Permission to Be Frank? The Debate Continues
Over an Absolute Versus Qualified Immunity in U5 Defamation Cases

By Terry R. Weiss and Nathan D. Chapman

The scenario is a familiar one: a broker's employment with a broker-dealer is terminated, triggering the brokerage firm's duty to file a Form U5 with the NASD. The brokerage firm makes what it considers to be a complete and accurate disclosure of the reasons for the broker's termination. The broker is convinced that he is being blackballed by his former employer. Fearing that regulators and customers will soon be coming after him and that he will never get another job in the securities industry, the broker files a defamation claim against the brokerage firm, demanding a substantial amount of damages.

The securities industry has effectively argued for years that the investing public will be better served if statements made in a Form U5 enjoy an absolute, rather than a qualified privilege. The argument is that brokerage firms are more likely to make full, uninhibited disclosures if they do not face costly defamation claims. Moreover, application of a qualified privilege may act as a deterrent to candid disclosure, thereby impeding the NASD's regulatory function, potentially to the detriment of investors.

In Rosenberg v. Metlife, Inc., New York's highest court ruled definitively that defamatory statements contained on a Form U5 are subject to an absolute privilege from civil liability under New York law. In reaching that conclusion, the New York Court of Appeals recognized that "[t]he absolute privilege generally is reserved for communications made by individuals participating in a public function, such as executive, legislative, judicial or quasi-judicial proceedings."1 Because the Form U5 is integral to the NASD's self-regulatory, quasi-judicial

function, reasoned the court, "statements made by an employer on the form should be subject to an absolute privilege."2

Although the Rosenberg decision was appropriately greeted with much fanfare, it may not yet resolve the U5 absolute vs. qualified privilege debate beyond the borders of New York. Indeed, the majority of courts that have addressed this issue have held that statements made by an employer on a Form U5 enjoy only a qualified privilege, meaning that the privilege is lost if the former broker is able to establish that the statements were made with actual malice or reckless disregard for the truth. Recently, 11 states have enacted statutes providing for qualified immunity, adopting the National Conference of Commissioners on Uniform State Laws’ Uniform Securities Act. Of the 19 states that have addressed the Form U5 privilege issue, either judicially or statutorily, 17 have opted in favor of qualified immunity.3 As discussed below, New York is only one of two states in which courts have held that Form U5 disclosures enjoy an absolute privilege that renders the brokerage firm fully immune from suit.

This paper examines the law governing Form U5 disclosures in jurisdictions that have addressed this issue. This paper also discusses general qualified privilege principles in the states that have not addressed the U5 privilege head on, but have considered the topic in the context of (1) where the speaker has an interest in the subject; or (2) where the speaker is duty bound to make the statement to a person having a reciprocal duty or interest. Finally, this paper examines how the qualified privilege may be lost and the plaintiff’s burden of proof to overcome the qualified privilege.

New York, California and the Absolute Privilege. Courts sitting in nine states have addressed the question of qualified versus absolute privilege for statements made by an employer on a Form U5.4 Before and after the Rosenberg decision was issued, the only state that accorded absolute immunity to Form U5 disclosures outside of New York was California.5 Unlike New York, California courts have based their approach on the California Strategic Litigation Against Public Participation statute (anti-SLAPP).6 In Fontani v. Wells Fargo Investments, LLC, 28 Cal. Rptr. 3d 833 (Cal. Ct. App. 2005), California’s seminal case on this issue, the employer filed a motion to strike defamation and interference with prospective business advantage claims brought by a former broker.7 Relying on California’s anti-SLAPP law, the court noted that communications “made in preparation for or to prompt an investigation” are shielded from defamation suits.8 Thus, the Fontani court reasoned, because Form U5 disclosures may be a precursor to an investigation into a broker’s conduct, the statements they contain are not actionable for defamation or interference with prospective business advantage.9

