conducted an audit of the Shore Road office, including Rosenberg's sales practices. MetLife focused on nine insurance policies that Rosenberg had written because the premiums for those policies were paid by someone other than the policy holder. Rosenberg contended that the premiums for those policies were paid by the Gemach and that the funds should, for all intents and purposes, be considered the funds of the insured.

On April 29, 2003, MetLife terminated Rosenberg's employment on the basis of the audit. As required by NASD regulations, MetLife submitted a Form U-5, Uniform

Termination of Employment, to the NASD within 30 days of Rosenberg's last day of employment. In the U-5, MetLife stated it had terminated Rosenberg because "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."

Rosenberg commenced a lawsuit against MetLife in the United States District Court for the Southern District of New York. In his complaint, Rosenberg alleged that he and several other former MetLife employees were terminated because they are Hasidic Jews. Rosenberg also stated a cause of action for libel on the grounds that MetLife's stated reasons for termination in the Form U-5 were false and made in order to prevent him from obtaining future employment in the securities industry.

MetLife moved for summary judgment[5] on all of Rosenberg's claims. The court denied the motion with respect to the discrimination claims but granted it with respect to the libel claim. The court concluded that New York law on the issue of immunity for statements made in a U-5 was well settled and spent only one brief paragraph analyzing that issue:

> The same is not true of Rosenberg's libel claim since, under New York law (which governs this claim), statements in a Form U-5 are absolutely privileged. See Herzfeld & Stern, Inc. v. Beck, 572 N.Y.S.2d 683 (1st Dep't 1991); Culver v. Merrill Lynch & Co., 1995 U.S. Dist. LEXIS 10017, *16 (S.D.N.Y. Jul. 17, 1995). "If the privilege is absolute, it confers immunity from liability regardless of motive." Park Knoll Assoc. v. Schmidt, 59 N.Y.2d 205, 209 (1983). Accordingly, Rosenberg's libel claim must be dismissed.[6]

Rosenberg proceeded to trial on the remaining claims, which were all rejected by the jury or dismissed by the court. Rosenberg subsequently appealed the District Court's decision on the libel claim. In his appeal, Rosenberg argued that the District Court erred in holding that statements in a Form U-5 are absolutely privileged and argued that the Second Circuit's decision in Fahnestock v. Waltman, 935 F.2d 512 (2d Cir. 1991) afforded statements in a U-5 only a qualified privilege.[7]

The Second Circuit issued its opinion on Rosenberg's appeal on June 28, 2006. In that opinion, the Second Circuit disagreed that New York law is clear as to the level of privilege that statements in a Form U-5 enjoy; therefore it concluded that the necessary criteria existed for it to certify the following question to the New York Court of Appeals:

> Are statements made by an employer on an NASD employee termination notice ("form U-5") subject to an absolute or a qualified privilege in a suit for defamation?[8]

The Court Of Appeals Decision

The New York Court of Appeals accepted the Certified Question, heard oral argument on February 13, 2007 and issued its opinion just six (6) weeks later. In its opinion, the Court notes the competing and extremely important policy interests of (a) protecting the investing public through full and candid disclosure of wrongdoing by brokers and (b) the interests of brokers in protecting their reputations from false statements made by vindictive employers. The Court reasoned that while both of these interests are important, the policy of investor protection takes precedence:

> The public interests implicated by the filing of Forms U-5 are significant. The

> form is designed to alert the NASD to potential misconduct and, in turn, enable the NASD to investigate, sanction and deter misconduct by its registered representatives. The NASD's actions ultimately inure to the benefit of the general investing public, which faces the potential for substantial harm if exposed to unethical brokers. Accurate and forthright responses on the Form U-5 are critical to achieving these objectives.[9]

In reaching the conclusion that statements on a U-5 are afforded an absolute privilege, the Court noted that one of NASD's primary functions is the "investigation and adjudication of suspected violations of the SEC's laws and regulations as well as [its] own rules."[10] The Court further noted the role played by U-5's in assisting NASD to carry out this important quasi-judicial function and in regulating the over 660,000 securities professionals registered with NASD:

> Upon receipt of the Form U-5, the NASD routinely investigates terminations for cause to determine whether the representative violated any securities rules. The form is often the first indication that the NASD receives regarding possible misconduct by members of the securities industry, and investigations of misconduct reported on the Form U-5 frequently lead to the initiation of disciplinary action by the NASD. . . . As such, the compulsory Form U-5 can be viewed as a preliminary or first step in the NASD's quasi-judicial process.[11]

The Court reasoned that in order for NASD to fully and properly oversee the conduct of registered representatives, employers must be able to file U-5s without fear of being sued for libel by their former employees.[12] In a nod to the interests of brokers, the Court noted that even though an employee could no longer sue a former employer for libel for statements made on a U-5, a registered representative is not without a remedy when he is maliciously defamed on a U-5 as he could commence an arbitration or lawsuit to expunge the defamatory language.[13]

The Rosenberg Court's decision that statements made in a U-5 are absolutely privileged represents a victory for securities industry employers who often struggle with how to properly word the basis for a termination and at the same time avoid being sued. Still, the Rosenberg decision does create the potential for a vindictive employer to utilize a U-5 for improper purposes and, even if expungement does provide a potential remedy, obtaining that remedy will be quite costly for an employee who has been maliciously defamed. The decision may not provide any protection against regulatory action if it is determined that an employer used the U-5 for improper purposes. Lastly, and significantly, the Rosenberg decision only has precedential effect in New York. Other jurisdictions may have already decided this same issue in a different way. Thus, it is vital to check the law in the jurisdiction in which a U-5 libel claim is commenced to determine the scope of the privilege that is available.

Endnotes

1 The decision, which is cited herein as "Opinion", has not yet been officially published and is subject to correction.

2 Rosenberg sued MetLife, Inc., Metropolitan Life Insurance Company and MetLife Securities, Inc. All three entities are collectively referred to herein as ("MetLife").

3 Rosenberg v. Metlife, Inc., et al., 104 cv 01751, 2-3 (S.D.N.Y., Feb. 15, 2005).

4 Id., at 2.

5 Summary judgment is a motion filed by a party, usually after discovery has been completed, that requires the non-moving party, usually the plaintiff, to come forward with sufficient evidence in support of his claims to demonstrate that there are material issues of fact which can only be resolved after trial. If the non-moving party fails to meet its burden, the movant is entitled to judgment and the non-movant may appeal.

6 Rosenberg v. Metlife, Inc., et al., 104 cv 01751, at 7.

7 Rosenberg v. Metlife, Inc., et al., No. 05-4363-cv, at 6 (2d Cir., June 28, 2006).

8 Id., at 14. Under New York state law and the rules of the Second Circuit, the Second Circuit may certify to New York's highest court "determinative questions of New York law [that] are involved in a cause pending before [us] for which no controlling precedent of the Court of Appeals exists." Id., at 11. In essence, the certified question procedure allows the Second Circuit to have a state's highest court speak directly to an issue of unsettled law instead of attempting to determine what the highest court might say if faced with the same question then pending before the federal appeals court.

9 Opinion at 11.

10 Opinion at 10.

11 Opinion at 10-11, citations omitted.

12 Opinion at 8.

13 Opinion at 12.

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