PLEASE BE DELICATE WITH MY PERMANENT RECORD: THE PENDULUM INCHES TOWARDS ABSOLUTE PRIVILEGE IN MERKAM v. WACHOVIA

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I. INTRODUCTION

“[I]t will go on your permanent record . . . [!]”1 For elementary school students the notion of an eternal “permanent record” is quite believable.2 Fortunately for unruly children, permanent records do not actually exist.3 At least not until they decide to work in the securities industry.4

Employers in the securities industry are required to state the reasons why an employee was fired in a Uniform Termination Notice for Securities Industry Registration (Form U-5).5 After completing an employee’s Form U-5, an employer files and stores it in the Financial Industry Regulatory

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2. See id. (providing examples of teachers’ use of permanent records to ensure students behave in school).


4. For a discussion of how Form U-5s operate as permanent records in the securities industry, see infra notes 5-7 and accompanying text.

5. See FINRA, FORM U5: UNIFORM TERMINATION NOTICE FOR SECURITIES INDUSTRY REGISTRATION 4 (2009), available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015113.pdf (describing requirements for employers after terminating registered professional). Employers must explain why an employee was fired if he or she was “permitted to resign,” “discharged,” or let go for other involuntary reasons. See id. (requiring employers to provide explanation if termination was involuntary).

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Authority’s (FINRA’s) Central Registration Depository (CRD) where it is made accessible to all FINRA member firms. As if having a “permanent record” available for future bosses to see is not bad enough, FINRA requires employers to review each candidate’s Form U-5 as part of their hiring process. Not surprisingly, employees’ reputations are likely to suffer greatly from any negative statements in their Form U-5.

Although a major purpose of the Form U-5 is to alert regulators and other employers to unscrupulous broker-dealers, the potential for abuse is great. Form U-5s have been used as a weapon to punish and even blackmail ex-employees who might leave the firm and take clients with them.


7. See Regulatory Notice 07-55, FINRA 1–4 (2007), available at www.finra.org/web/groups/industry/@ip/@reg/notice/documents/notices/p037480.pdf (reminding firms of obligation to investigate business reputation of applicants as part of hiring process). The notice explained that checking the backgrounds of prospective employees ultimately protects customers because the searches will show if the candidate has a history of regulatory violations. See id. (discussing importance of background search); see also Richard G. Ketchum, About the Financial Industry Regulatory Authority, FINRA, http://www.finra.org/AboutFINRA/ (last visited Oct. 16, 2012) (stating that FINRA oversees about 4,345 firms including 163,410 branch offices).

8. See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (noting negative statements in Form U-5s can bar professionals from industry); cf. Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1164 (7th Cir. 1998) (“Any embellishment or exaggeration can only damage the agent’s professional reputation and make the job hunt more difficult.”); Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132, 138 (6th Cir. 1996) (observing difficulties experienced by professionals after being defamed in Form U-5s); Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 446 (N.Y. 2007) (Pigott, J., dissenting) (“When a defamatory statement is made on such a Form, there is the danger of substantial harm to the individual about whom the statement is made.”); see also Jeffrey L. Liddle & Ethan A. Brecher, Form U-5 Defamation Claims: The End of the Line? Not So Fast, in SECURITIES ARBITRATION 2007 673, 690 (2007) (“A defamatory Form U-5 can ruin an individual’s career in the financial services industry.”); Vivek G. Bhatt, The Amended Form U-5: Two Proposals for Solving the Privilege Dilemma, 21 Whittier L. Rev. 963, 964 (2000) (explaining how negative statements in Form U-5s can serve as scarlet letters in individual’s reputation and inhibit job searches).


10. See Eaton Vance Distrib., Inc. v. Ulrich, 692 So. 2d 915, 916-17 (Fla. Dist. Ct. App. 1997) (noting departing employee’s Form U-5 was allegedly used as bartering tool to obtain preferential settlement). In Eaton, the plaintiff claimed that
In one instance, an employee was fired after allegedly being told to ignore or participate in regulatory fraud.11 Ironically, the employee’s Form U-5 explained that he was terminated for “failure to perform duties . . . .”12 In a defamation suit, the employee was awarded $40,535 in compensatory damages and $100,000 in punitive damages.13 However, if this outrageous conduct occurred in New York today, the employer would be completely immune from civil liability.14

his employer told him that the wording in his Form U-5 would be modified if he accepted a certain severance package offer. See id. (discussing plaintiff’s claim); cf. Culver v. Merrill Lynch & Co., No. 94 CIV. 8124, 1995 WL 422203, at *1 (S.D.N.Y. July 17, 1995) (describing plaintiff’s claim that his ex-employer intentionally reported false statements in his Form U-5). In Culver, the plaintiff alleged that his employer used the Form U-5 to retaliate against him for reporting unethical activities to regulators. See Culver, 1995 WL 422203, at *1 (discussing plaintiff’s claim). However, the court held that regardless of the employer’s motive, statements made in Form U-5s are subject to absolute privilege making the employer immune from civil liability. See id. at *5 (stating Form U-5s are absolutely privileged); see also Scott Krady, You Have Recourse if Ex-Employer Defames You on U-5 Termination Form, eFINANCIAL CAREERS (Mar. 31, 2010), http://news.efinancialcareers.com/2603/you-have-recourse-if-ex-employer-defames-you-on-u-5-termination-form/ (listing situations where employees were defamed by former employers in Form U-5s and received large awards); Wright, supra note 6, at 1302 (“Indeed, it is widely acknowledged that false Form U-5 reporting has sometimes been used to retaliate against departing employees or threatened to gain concessions from such employees.” (footnote omitted)).

11. See Acciardo v. Millennium Sec. Corp., 83 F. Supp. 2d 413, 415 (S.D.N.Y. 2000) (discussing plaintiff’s defamation claim). The district court determined whether the arbitration panel acted with a manifest disregard for the law and awarded the plaintiff with punitive damages for his defamation claim. See id. (providing background information of case); see also Petitioner-Respondent’s Memorandum of Law in Support of Motion to Confirm Arbitration Award and in Opposition to Respondents-Cross-Petitioners’ Cross-Motion to Vacate Award, Acciardo v. Millenium Sec. Corp., 83 F. Supp. 2d 413 (S.D.N.Y. 2000) (No. 99 Civ. 3371), 1999 WL 33885589 (describing regulatory frauds taking place at firm). The plaintiff claimed that his ex-employer was intentionally failing to inform regulators of over forty-two customer complaints. See Petitioner-Respondent’s Memorandum, supra (describing employer’s misconduct). According to the plaintiff, he was fired after refusing to sign a legal document that stated the company had no customer arbitration claims, regulatory proceedings, and subordinate debt. See id. (noting plaintiff’s refusal facilitated fraud). The plaintiff’s replacement also testified that the defendant threatened to make unfavorable statements in her Form U-5 if she said anything negative about the firm. See id. (detailing replacement’s experience with defendant).


13. Id. at 416 (explaining arbitration award); see also Petitioner-Respondent’s Memorandum, supra note 11 (recounting reasoning for punitive award). The arbitration panel’s decision to award punitive damages was based on findings of malice. See Petitioner-Respondent’s Memorandum, supra note 11 (“The Panel apparently found that Millennium played the ‘U-5 game’ and intentionally sought to harm Acciardo as it had done with various other departing employees whose Form U-5s were admitted into evidence and who testified at the hearing.”).

14. For a discussion of the absolute privilege standard in New York, see infra note 17 and accompanying text. If this case were decided seven years later the employer would be completely immune from civil liability. See generally Acciardo, 83 F. Supp. 2d 413.
The issue of how much protection employers should receive for statements made in Form U-5s remains controversial and unsettled. A majority of courts have held that employers should receive qualified privilege, or protection that can be lost if the employer acts with malice or a reckless disregard for the truth. However, a call for absolute immunity has emerged. Weighing in on the dispute, a former commissioner of the Securities Exchange Commission (SEC) reasoned that the SEC should consider establishing a uniform qualified-privilege rule if “the pendulum begins to swing in favor of absolute immunity” because of the inequitable results which can occur when employees are maliciously defamed.

In the absence of any uniform rule, jurisdictions without laws requiring qualified privilege are likely to hear arguments favoring absolute privilege: 

15. See Tann, supra note 6, at 1027 (“Whether an absolute or qualified privilege applies to the Form U-5 is a hotly contested issue that has evaded uniform resolution.”).