Qualified Immunity—The Majority Position. Prior to Rosenberg, the courts outside of New York and California that have considered the issue have applied a qualified privilege to potentially defamatory statements by an employer on a Form U5.10 Also within the last four years, eleven state legislatures and the U.S. Virgin Islands have adopted Section 507 of the Uniform Securities Act, which statutorily provides for qualified immunity.11

2 Id. at *11.
6 CAL. CIV. P. CODE § 428.16 (2005).
7 The Fontani decision was recently criticized by the California Supreme Court as taking too narrow a view of the statute’s protections. See Kibler v. N. Inyo County Local Hosp. Dist., 46 Cal. Rptr. 3d 41, 48 n. 5 (Cal. 2006) (holding that protection of anti-SLAPP statute was not limited to proceedings before governmental entities and applied to statements by hospital peer review board). The Kibler court specifically noted that it expressed no view on the Fontani court’s assessment of the NASD. Id.
8 Fontani, 28 Cal. Rptr. at 842.
9 Id. at 843.
10美学 see note 4 supra.
A broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative is not liable to another broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative for defamation relating to a statement that is contained in a record required by the administrator, or designee of the administrator, the Securities and Exchange Commission, or a self-regulatory organization, unless the person knew, or should have known at the time that the statement was made, that it was false in a material respect or the person acted in reckless disregard of the statement's truth or falsity. 12

The states that have adopted Section 507 (pre-Rosenberg) follow the position taken by a majority of courts and the NASD. 13 The two leading cases holding that qualified immunity is the appropriate standard are Bavarati v. Josephthal & Ross, Inc., 28 F.3d 704 (7th Cir. 1994) (applying Illinois law), and Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132 (6th Cir. 1996) (applying Tennessee law). Both were decided over a decade ago. The Bavarati and Glennon courts expressly rejected the industry's position that a brokerage firm's submission of Form U5 is part of the NASD quasi-judicial regulatory process. Rather, both courts found the filing of Form U5 to be an investigative or preliminary formality that falls outside the scope of the quasi-judicial privilege applicable to statements made in NASD disciplinary actions. 14 The Bavarati court reasoned that any piece of information, including a Form U5, could furnish the basis for an NASD investigation or serve as evidence in a disciplinary proceeding. 15 Accordingly, the court viewed insulating employers from liability as "tantamount to allowing a member of the NASD to blackball a former employee from employment throughout the large sector of the industry that membership of the association constitutes." 16 Under analogous circumstances, Arizona, Connecticut, Florida, Michigan, and Oklahoma reached the same conclusions as Bavarati and Glennon, and determined that statements made in connection with a U5 are subject to a qualified privilege. 17

Immunity Principles in the Remaining 31 States. The remaining 31 states, which have not addressed the Form U5 disclosure issue specifically, have, in widely varied contexts, accorded some level of immunity to good faith communications in two situations: (1) where the speaker has an interest in the subject; or (2) where the speaker is duty bound to make the statement to a person having a reciprocal duty or interest. 18 As one court described the general common law rule applicable to statements made under such circumstances,

[a communication made in good faith and on subject-matter in which the person making it has an interest, or in reference to which he has a duty, is privileged if made to a person or persons having a corresponding interest or duty, even though it contains matter which without this privilege would be slanderous, provided the statement is made without malice and in good faith. 19

Notably, Nevada and North Carolina provide absolute immunity for employers' statements made to their respective states' employment agencies in connection with unemployment benefits. 20 Similar to the NASD's Form U5 disclosure requirement, both states have enacted statutes that require employers to provide the respective state employment agencies with information upon request. 21

Other states have enacted statutes, however, which confer only a qualified immunity in limited factual situations. 22 For example, a Maryland statute confers a


14 Bavarati, 28 F.3d at 708; Glennon, 83 F.3d at 137.

15 Id.


18 There is enormous variation between the states' approaches to immunity issues in the defamation context. Thus, the following discussion is intended to be exemplary, rather than comprehensive.

