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NEW YORK EMPLOYERS HAVE ABSOLUTE IMMUNITY FROM DEFAMATION FOR STATEMENTS IN FORMS U-5

In a decidedly positive decision for New York financial services companies, New York's highest state court decided on March 29 that employers have absolute immunity from defamation claims brought by former registered representative employees based on employer statements made in the Form U-5 filed with the National Association of Securities Dealers (NASD). As a result, financial services employers with New York employees now enjoy complete protection from a defamation claim based upon disclosures of the reasons for termination of their registered representatives made in the Form U-5. This is true even if the statements are untrue and made with malice by the employer.

New York appears to be the first state to grant absolute immunity to Form U-5 disclosures. Several states, including Illinois, Florida and Tennessee, recognize that statements made by employers in the Form U-5 are subject to a qualified immunity. Employers in those states are protected from defamation claims arising from the U-5 statements, unless an employee can prove that the statement was false and made with intent to harm the employee or in knowing or reckless disregard of its falsity.

In *Rosenberg v. MetLife*, the New York Court of Appeals took the unusual step of conferring an absolute privilege on employer disclosures on the Form U-5 because it determined that the filing of the Form U-5 is part of a quasi-judicial process. Absolute privilege from defamation claims historically has been limited to statements made by individuals participating in a public function, such as executive, legislative or judicial or quasi-judicial proceedings. For example, statements made in a court complaint enjoy an absolute privilege because of the public interest in having an open court system. The grant of a complete privilege has been justified by the public interest in insuring that protecting one's personal interests against the threat of litigation does not interfere with one's public function.

In concluding that the Form U-5 is part of a quasi-judicial process, the court first observed that the NASD fulfills many of the day-to-day functions of the Securities and Exchange Commission (SEC) in supervising registered representatives and their employers, the member firms of the NASD. As part of this function, the court found the NASD requires employers to file a Form U-5 within 30 days of termination of employment for any reason. Thereafter, the court reasoned, the NASD

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"routinely investigates terminations for cause to determine whether the representative violated any securities rules" and these investigations "frequently lead to the initiation of disciplinary action by the NASD [against the registered representative]." NASD disciplinary actions are the quasi-judicial functions that the court sought to protect in support of the public interest of insulating the securities purchasing public from improper conduct by registered representatives. The Court of Appeals held that encouragement of frank initial disclosures by employers was required to preserve the integrity and effectiveness of the NASD investigatory and disciplinary process.

We urge caution to avoid a false sense of security in the absolute immunity protection, however. Complete immunity does not extend to statements made outside the Form U-5—in investigatory materials or internal e -mails, for example. Statements made in the course of an investigation into alleged improper behavior are generally accorded only qualified immunity. That is, the statements made by employees and managers to a corporate investigator, and the investigatory report itself, still may form the basis for a defamation claim. However, to defeat the protection of the *qualified* privilege, the employee must prove that the statement is inaccurate and was made with actual malice or a knowing or reckless disregard of the truth. Furthermore, false statements by employees or officers of an employer that are unrelated to an investigation may not enjoy either a qualified or an absolute immunity and, thus, may continue to be the basis of a defamation claim. For this reason, employers should continue to alert managers to avoid informal negative commentary concerning employee behavior and/or unfavorable conclusory statements about an employee without having strict factual support about the referenced behavior or performance. Certainly, internal investigations should be conducted by inside or outside counsel, or by a properly trained human resources professional, who have knowledge of the best practices to avoid defamation and other claims by employees.

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