16. See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (applying Illinois law and holding Form U-5 disclosures were subject to qualified privilege); cf. Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132, 137 (6th Cir. 1996) (applying Tennessee law and determining statements in Form U-5s were subject to qualified privilege); Wietecha v. Ameritas Life Ins. Corp., Civ. 05-0324, 2006 WL 2772838, at *18 (D. Ariz. 2006) (concluding that qualified privilege for Form U-5s comport with Arizona law); Dickinson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 431 F. Supp. 2d 247, 262 (D. Conn. 2006) (holding employers’ statements in Form U-5s were protected by qualified privilege after reviewing Connecticut law); In re Wakefield, 293 B.R. 372, 384 (N.D. Tex. 2003) (stating Form U-5s were entitled to qualified privilege in Texas); Eaton Vance Distribrs., Inc. v. Ulrich, 692 So. 2d 915, 916 (Fla. Dist. Ct. App. 1997) (concluding that qualified privilege applied to Form U-5 disclosures in Florida).


18. See Hunt, supra note 9, at 6 (advocating for uniform qualified privilege rule if courts begin to hold in favor of absolute privilege). Commissioner Hunt was concerned that without the safeguard of civil liability the risks of employer abuse would be “too great.” See id. (discussing dangers of absolute privilege standard); see also Wright, supra note 6, at 1328 (“Regulators generally have supported according broker-dealers a qualified privilege for Form U-5 reporting that is defamation and untrue.”). Leaders of the SEC and Self-Regulatory Organizations (SROs) have supported a qualified privilege standard. See Wright, supra note 6, at 1328 (describing support for qualified privilege rule).
Pennsylvania, a state that is home to one of the largest populations of securities industry professionals, does not have a uniform standard regarding the degree of protection employers should receive.20 As a result, Pennsylvanian employees have obtained large defamation awards against former employers who inaccurately or maliciously filed their Form U-5s.21

Yet, according to the court in *Merkam v. Wachovia Corp.*, securities professionals in the Keystone state should not be able to sue employers for defamation under any circumstances.22 The court explained that absolute immunity best promotes the candid flow of information from firms to regulators and, in effect, provides the best protection to investors.23 The court, however, refrained from addressing the clear potential for abuse or the significant damage employees might experience if employers draft Form U-5s with malicious or reckless intent.24

The *Merkam* case is evidence that the call for absolute privilege has reached the trial court level and illustrates a likely trend in Form U-5 defamation litigation.25 Hence, if the pendulum continues to swing towards absolute privilege, the SEC should take action to protect employees’ repu-

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23. See id. at *19 (concluding statements made in Form U-5s should be absolutely privileged).

24. See id. at *18 (explaining absolute privilege promotes flow of information from employers to regulators).

25. For a discussion of the court’s reasoning, see *infra* notes 115–44 and accompanying text.

26. See John P. Clarke & Mary Noe, *Legal Actions for Defamation by Terminated Employees in the Financial Services Industry: Can a Required Filing Have an Unfair Effect on Some Terminated Employees*, 23 BANK ACCT. & FN., Dec. 1, 2009, at 41 available at 2009 WLNR 26393944 (“[I]t is more likely that the absolute privilege rule will ultimately be the prevailing rule in the industry.”).
If absolute privilege becomes the law in Pennsylvania, securities professionals will be at the mercy of their employers, not regulators.

This Note argues that the Merkam court reached the correct outcome, but that the court should not have extended absolute privilege to the Form U-5. Part II describes the regulatory role of the Form U-5, discusses the arguments for qualified and absolute privilege, and provides a brief history of absolute privilege in Pennsylvania. Part III provides an overview of the facts and the court’s reasoning in Merkam. Part IV argues that the Form U-5 reporting system should not be absolutely privileged because it is not part of a quasi-judicial process, and it does not definitively protect the general investing public. Finally, Part V concludes by explaining the significance of Merkam.

II. BACKGROUND

Generally, employers refrain from giving negative letters of recommendation regarding ex-employees to avoid defending costly defamation suits. Much to the distaste of cautious employers, regulators require them to provide “employee references” by completing a Form U-5. Thus, it should come as no surprise that the compulsory nature of Form U-5 reporting has sparked substantial debate over whether employers should be given qualified or absolute immunity. Reviewing the arguments for both types of immunity, as well as the conservative history of

27. See Hunt, supra note 9, at 5–6 (addressing importance of protecting vulnerable employees). Hunt explained that “regulators should proceed cautiously before establishing a system that would insulate intentional retaliatory conduct from review.” Id. at 5

28. See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (concluding that allowing employers to be absolutely immune from civil liability would allow employers to “blackball” former employees from the industry).

29. For a discussion of why the court in Merkam should not have extended absolute privilege to the Form U-5, see infra notes 164–73 and accompanying text.

30. For a further discussion of the regulatory role of Form U-5s in the securities industry, see infra notes 34–54 and accompanying text. For a discussion of the arguments for absolute privilege and qualified privilege, see infra notes 55–98 and accompanying text. For a discussion of the history of absolute privilege in Pennsylvania, see infra notes 99–114 and accompanying text.

31. For a further discussion of the facts and reasoning of the court in Merkam, see infra notes 115–44 and accompanying text.

32. For a critical analysis of the Merkam decision, see infra notes 164–73 and accompanying text.

33. For a further discussion of the impact of Merkam, see infra notes 184–86 and accompanying text.


35. For a description of the role of Form U-5s in the securities industry, see infra notes 44–49 and accompanying text.

36. For a discussion of how Form U-5s can potentially spark defamation suits, see infra notes 50–54 and accompanying text.
absolute immunity, reveals that extending absolute immunity to employers unfairly jeopardizes employees’ reputations and conflicts with its original purpose.37

A. The Role of Permanent Records in the Securities Industry

In the schoolyard of the securities industry, the SEC is the school board; FINRA is the principal; firms are teachers, and employees are students.38 In much the same way that a school depends on its teachers to report problematic students to the principal, the securities industry relies on firms to inform regulators of employees’ unethical or illegal behavior.39 At the heart of this self-regulatory system are the Form U-4 and Form U-5, which register and terminate professionals with FINRA, respectively.40

To “enroll” in the securities industry, individuals must register with FINRA by submitting a Form U-4.41 By filing Form U-4s, individuals con-

37. For a discussion of the arguments for qualified and absolute privilege and the history of absolute privilege, see infra notes 70–114 and accompanying text.
38. See Roberta S. Karmel, Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies? 1–8 (Mar. 2008), available at http://works.bepress.com/cgi/viewcontent.cgi?article=1087&context=roberta_karmel (providing overview of self-regulatory system in securities industry and discussing essential role played by SROs). Traditionally, SROs have been private membership organizations that promote regulatory and market functions. See id. at 1–5 (defining traditional roles of SROs). As regulators, SROs enforced their own standards and federal securities laws but in their private role SROs created exchanges where member firms could sell and trade securities. See id. at 5 (describing SROs’ functions). The most prominent SROs include the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE). See id. at 2 (identifying major SROs). In order to successfully perform regulatory functions, SROs depend on its member firms to voluntarily self-regulate and report violations. See id. at 13–14 (discussing self-regulation). In an effort to consolidate rules, improve SEC oversight, and to make self-regulation more efficient, the SEC approved the merger of the NASD and NYSE’s regulatory bodies into FINRA. See id. at 27–29 (discussing inclusion of NASD and NYSE); see also FINRA, GET TO KNOW US 1–3 (2012), available at http://www.finra.org/web/groups/corporate/@corp/@about/documents/corporate/p118667.pdf (describing FINRA’s role in securities industry). FINRA’s principal duties include licensing and monitoring industry professionals, ensuring that firms comply with industry and federal regulations, and administering the largest arbitration forum to resolve securities-related disputes. See Karmel, supra, at 27–29 (explaining FINRA’s principal duties).
39. See Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 444 (N.Y. 2007) (explaining that information provided by firms to regulators is critical to effective self-regulatory system). The court emphasized that candid information provided by firms in Form U-5s enables FINRA to carry out its regulatory functions and sanction unethical brokers. See id. (noting benefits of Form U-5s).
40. See Liddle & Brecher, supra note 8, at 677 (describing regulatory significance of Form U-4 and Form U-5).
41. See FINRA, FORM U4: UNIFORM APPLICATION FOR SECURITIES INDUSTRY REGISTRATION OR TRANSFER 1 (2009), available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015111.pdf (explaining purpose of Form U-4). The official instructions of the Form U-4 provide that, “[r]epresentatives of broker-dealers, investment advisers, or issuers of securi-
sent to settle any disputes with their employers through FINRA’s arbitration system. Additionally, Form U-4s authorize employers to furnish information regarding an employee’s history at the firm and reasons for termination to prospective employers.