19 Smith v. White, 799 So. 2d 83, 86 (Miss. 2001); see generally RESTATEMENT (SECOND) OF TORTS §§ 595, 596, 598 (discussing situations in which a conditional privilege applies).


21 See Circus Circus Hotels, Inc. v. Witherspoon, 657 P.2d 101, 104 ( Nev. 1983) (employer disclosures to Nevada's employment security agency made after an employee has filed a claim for unemployment compensation are considered to be in the context of a quasi-judicial proceeding, and protected by an absolute privilege). There are no reported decisions in North Carolina interpreting section 96-4(6)(5).

qualified immunity upon employers who provide statements to private regulatory authorities, and in other similar contexts. Similarly, North Dakota, Ohio, Pennsylvania, Texas, Virginia, and Wyoming extend qualified immunity to employer statements made to prospective employers.

Courts in several states have also extended the qualified immunity to a variety of circumstances involving a perceived legal, moral, private or social duty to speak. Examples of these situations include: statements made to an examiner during a statute required fact-finding investigation by the FDIC; statements made by a teacher’s alleged child abuse; disclosures by a former employer to prospective employers regarding employees; statements to election boards about political candidates; statements made to inquiring employers by background check companies; a report of death threats to police; 30 accusations of sexual mistreatment; and with “ill will” and with a specific intent to cause substantial injury or to harm. In attempting to demonstrate malice, a plaintiff must show more than mere speculation concerning the speaker’s intent. For example, failure to conduct an adequate investigation into the truthfulness of a statement prior to speaking has been held insufficient, standing alone, to establish ill intent. Although “ill will” is not required to show a reckless disregard, a speaker’s “serious doubts” about the truth of the statements have been held to give rise to an inference of reckless disregard.

States vary in the burden of proof required to establish an abuse of the privilege. In no fewer than 11 states, the plaintiff must show by clear and convincing evidence an abuse of the privilege. In order to meet this burden, one court has stated that the plaintiff must “produce in the mind of the trier of fact a firm belief or conviction as to the truth of the allegations sought to be established, evidence so clear, direct and weighty and convincing as to enable [the fact finder] to come to a clear conviction, without hesitancy, of the truth of the precise facts in issue.” Other states, however, require a plaintiff to prove an abuse of the privilege by the lesser standard of preponderance of the evidence.

Note to Readers
The editors of BNA’s Securities Regulation & Law Report invite the submission for publication of articles of interest to practitioners. Prospective authors should contact the Managing Editor, BNA’s Securities Regulation & Law Report, 1231 25th St., N.W., Washington, D.C. 20037; telephone (202) 452-4339; fax (202) 728-5208; or e-mail to sjenkins@bna.com.
The Rosenberg Case's Potential Implications. In Rosenberg, the New York Court of Appeals adopted a standard that best fulfills the purpose of Form U5: to provide candid, accurate information regarding the circumstances of a broker's termination. Outside of New York, however, it may be too early to tell what impact Rosenberg will have on future decisions. In jurisdictions addressing the U5 defamation question as one of first impression, Rosenberg certainly provides sound, well-reasoned authority for adoption of an absolute privilege. In jurisdictions that have opted in favor of a qualified privilege, Rosenberg should serve as the basis for renewed challenges to the majority position.

Application of a qualified privilege can impede the NASD's regulatory function because brokerage firms may be reluctant to make full, uninhibited disclosures when they face a very real risk of litigation. Ultimately, the investing public may not be well served by an arrangement that allows culpable brokers to use defamation suits to frustrate the very purpose of Form U5. As the New York Court of Appeals noted in Rosenberg, NASD procedures provide other means of protecting brokers from erroneous filings. For brokerage firms, application of an absolute privilege to statements contained in a Form U5 provides meaningful protection. Without that protection, firms must walk a tightrope between fulfillment of their regulatory duties and the threat of defamation suits.