The Form U-5, or the “permanent record,” is the official filing used to terminate the association between securities professionals and FINRA. Employers must complete and submit an ex-employee’s Form U-5 within thirty days of termination. While the Form U-5’s primary function is to notify FINRA that an employee has left a firm, its higher purpose is to protect investors and employers from unscrupulous representatives by alerting regulators and other firms to problematic representatives.

Registered representatives have a continual obligation to update their Form U-4s. See id. (noting individuals are under ongoing obligation to make sure information is accurate).

42. See Uniform Application for Securities Industry Registration or Transfer, FINRA 15 (May 2009), http://www.finra.org/web/groups/industry/@ip/@comp/@reg/documents/appsupportdocs/p015112.pdf (providing consent to settle disputes via FINRA arbitration). Part 5 of question 15A states, “I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the SROs indicated in Section 4 . . . .” Id.

43. See id. (providing consent to disclose information to prospective employers). Part eight of question 15A states:

I authorize all my employers and any other person to furnish to any jurisdiction, SRO, designated entity, employer, prospective employer, or any agent acting on its behalf, any information they have, including without limitation my creditworthiness, character, ability, business activities, educational background, general reputation, history of my employment and, in the case of former employers, complete reasons for my termination.

Id.

44. See FINRA, WHAT TO EXPECT FROM THE U4 AND U5 FILING PROCESS 3 (2010), available at http://www.finra.org/web/groups/industry/@ip/@edu/documents/education/p018907.pdf (stating that employers must complete Form U-5s when employees stop working at firm).


In a Form U-5, an employer must state his or her reasons for firing an employee and provide explanations if the ex-employee is undergoing any internal or criminal investigations. The Form U-5 is then filed in FINRA’s CRD, making individuals’ permanent records available to virtually all employers in the securities industry. Ideally, the flow of information from firms to regulators and other employers better positions regulators to sanction rogue brokers and helps employers make informed hiring and supervisory decisions.

In an era of highly publicized financial fraud, preventing rogue brokers from roaming recklessly through the industry has become a significant public interest. These rogue brokers include individuals who participate in Ponzi schemes, falsify customer documents, or convert client funds to their own use. Although stopping the movement of these un-

47. See FORM U5: UNIFORM TERMINATION NOTICE FOR SECURITIES INDUSTRY REGISTRATION, supra note 5, at 5 (providing requirements for Form U-5 filing process). In section three, employers are required to state the reason why an employee was fired if the termination was involuntary. See id. (describing requirements for completing reason of termination). In section seven, employers must provide a detailed explanation if they answer “yes” to any of the listed questions. See id. at 6 (providing disclosure requirements when criminal or regulatory proceedings are pending or ongoing against employee); see also Uniform Termination Notice for Securities Industry Registration, FINRA 7-8 (May 2009), http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015114.pdf (listing mandatory disclosure questions).

48. See Uniform Termination Notice for Securities Industry Registration, supra note 47, at 1 (requiring submission of Form U-5 to CRD). An individual’s Form U-5 is available to virtually the entire industry because FINRA regulates around 4,345 firms including 163,410 branch offices. See Ketchum, supra note 7 (providing statistics).

49. See Cicconi, 808 N.Y.S.2d at 607 (declaring significance of information flow from firms to regulators). The court stated, “[o]nly by clear descriptions of questionable conduct by brokers can we best ensure that any future employers and customers have notice of any such conduct in their interactions with those brokers.” Id.; see also Hunt, supra note 9, at 2 (explaining Form U-5s ensure firms are aware of important risks employees pose).

50. See Fontani v. Wells Fargo Invs., 28 Cal. Rptr. 3d 833, 841 (Cal. Ct. App. 2005) (recognizing content of Form U-5s are matter of public interest). The court in Fontani implied that disclosures in Form U-5s are a matter of public interest because broker misconduct can affect a significant amount of investors or even an entire market. See NASD NOTICE TO MEMBERS 97-77, supra note 20, at 662 (declaring that Form U-5s are matter of public interest). The notice explained that the “full disclosure of disciplinary problems on Forms U-4 and U-5 is in the public interest.” Id.

51. See Nicholas J. Guiliano, FINRA Boots Broker for Misappropriating $100K, STOCKBROKER FRAUD, SECURITIES ARBITRATION, INVESTMENT FRAUD LAWYERS (July 27, 2012), http://www.stockbrokerfraud.com/law-blog/finaa-boots-broker-for-misappropriating-100k (describing case where broker converted clients' funds to his own use). FINRA permanently barred a representative from the securities industry after he converted over $100,000 of his customers' funds. See id. (discussing broker’s misconduct); cf. Bruce Kelly, Private Placements Cause Finra to Slam Eight Broker-Dealers, INVESTMENTNEWS (Dec. 4, 2011, 6:01 AM), http://www.investmentnews.com/article/20111204/REG/312049969 (providing examples of fraudulent practices and FINRA disciplinary actions); see also FINRA Lawyers on Ponzi Schemes in
ethical brokers is a worthy cause, employees that are far from “rogue” sometimes become the reporting system’s collateral damage.52 For example, negative remarks in the Form U-5 of an employee who was fired for mediocre job performance or for personality mismatches can prevent the employee from reentering the industry.53 Due to the serious impact of these negative statements, Form U-5s have become a hotbed for defamation disputes.54

### B. When Teachers Are not Delicate with Students’ Permanent Records

In Pennsylvania, a person has an action for defamation if an opinion is vague and “implies the allegation of undisclosed defamatory facts.”55 The Third Circuit rationalized the importance of providing facts by explaining that when an opinion “draws upon unstated facts for its basis, the listener is unable to make an evaluation of the soundness of the opinion.”56 On the other hand, if an individual clearly lays out facts to support

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52. See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (explaining how negative statements in Form U-5s can seriously impact employees’ reputations).

53. See Tann, supra note 6, at 1019 (discussing fragile nature of securities professionals’ reputations). The author stated, “even one negative statement on the Form U-5 may hamper the broker’s job opportunities.” Id.; see also Liddle & Brecher, supra note 8, at 675 (describing how Form U-5s can be unfair to good brokers). Form U-5 disclosures might protect the general public from “bad brokers” at the expense of the reputation of “good brokers.”

54. See Bhatt, supra note 8, at 964 (describing how embellishments in Form U-5s can have devastating effects on reputations); cf. Tann, supra note 6, at 1025 (noting false statements in Form U-5s can prevent individuals from becoming employed in securities industry); see also Kevin Burke, Breaking Up Is Hard to Do, Inv. Adviser (Sept. 22, 2008), 2008 WLNLR 17993329 (“In a highly competitive field, the mere appearance of impropriety is enough for a firm to pass on hiring you.”); Liddle & Brecher, supra note 8, at 690 (“A defamatory Form U-5 can ruin an individual’s career in the financial services industry.”).

55. See Green v. Mizner, 692 A.2d 169, 174 (Pa. Super. Ct. 1997) (“A defamatory communication may consist of a statement in the form of an opinion but a statement of this nature is actionable only if it implies the allegation of undisclosed defamatory facts as the basis for the opinion.” (quoting RESTATEMENT (SECOND) OF TORTS § 566 (1977))). The court cited comment (c) of section 566 of the Second Restatement of Torts that states:

A simple expression of opinion based on disclosed or assumed nondefamatory facts is not itself sufficient for an action of defamation, no matter how unjustified and unreasonable the opinion may be or how derogatory it is. But an expression of opinion that is not based on disclosed or assumed facts and therefore implies that there are undisclosed facts on which the opinion is based, is treated differently.

Id.; see also RESTATEMENT (SECOND) OF TORTS § 566 cmt. c (1977).

his or her opinion, the statement will not be defamatory. In effect, statements can be embarrassing or even detrimental to one’s reputation but not defamatory if enough supporting facts are provided.

To defend against defamation, employers can argue that their statements were true or privileged. First, the truth is always an absolute defense to defamation. In Form U-5 disputes, employers will never be liable if they are honest and identify sufficient facts to support the basis of their statements. Although the degree of privilege in Pennsylvania is undetermined, employers, at a minimum, will receive qualified privilege.

57. See Goralski v. Pizzimenti, 540 A.2d 595, 598 (Pa. Commw. Ct. 1988) (holding statements cannot be defamatory if they clearly lay out supporting facts). In Goralski, a teacher claimed that her former employer defamed her by publishing a letter documenting the reasons for her termination. See id. (describing plaintiff-teacher’s claims). However, the court explained that the letter was not defamatory because it contained facts including that the plaintiff failed to return calls and mistreated another employee. See id. (reasoning statements were not defamatory because facts were supplied).

58. See id. (“It is not sufficient, however, if the words are merely annoying or embarrassing to plaintiff.”).

59. See 42 PA. CONS. STAT. ANN. § 8343(b)(1)-(2) (West 1978) (“In an action for defamation, the defendant has the burden of proving, when the issue is properly raised: (1) The truth of the defamatory communication[, and] (2) The privileged character of the occasion on which it was published.”).


61. See Tann, supra note 6, at 1025 (explaining truth is absolute defense in Form U-5 defamation); see also Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1168 (7th Cir. 1998) (noting employers are required to provide complete and accurate information in Form U-5s). The court observed that the NASD requires firms to provide “all relevant information available to the member, including facts that would lend support to or cast doubt on the truth of the allegations.” Dawson, 135 F.3d at 1168.

62. See Weiss, supra note 17, at 3–4 (explaining that in Pennsylvania statements made by employers on Form U-5s are subject to qualified privilege). The article cites 42 PA. CONS. STAT. ANN. § 8340.1, which in relevant part states: An employer who discloses information about a current or former employee’s job performance to a prospective employer of the current or former employee, upon request of the prospective employer or the current or former employee, is presumed to be acting in good faith and, unless lack of good faith is demonstrated by clear and convincing evidence is immune from civil liability for such disclosure or its consequences in any case brought against the employer by the current or former employee. The presumption of good faith may be rebutted only by clear and convincing evidence establishing that the employer disclosed information that: (1) the employer knew was false or in the exercise of due diligence should have known was false; (2) the employer knew was materially misleading; (3) was false and rendered with reckless disregard as to the truth or falsity of the information; or (4) was information the disclosure of which is prohibited by any contract, civil, common law or statutory right of the current or former employee. 42 PA. CONS. STAT. ANN. § 8340.1(a).
Under qualified privilege, employers are protected unless they act with malice or a reckless disregard for the truth.63

Despite two strong defenses to defamation, employers hesitate to disclose important details regarding an employee’s termination.64 This “chilling effect” results primarily from the possibility of civil liability.65 In other words, employers are keenly aware that they can find themselves in arbitration proceedings where “big money” can be at stake.66

New York is the only state to uniformly provide employers with the ultimate assurance of absolute immunity.67 However, courts in California and Pennsylvania have also held that employers’ statements in Form U-5s should be absolutely privileged.68 In this debate over the degree of privilege, the arguments for and against qualified and absolute privilege are well documented.69

1. The Pro-Student Rule: Qualified Privilege

Proponents of qualified privilege argue that it best balances the interests of employees, employers, regulators, and investors.70 First, qualified

63. See Corabi, 273 A.2d at 909 (“[I]f the privileged occasion is but a qualified one and it be shown that defendant was actuated by malice, the defense of qualified privilege is vitiated.”).

64. For a discussion of the defenses, see supra notes 60–63 and accompanying text.

65. See Wright, supra note 6, at 1300–01 (noting that some employers believe it is safer choice to issue clean Form U-5s regardless of whether it is warranted); see also Clarke, supra note 26 (“While truth is an absolute defense in defamation complaints, the employer’s high cost of defending those actions could have an adverse influence on setting forth the full basis for termination.”); SEC Has No Evidence U-5 Defamation Claims Hurt Firms, WEALTHMANAGEMENT.COM (Oct. 1, 2000), http://wealthmanagement.com/archive/sec-has-no-evidence-u-5-defamation-claims-hurt-firms (explaining that regulators are concerned employers’ fear of defamation claims has reduced informational value of Form U-5s).

66. See Martin Harris, Defamation on Form U-5: Caught Between a Rock and a Hard Place, SEC. INDUSTRY EMP. LITIG. ALERT (Drinker, Biddle & Reath L.L.P, Chicago, Ill.), Oct. 2008, at 1, available at http://www.drinkerbiddle.com/resources/publications/2008/defamation-on-form-u-5—caught-between-a-rock-and-a-hard-place (“In a number of recent cases, negative information on a U-5 has triggered lawsuits for defamation in which the plaintiffs won millions of dollars.”); see also Liddle & Brecher, supra note 8 (listing NASD and NYSE defamation awards).


69. See Weiss, supra note 17, at 1–5 (reciting arguments for absolute and qualified privilege).

70. See Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1164 (7th Cir. 1998) (holding that qualified privilege protects interests of all parties); see also Tann, supra
privilege protects employees by allowing them to hold employers accountable for false or misleading statements made in Form U-5s. Given the serious consequences that Form U-5 disclosures can have on an individual’s career, qualified privilege can be viewed as more equitable because it enables employees to be fairly compensated for damages that arise when employers misuse Form U-5s to intentionally damage reputations. Under an absolute privilege standard, however, defamed employees can only clear their names through expensive expungement proceedings.

Second, qualified privilege protects employers because they retain immunity as long as they tell the truth and refrain from recklessly drafting Form U-5s. Moreover, the threat of liability can deter employers from exaggerating or drafting misleading statements in Form U-5s. As a result, regulators and the general investing public benefit because more accurate information is transmitted from firms to regulators.

Acknowledging that qualified privilege provides benefits to all parties, a majority of courts have held in favor of qualified privilege. Several states have even enacted statutes requiring qualified privilege. Finally,
prominent regulatory officials in the industry have also called for a uniform qualified privilege rule to be adopted.\footnote{79}

2. The Pro-Teacher Rule: Absolute Privilege

Proponents of absolute privilege argue that it best supports the regulatory objectives of the Form U-5 and protects employers who are compelled to make the statements as part of a quasi-judicial proceeding.\footnote{80} First, removing civil liability eliminates the main reason why employers issue "clean" Form U-5s.\footnote{81} Second, the mandatory submission of Form U-5s to FINRA can be viewed as part of a quasi-judicial proceeding.\footnote{82} Finally, Form U-5s should be absolutely privileged because their content is a matter of general public concern (i.e., unethical brokers can seriously harm the investing public).\footnote{83}

In response to the argument that employers might abuse their immunity, supporters of absolute privilege argue that there are safeguards in the

\begin{footnotesize}
A broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative shall not be liable to another broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative for defamation . . . 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.

\textit{HAW. REV. STAT. ANN. § 485A-507 (LexisNexis 2006).}

\footnote{79. See Wright, supra note 6, at 1328 ("[R]egulators generally have supported according broker-dealers a qualified privilege for Form U-5 reporting that is defamatory and untrue."); cf. Tann, supra note 6, at 1043–45 (noting efforts to create qualified privilege standard). In 1998, the NASD proposed a uniform qualified immunity rule to protect employees from misleading or false statements made in Form U-5s. See Tann, supra note 6, at 1043–45 (describing proposed qualified privilege rule). However, the proposal never became law due to concerns over whether the NASD had the authority to impose a uniform rule that differed from state law. See id. (explaining failure of proposal to become effective). Four years later in 2002, Commissioners of the Uniform Securities Act proposed a model qualified privilege rule for states to adopt. See id. (noting that several states have adopted model qualified privilege statutes); see also Uniform Securities Act, § 507 (2002) ("A broker-dealer . . . is not liable . . . 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.").


\footnote{81. See Tann, supra note 6, at 1040–41 (describing employers reluctance to provide more information without absolute immunity); see also Hunt, supra note 9, at 3 ("[A] widely-held believe is that some firms supply 'clean' Forms U-5 to avoid possible defamation exposure.").

\footnote{82. See Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 444 (N.Y. 2007) (finding Form U-5s to be part of quasi-judicial process).

\footnote{83. See Fontani v. Wells Fargo Invs., 28 Cal. Rptr. 3d 833, 842 (Cal. Ct. App. 2005) (holding statements in Form U-5s should be absolutely privileged because they concern conduct capable of affecting large numbers of people).}
reporting system to protect employees.84 As a general matter, all FINRA member firms are under an obligation to act in good faith when completing and updating Form U-5s.85 Employers that purposely report inaccurate or misleading information on a Form U-5 can be subjected to fines and other administrative penalties.86 To ensure compliance, FINRA routinely investigates Form U-5s for accuracy.87 Finally, employees can find relief within the system by commencing expungement proceedings to clear their records.88

The most significant decision in favor of absolute privilege comes from the New York Court of Appeals in Rosenberg v. MetLife, Inc.89 In Rosenberg, the court classified the submission of Form U-5s as being part of a quasi-judicial process.90 The court reasoned that NASD is a quasi-govern-

84. See Jeffery Zuckerman, New York Court Finds Absolute Immunity Applies to Broker-Dealer U-5 Termination Statements, MONDAQ BUS. BRIEFING (Apr. 5, 2007), available at 2007 WLNR 6492222 (describing safeguards in Form U-5 reporting system that protect employees).

85. See id. (explaining that FINRA requires firms to complete accurate disclosures); see also FINRA, FORM U4 AND U5 INTERPRETIVE QUESTIONS AND ANSWERS 1-13 (2013), available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p119944.pdf (acknowledging employers' continuing obligation to provide accurate and complete information in Form U-5).

86. See REGULATORY NOTICE 10-39, supra note 45, (explaining that firms can face administrative and civil penalties for not providing complete and accurate information in Form U-5s); see also Melanie Waddell, FINRA’s Top 5 Enforcement Issues of 2011, ADVISORONE (Mar. 12, 2012), http://www.advisorone.com/2012/03/12/finras-top-5-enforcement-issues-of-2011?page=2 (listing FINRA’s top enforcement issues). In 2011, there were four cases where an employer was fined over $600,000 for not reporting material information in a Form U-5. See Waddell, supra (discussing violations for inaccurate Form U-5s).

87. See id. (noting regulators often check accuracy and completeness of Form U-5s).

88. See Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 445 (N.Y. 2007) (explaining that defamed employees can commence arbitration proceedings to clear their records). But see Tann, supra note 6, at 1042–43 (discussing realities of expungement proceedings). Expungement proceedings are expensive and a defamed employee’s reputation may be damaged too greatly before the proceeding can provide a result. See Tann, supra note 6, at 1043 (“If a broker is in fact successful in getting a statement expunged, he may be out of work for years until the expungement actually occurs, and the harm at that point may be irreparable.”).

89. 866 N.E.2d 439, 445 (N.Y. 2007); see also Weiss, supra note 17, at 5 (discussing Rosenberg’s significance).

90. See Rosenberg, 866 N.E.2d at 443–44 (comparing Form U-5 reporting to other quasi-judicial proceedings). The court analogized Form U-5 reporting to absolutely privileged complaints made to a New York bar association’s grievance committee. See id. (noting complaints to bar association were absolutely privileged). But see id. at 446 (Pigott, J., dissenting) (rejecting majority’s position that Form U-5 reporting is quasi-judicial). The dissent stated that the Form U-5 system is not a quasi-judicial proceeding because “statements made on a Form U–5 are not intended to be part of any court proceeding nor are they presented to a committee having attributes similar to a court.” Id. at 445 (Pigott, J., dissenting). The dissent also distinguished employers’ statements in Form U-5s from complaints made to the bar association’s grievance committee by noting that the complaints
mental agency because it has been delegated authority to enforce federal laws and is the “primary regulator of the broker-dealer industry.”

Furthermore, the court explained that the NASD performs quasi-judicial functions by investigating complaints from member firms and administering disciplinary proceedings.

The court also emphasized that Form U-5s promote a significant public interest by protecting investors and other employers from unethical brokers. Assuming that absolute privilege would be more likely to promote accurate disclosures, the court explained that the NASD could more efficiently investigate brokers. Additionally, the availability of Form U-5s to prospective employers aids them in researching the background of potential employees and ultimately helps the industry maintain high standards.

Outside of New York, only a few cases have held that employers are subject to absolute privilege. Nonetheless, Rosenberg has a substantial impact on the industry as a significant number of these disputes arise in New York. The decision is also likely to serve as persuasive authority in states that have yet to determine whether Form U-5s are absolutely privileged.

to the bar association were made confidentially and were not disseminated across the legal industry. See id. (distinguishing Form U-5 statements from complaints to bar association).

91. Id. at 443. The court explained that the compulsory nature of Form U-5s in the self-regulating system could be viewed as the first step of a quasi-judicial process. See id. at 444 (discussing quasi-judicial qualities of Form U-5 reporting system).

92. See id. (describing quasi-judicial functions performed by NASD).

93. See id. (noting significant public interest of investor protection). But see Liddle & Brecher, supra note 8, at 688 (“While investor protection is a worthy public policy, the Court’s conclusion in Rosenberg is based on the faulty premise that brokerage firms always act in the public’s interest and will be even more likely to do so with an absolute privilege.”).

94. See Rosenberg, 866 N.E.2d at 444 (implying that absolute privilege is more likely to promote accurate disclosures to regulators).

95. See id. (noting accurate Form U-5 disclosures assist other employers in researching employee backgrounds).


97. See Tann, supra note 6, at 1028 (describing impact of New York law on securities industry). The article explained that:

New York City accounts for 90% of all securities jobs in the state and more than 22% of securities jobs in the nation. In fact, the New York metropolitan area provided 230,000 jobs in the securities industry in 2006, far more than any other city. Wall Street alone accounted for 41% of the jobs gained in New York City between 2003 and 2006.

Id. (footnote omitted).

98. For a discussion of the significance of Rosenberg, see infra note 174 and accompanying text.
C. Today’s History Lesson: Absolute Privilege in Pennsylvania

In Pennsylvania, absolute privilege provides immunity from civil liability regardless of “occasion or motive.”99 Such privilege has primarily been reserved for statements made during the course of judicial or quasi-judicial proceedings as well as statements made by high public officials acting in their official capacity.100 In these settings absolute privilege is necessary to promote candid discourses in areas of public interest.101

In the employment context, Pennsylvania courts have held that absolute privilege can extend to statements made by employers regarding a former employee’s history at the firm.102 However, this extension of absolute privilege narrowly applies to an individual who consented to publish and receive potentially defamatory statements.103 In addition, the Pennsylvania Superior Court in Baker v. Lafayette College104 held that “an em-

100. See Post v. Mendel, 507 A.2d 351, 355 (Pa. 1986) (“[T]he protected realm has traditionally been regarded as composed only of those communications which are issued in the regular course of judicial proceedings and which are pertinent and material to the redress or relief sought.”); cf. Barto v. Felix, 378 A.2d 927, 929 (Pa. Super. Ct. 1977) (holding that public officials enjoy absolute immunity when making statements pursuant to their official duties); see also Milliner v. Enck, 709 A.2d 417, 419 (Pa. Super. Ct. 1998) (explaining statements made during quasi-judicial proceedings are absolutely privileged); Moses v. McWilliams, 549 A.2d 950, 956 (Pa. Super. Ct. 1988) (recounting Pennsylvania’s traditional application of absolute privilege to statements made in judicial proceedings). The court in Barto explained that public officials need the protection of absolute privilege to act freely in areas of public interest. See Barto, 378 A.2d at 929 (“The threat of a potential civil suit for damages would unquestionably dampen a public official’s enthusiasm to act in certain situations . . . .”).
103. See Frymire v. Painewebber, Inc. (In re Frymire), 87 B.R. 856, 859 (Bankr. E.D. Pa. 1988) (reviewing Pennsylvania case law concerning absolute privilege in employment contexts). The court explained, “if no consent of the employee to the publication of his evaluation by his employer has been established, by a collective bargaining agreement or otherwise, no absolute privilege should attach.” Id.
ployer should not be subject to a defamation suit by an employee based on statements the employer is contractually compelled to make . . . .” 105

In Baker, the plaintiff-professor claimed that a co-worker and his superior defamed him by exchanging letters that were critical of his job performance. 106 The plaintiff alleged that the letters were biased, false, and ultimately led to his termination. 107 Despite the plaintiff’s claims, the court held that the superior’s letters were subject to absolute privilege because the plaintiff consented to such written evaluations in the employee handbook. 108

Relying on section 583 of the Restatement (Second) of Torts, the Baker court stated that if consent is given to an employer to publish potentially defamatory matters, then the employer enjoys absolute privilege. 109 However, the plaintiff’s co-worker was not entitled to absolute privilege because the handbook only stated that department heads would make written evaluations. 110 Although the court recognized the possibility that an evaluation could be recklessly or maliciously drafted, it stated that as long as employees consented to having written evaluations published, they must have assumed the risk that the evaluations might be unfavorable. 111

On the other hand, the dissent emphasized that the plaintiff only consented to honest evaluations, and there was substantial evidence showing 105. Id. at 249.

106. See id. at 248 (describing allegedly defamatory letters). The letters focused on the plaintiff’s teaching ability, relationship with co-workers, and the presence of his wife in his classes. See id. at 260 (“Professor Gluhman wrote a letter to Provost Sause complaining of the ‘extraordinary, peculiar, and academically deplorable arrangement’ of [plaintiff’s] wife’s ‘habitual’ presence in [plaintiff’s] classes.”).

107. See id. at 249 (discussing plaintiff’s claim).

108. See id. (describing manner in which plaintiff consented). The court looked at the plaintiff’s employment contract and the university’s handbook to determine if plaintiff gave consent. See id. (discussing contents of handbook). The employee handbook provided for “annual written evaluations by the department head.” Id.

109. See id. (quoting Restatement (Second) of Torts § 583). The court quoted comment (f) that states:

The privilege conferred by the consent of the person about whom the defamatory matter is published is absolute. The protection given by it is complete, and it is not affected by the ill will or personal hostility of the publisher or by any improper purpose for which he may make the publication.

Id.; see also Restatement (Second) of Torts § 583 cmt. f (1977).

110. See Baker, 504 A.2d at 250 (finding co-worker’s letter not subject to absolute privilege on consent grounds). The employee handbook only provided for formal evaluations by department heads. See id. at 249 (discussing conditions in handbook).

111. See id. at 250 (reasoning that when employees agree to be evaluated they risk criticism might be unfavorable or negative). The court stated, “[t]he person who agrees to submit his work to criticism or evaluation assumes the risk that the criticism may be unfavorable.” Id.
that his superior’s evaluations were dishonest. The dissent also added that “where one does not know that a statement exists but does know that in the course of an investigation of one’s conduct it may be made and published . . . one’s consent to publication is consent only to publication of honest findings.” Applying this reasoning to Form U-5 defamation disputes, it would be inequitable to allow employers to avoid civil liability when they use Form U-5s to retaliate or intentionally injure an ex-employee’s career.

III. SCHOOL IS IN SESSION: MERKAM V. WACHOVIA

Gal Merkam, a former financial specialist at Wachovia, was fired for violating the company’s code of conduct by accepting loans from a third party and entering them into Wachovia’s computer system without first notifying the customer. Merkam appealed his dismissal by filing a termination appeal request. In the appeal letter, Merkam admitted to violating Wachovia’s code of conduct on at least one occasion. After reviewing the appeal, Wachovia upheld its decision to terminate Merkam.

Following his departure, Dawn Lang, Merkam’s former supervisor, prepared a report for an unemployment compensation hearing to determine Merkam’s eligibility for benefits. At this hearing, Lang recited the specific code of conduct violation that led to Merkam’s termination.

112. See id. at 268 (Spaeth, J., dissenting) (asserting consent only provides absolute privilege for honest statements). Baker relied on comment d in Section 583 of the Second Restatement of Torts, which states, “one who agrees to submit his conduct to investigation knowing that its results will be published, consents to the publication of the honest findings of the investigators.” Id. at 250 (majority opinion); see also RESTATEMENT (SECOND) OF TORTS § 583 cmt. d (1977).

113. See Baker, 504 A.2d at 269 (Spaeth, J., dissenting).

114. See Matthew W. Finkin & Kenneth G. Dau-Schmidt, Solving the Employee Reference Problem: Lessons from the German Experience, 57 AM. J. COMP. L. 387, 399 (2009) (“It is doubtful that we should be prepared to allow an employer to escape device, or uses the threat of a malicious reference . . . .” (footnotes omitted)).


116. See id. at *2 (noting Merkam’s appeal).

117. See id. (describing Merkam’s appeal letter). The court stated, “[i]n his letter, [Merkam] expressly conceded that, on one occasion, he had received a faxed application for an auto loan from Tri State Auto and entered the application into Wachovia’s computer system without first speaking to the customer.” Id.

118. See id. at *5 (noting Wachovia upheld its decision to terminate Merkam).

119. See id. (describing Dawn Lang’s involvement with Merkam’s unemployment compensation hearing).

120. See id. (At the hearing, Ms. Lang testified and corroborated the facts as set forth in her [r]eport.”). In her report, Lang identified the exact company
few days after the hearing, Wachovia filed Merkam’s Form U-5 with the NASD.\footnote{121}

In the Form U-5, Wachovia stated that Merkam was “[t]erminated by Wachovia Bank, for violation of Wachovia Bank’s code of conduct.”\footnote{122} Wachovia went on to explain that, “[n]o Wachovia Bank or Wachovia Securities Clients were affected by the code of conduct violation.”\footnote{123} After reviewing Wachovia’s statements in Merkam’s Form U-5, the NASD decided to investigate Merkam.\footnote{124} However, the NASD quickly ended its investigation after Wachovia identified all of the relevant facts to support its opinion that Merkam violated its code of conduct.\footnote{125}

Merkam proceeded to sue Wachovia and Lang, claiming that he was defamed by the statements made by Lang in the unemployment compensation hearing and by Wachovia in his Form U-5.\footnote{126} Among other things, Merkam alleged that the negative statements in his Form U-5 tarnished his business reputation.\footnote{127} In response, Wachovia filed preliminary objections and the court dismissed the claim for legal insufficiency.\footnote{128}

On appeal, the Court of Common Pleas affirmed that Merkam failed to show that Wachovia’s statements at the unemployment compensation hearing and in the Form U-5 were defamatory.\footnote{129} The Superior Court of Pennsylvania affirmed the lower court’s ruling in an unreported memorandum opinion.\footnote{130} In its opinion, the Superior Court refrained from dis-
cussing whether Wachovia’s statements in the Form U-5 were subject to absolute or a qualified privilege.131

The Court of Common Pleas began its discussion by identifying the burdens of proof for defamation in Pennsylvania.132 First, the court analyzed whether Lang or Wachovia’s statements could be capable of a defamatory meaning.133 Focusing on the amount of supporting facts provided by Lang and Wachovia in their statements, the court concluded that none of the statements were capable of a defamatory meaning.134 The court recognized that Lang’s statements clearly laid out all of the relevant facts to support her opinion that Merkam violated Wachovia’s Code of Conduct.135 Similarly, the court explained that Wachovia provided all of the supporting facts through its disclosures in the Form U-5 and its statements to the NASD during the investigation.136

The second half of the court’s analysis focused on whether Wachovia and Lang’s statements were protected by the truth and if they were absolutely privileged.137 First, the court determined that Wachovia’s statements were true because Merkam admitted to violating the company’s code of conduct in his letter to appeal termination.138 Although not necessary, the court proceeded to discuss whether absolute privilege applied to Wachovia’s communications in the unemployment compensation hearing and statements on the Form U-5.139

After reviewing Pennsylvania case law regarding the purpose of absolute privilege, the court concluded that Wachovia’s communications to

131. See id. at 4–5 (discussing Form U-5 privilege). The superior court did not classify the degree of privilege provided to Form U-5s as absolute or qualified. See id. at 5 (“[W]e conclude the trial court did not err in finding this communication was privileged.” (emphasis added)).


134. See id. at *6–7 (concluding Lang and Wachovia’s statements were incapable of defamatory meaning).

135. See id. at *15 (explaining that Lang clearly laid out relevant facts to support her opinion).

136. See id. at *12 (“The Form U-5 submitted to NASD and the NASD correspondence . . . conclusively establish that Wachovia informed the NASD of its opinion that Plaintiff had violated Wachovia’s Code of Conduct and specifically identified all of the facts supporting its opinion.”).

137. See id. (analyzing Lang and Wachovia’s burden of proof).

138. See id. at *13 (“Plaintiff admitted in his appeal letter that he did, on at least one occasion, receive a faxed loan application from Tri State Auto and entered the application into Wachovia’s computer system without first speaking with the customer.”).

139. See id. (discussing applicability of absolute privilege). At this point, the court already determined that Lang and Wachovia’s statements were not capable of a defamatory meaning and were protected under the absolute defense of the truth. See id.
the unemployment compensation referee were absolutely privileged. The court explained that absolute privilege applied because unemployment compensation hearings are “judicial” and Lang’s statements were relevant and material to the proceedings.

Relying on New York case law, the court explained that Wachovia’s statements in Merkam’s Form U-5 were subject to absolute privilege. In reaching its conclusion, the court emphasized that without the threat of civil liability, employers would be more likely to provide more accurate information on Form U-5s. However, the court did not acknowledge that the majority rule outside of Pennsylvania is qualified privilege.

IV. CRITICAL ANALYSIS

The Court of Common Pleas correctly held that Wachovia and Lang were not liable for defamation because the statements were true but should not have extended absolute privilege to Merkam’s Form U-5. First, making Form U-5s immune from all liability under any circumstance is inconsistent with the purpose of absolute privilege. The court did not definitively show that the public interest is actually protected by providing absolute privilege. Finally, if absolute privilege becomes the law in Pennsylvania, employees’ reputations will be left at the mercy of their employer.

140. See id. at *17 (“Since Ms. Lang’s alleged statements were relevant and material to the judicial proceedings before the Unemployment Compensation Referee, they are protected by an absolute privilege.”). In its review of the original purpose of absolute privilege, the court cited the Supreme Court of Pennsylvania in Binder to show that absolute privilege was initially deployed to promote the free administration of justice in judicial proceedings. See id. at *16.

141. See id. at *17 (citing Milliner v. Enck, 709 A.2d 417, 419 (Pa. Super. Ct. 1998)) (implying unemployment compensation hearings are judicial proceedings protected by absolute privilege).

142. See id. at *18 (relying on New York case law applying absolute privilege to statements made on Form U-5s). The court was persuaded by the reasoning of the New York Court of Appeals in Rosenberg. See id.

143. See id. (citing Cicconi v. McGinn, Smith & Co., 808 N.Y.S.2d 604, 607–08 (N.Y. App. Div. 2005)) (noting that Form U-5s protect investors “by assuring brokerage firms that they will not be liable in tort for statements in their mandatory U-5 filings, [thus] avoid[ing] the possibility that they will hesitate to clearly state the exact grounds for an employee’s termination”).

144. See generally id. (avoiding discussion of majority view of courts that statements made in Form U-5s are subject to qualified privilege).

145. For a discussion of why the court should not have extended absolute privilege, see infra notes 149–90 and accompanying text.

146. For a further discussion of how the Form U-5 is not part of a quasi-judicial proceeding, see infra notes 149–63 and accompanying text.

147. For a further discussion of how absolute privilege for Form U-5s does not necessarily benefit the investing public, see infra notes 164–73 and accompanying text.

148. For a further discussion of the potential impact of Merkam’s holding, see infra notes 174–90 and accompanying text.
2013] NOTE 233

A. The Form U-5 Reporting System Lacks the “Judicial” Part of a Quasi-Judicial Proceeding

When employers file Form U-5s, they are not participating in a typical quasi-judicial process worthy of absolute privilege. In some respects, the Form U-5 reporting system administers quasi-judicial functions because it enables regulators to investigate brokers and allows FINRA to enforce federal securities laws. On the other hand, the reporting system reaches outside the scope of the quasi-judicial process by creating a massive database of “employee references” for its member firms. To address this conundrum, it is important to review the purpose of absolute privilege.

The Court of Common Pleas correctly identified that the original purpose of absolute privilege was to promote the free administration of justice by judges and to promote the participation of litigants and witnesses in trials. While Pennsylvania has extended absolute privilege to quasi-judicial proceedings like unemployment compensation hearings, those proceedings retain essential elements of a traditional judicial process. Unlike an unemployment compensation hearing, the Form U-5 reporting system lacks fundamental “judicial” characteristics. For example, em-


150. See Baravati, 28 F.3d at 708 (explaining NASD performs quasi-judicial functions). The court explained that the NASD performs quasi-judicial functions by requiring member firms to self-report violations, conducting investigations, and imposing sanctions. See id.

151. See id. (stating that disseminating Form U-5s across securities industry is not quasi-judicial).

152. For a discussion of the purpose of absolute privilege, see infra notes 153–63 and accompanying text.


154. See Shortz v. Farrell, 193 A. 20, 22 (Pa. 1937) (holding proceedings before unemployment compensation hearing board are quasi-judicial). The Pennsylvania Supreme Court explained that the proceeding was of a judicial character because the unemployment compensation board had the power to issue subpoenas, apply legal rules, administer oaths, require attendance of witnesses, and adjudicate disputes. See id. (explaining that proceeding possessed fundamental characteristics of typical courtrooms); see also Milliner v. Enck, 709 A.2d 417, 421 (Pa. Super. Ct. 1998) (noting other instances where absolute privilege was extended to quasi-judicial proceedings).

155. See Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132, 137 (6th Cir. 1996) (finding submission of Form U-5s to be formality that is not part of NASD’s
employees lack a meaningful opportunity to dispute potentially defamatory or false statements, FINRA regulators are not necessarily weighing evidence and resolving disputes, and investigations do not accompany all Form U-5 filings.\footnote{156}

The Merkam court also emphasized that absolute privilege applies to all pleadings pertinent to a judicial proceeding.\footnote{157} However, unlike traditional pleadings in which both parties submit statements to be evaluated by a judge, employers truly dominate the Form U-5 reporting system.\footnote{158} Moreover, under an absolute privilege standard, employees can only challenge an employer’s statements through an expensive expungement process.\footnote{159} Recognizing this issue, the dissent in Rosenberg stated that “[i]f the Form U–5 were part of a quasi-judicial process, then an expungement action would be entirely unnecessary.”\footnote{160}

Finally, the Merkam court did not explain how Form U-5’s role of providing “employee references” falls within the gambit of a “quasi-judicial” process that deserves absolute privilege.\footnote{161} On the contrary, the Pennsylvania legislature has stated in Section 8340.1 of the Pennsylvania Code that when employers provide employee references they are presumed to be acting in good faith unless it can be shown that the employer knew its statements were false, materially misleading, or made with reckless disregard for the truth.\footnote{162}

Given the serious impact Form U-5s can have on a quasi-judicial regulatory process); \cf{} Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 445 (N.Y. 2007) (Pigott, J., dissenting) (“[S]tatements made on a Form U–5 are not intended to be part of any court proceeding nor are they presented to a committee having attributes similar to a court.”); \see{} Tann, supra note 6, at 1036 (comparing formality of filing Form U-5s to filing police reports). The court noted that a majority of states only provide police reports with a qualified privilege to protect the reputation interest of individuals. \see{} Tann, supra note 6, at 1096 (“Although there is a vital public interest in ensuring that individuals report crimes to the police, there must also be sufficient protection of the accused’s reputational interest.”).

\footnote{156} See Rosenberg, 866 N.E.2d at 445 (Pigott, J., dissenting) (explaining why Form U-5s are not quasi-judicial). The dissent emphasized that the employee did not have an opportunity to challenge the statements made on his Form U-5. \see{} id. at 446.

\footnote{157} See Binder, 275 A.2d at 56 (“[S]tatements by a party, a witness, counsel, or a judge cannot be the basis of a defamation action whether they occur in the pleadings or in open court.”).

\footnote{158} See Rosenberg, 866 N.E.2d at 446 (Pigott, J., dissenting) (implying employers have too much control over Form U-5 reporting system).

\footnote{159} See id. at 446 n.3 (“Indeed, a costly expungement action is often the only means by which an employee may challenge defamatory statements made on a Form U-5.”); \see{} Tann, supra note 6, at 1042–43 (arguing that expungement proceedings do not provide adequate protection to employees).

\footnote{160} Rosenberg, 866 N.E.2d at 446 n.3 (Pigott, J., dissenting).


\footnote{162} See 42 PA. CONS. STAT. ANN. § 8340.1 (West 2005) (describing rebuttable good faith presumption for employers when making employee references).
professional’s reputation, the court in Merkam did not adequately explain how the widespread dissemination of Form U-5s across the securities industry is sufficiently judicial in character.\textsuperscript{163}

B. \textit{Absolute Privilege for Form U-5 Reporting Is not “Absolutely Necessary” to Protect the Public}

Merkam serves as evidence that the regulatory objectives of the Form U-5 can be satisfied without absolute privilege.\textsuperscript{164} According to the court’s reasoning, Merkam’s defamation claims would have failed under a qualified privilege standard because Wachovia was acting in good faith and telling the truth.\textsuperscript{165} In effect, regulators and other employers would have received the same information about Merkam’s employment history.\textsuperscript{166}

At the time Wachovia completed Merkam’s Form U-5, the company did not believe that its statements were absolutely privileged.\textsuperscript{167} Despite believing that it could be held liable for defamation, Wachovia was honest and gave Merkam a “negative reference.”\textsuperscript{168} Accordingly, Wachovia’s conduct demonstrates that the “chilling effect” of defamation might not be as strong as proponents of absolute privilege suggest.\textsuperscript{169}

Further, it is not entirely clear how disseminating the reasons for Merkam’s termination to prospective employers would better protect investors.\textsuperscript{170} Merkam’s violation had no negative effect on Wachovia’s clients.\textsuperscript{171} The behavior was not illegal, and regulators did not believe it was

\textsuperscript{163}. For a discussion of Merkam’s explanation, see \textit{supra} notes 132–44 and accompanying text.

\textsuperscript{164}. \textit{See} Tann, \textit{supra} note 6, at 1040–41 (“[Q]ualified privilege benefits the securities industry by encouraging employers to give complete and accurate references.”). To deter the submission of “clean” Form U-5s, states that have enacted qualified privilege statutes protect employers unless actual malice can be proven. \textit{See id.} at 1041.

\textsuperscript{165}. \textit{See} Brief of Appellees at 21–22 n.2, Merkam v. Wachovia Corp., 947 A.2d 839 (Pa. Super. Ct. May 23, 2008) (No. 230 EDA 2007), 2007 WL 2858008 (“[E]ven if this Court were to hold that a qualified, rather than absolute, privilege attaches to Wachovia’s statements to the NASD, the Complaint and attached exhibits, taken together, fall [sic] to establish Wachovia’s abuse of a qualified privilege . . . .”).

\textsuperscript{166}. For a description of the negative content of Merkam’s Form U-5, see \textit{supra} notes 126–27 and accompanying text.

\textsuperscript{167}. \textit{See} Brief of Appellees, \textit{supra} note 165, at 21–22 (citing majority of case law supporting qualified privilege and explaining absolute privilege does not apply outside of New York).


\textsuperscript{169}. \textit{See} Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1164 (7th Cir. 1998) (acknowledging firms are under pressure to provide clean Form U-5s but holding firms can still satisfy regulatory reporting under qualified privilege).

\textsuperscript{170}. \textit{See} Liddle & Brecher, \textit{supra} note 8, at 691 (arguing that public interest is not advanced by making statements in Form U-5s absolutely privileged).

\textsuperscript{171}. \textit{See} Merkam, 2008 Phila. Ct. Com. Pl. LEXIS 85, at *3 (noting Merkam’s conduct did not affect Wachovia’s clients).
even worthy of sanctions.\textsuperscript{172} In the words of the Seventh Circuit, applying absolute privilege to situations like Merkam’s is “strong medicine.”\textsuperscript{173}

C. Absolute Privilege Could Become a Reality in Pennsylvania

The \textit{Merkam} court’s adoption of \textit{Rosenberg} illustrates how states without a mandatory qualified privilege standard are likely to react to new arguments for absolute privilege.\textsuperscript{174} Although not binding in Pennsylvania, \textit{Merkam} laid a foundation for future arguments supporting absolute privilege.\textsuperscript{175}

One avenue by which this might occur is an employer arguing that its statements are absolutely privileged because the employee at issue consented to the employer publishing the reasons for the employee’s termination.\textsuperscript{176} According to the Pennsylvania Superior Court in \textit{Baker}, absolute privilege can be conferred by consent.\textsuperscript{177} Further, the court in \textit{Baker} explained that employers should not be liable for defamation when they are contractually compelled to make certain statements.\textsuperscript{178} Applying \textit{Baker} to Form U-5s, employers could argue that employees confer consent by signing their Form U-4, which expressly provides consent for employers to make the Form U-5 disclosures.\textsuperscript{179} Employers may also argue that they deserve protection because they are obligated by FINRA to submit Form U-5s after firing an employee.\textsuperscript{180}

Conversely, securities professionals can argue that application of \textit{Baker} should be limited to internal evaluations.\textsuperscript{181} Recognizing the serious risks to an individual’s reputation, the dissent in \textit{Baker} reasoned that individuals only consent to the publication of honest statements.\textsuperscript{182} Applying this rea-

\begin{footnotesize}
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\item \textsuperscript{172} See id. at *4 (stating that NASD chose to take no action against Merkam).
\item \textsuperscript{173} Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994).
\item \textsuperscript{174} See Weiss, supra note 17, at 5 (predicting that \textit{Rosenberg}’s holding will influence jurisdictions outside of New York).
\item \textsuperscript{175} See generally Merkam v. Wachovia, No. 230 EDA 2007, 1, 4 (Mem. Op.) (Pa. Super. Ct. May 23, 2008). The fact that the Superior Court of Pennsylvania avoided discussing whether absolute privilege applies to Form U-5s might suggest that the court was not ready to address the issue. \textit{See id.}
\item \textsuperscript{176} For a further discussion of this potential reality, see \textit{infra} notes 177–80 and accompanying text.
\item \textsuperscript{178} \textit{See id.} (stating employers should not be liable for defamation based on statements they are contractually compelled to make).
\item \textsuperscript{179} For a discussion of Form U-4’s consent aspect, see \textit{supra} note 42 and accompanying text.
\item \textsuperscript{180} For an explanation of how employers are obligated by FINRA to submit Form U-5s after firing employees, see \textit{supra} notes 44–45 and accompanying text.
\item \textsuperscript{181} See \textit{Baker}, 504 A.2d at 253 (noting significance that evaluation was limited to internal members of college).
\item \textsuperscript{182} \textit{See id.} at 268–69 (asserting that consent only applies to publication of honest remarks).
\end{enumerate}
\end{footnotesize}
soning to Form U-5 disclosures, employers would only be protected if their statements were honest.183

As former SEC Commissioner Isaac C. Hunt, Jr. argued, if absolute privilege becomes the law in Pennsylvania and other states, the SEC should enact a regulation mandating a qualified privilege.184 Such action would be necessary to protect employees who would be left at the mercy of their employers.185 Moreover, the need for a qualified privilege rule becomes especially apparent in certain egregious circumstances where employers use Form U-5s to retaliate against employees.186

One alternative to providing employers with absolute privilege, which Mr. Hunt and others have floated, could be to give employees an opportunity to challenge the content of their Form U-5 in front of a FINRA arbitration panel before the Form U-5s are published.187 This option allows employees to dispute the language they claim is defamatory and holds employers accountable for the statements they make.188 Having a FINRA arbitration panel determine whether a statement is defamatory before it is published may also provide employers with some assurance that they will not be held liable for defamation down the road.189 Ultimately, this type of proposal provides benefits to both employees and employers, shifts responsibility to FINRA regulators to determine the defamatory nature and truthfulness of statements, and makes the reporting system more judicial in character.190

183. See id. (explaining only honest evaluations are privileged).

184. See Hunt, supra note 9, at 6 (advocating SEC might need to act if absolute privilege becomes law). The former commissioner of the SEC believed that a qualified privilege rule might be necessary if the New York Court of Appeals ruled in favor of absolute privilege. See Jacob H. Zamansky, Form U-5: Unequal Justice in State, U.S. Courts, INVESTMENT NEWS (May 30, 2006), http://www.investmentnews.com/article/20060530/SUB/605300701 (stating SEC should enact qualified immunity rule to protect reputations of honest brokers).


186. For examples of employees maliciously defamed by employers, see supra notes 9–14 and accompanying text.

187. See Hunt, supra note 9, at 7 (presenting qualified privilege rules that can be considered by SEC). The commissioner detailed a proposal from the Vice Chairman of Merrill Lynch that calls for arbitration to settle disputes before Form U-5s are submitted to the CRD. See id. (“The arbitrator could affirm or modify the U-5 language, and the decision would preclude seeking other redress based upon the original or modified language.”).

188. See id. (explaining potential benefits for employees). Employees could have the language in their Form U-5 modified if they believe it is defamatory or untrue. See id. (describing employees’ ability to challenge language in Form U-5 in front of FINRA arbitrators).

189. See id. (describing potential benefits for employers).

190. See id. (discussing advantages and drawbacks of proposal).
V. Conclusion

Perhaps the most important aspect of the Merkam decision lies in its potential to demonstrate how Rosenberg’s reasoning can spread to states with unsettled law. The decision also comes at a time when arguments for absolute privilege are likely to increase as FINRA demands more information from employers. Therefore, if absolute privilege eventually becomes the law in Pennsylvania or other states, the SEC should take action to protect employees’ reputations.

191. See Anne Marie Estevez, Absolute Privilege Protects Employers’ Statements, Law360 2–3 (Apr. 2, 2007), http://www.morganlewis.com/pubs/Estevez_Employ-Law360.pdf (“The Rosenberg decision is likely to be used as support for extending the absolute privilege not only to Form U-5 reporting in other states but also to other similar forms of mandatory regulatory reporting designed to protect the public.”); see also Weiss, supra note 17, at 5 (discussing influence of Rosenberg decision).

192. See Regulatory Notice 10–39, supra note 45, at 3 (“[A] firm may be required to provide an affirmative answer to a question even if the matter is not securities-related.”); see also Chris Kentouris, Finra Wants More Details When Someone Gets Canned, OnWallstreet (Oct. 1, 2010), (“[T]he firm must also disclose if it fired an employee for ‘misconduct,’ even if the firm was not making the allegations, and even if the misconduct did not involve a customer of the firm.”); Edward Beeson, FINRA Warns on U5 Shortcomings, Compliance Rep. (Sept. 17, 2010), available at 2010 WLNR 19689664 (“Industry officials cautioned that complying with FINRA’s demands will ratchet up pressure on firms and likely spark lawsuits from aggrieved former workers.”).

193. See Hunt, supra note 9, at 6 (“If the pendulum begins to swing in favor of absolute immunity, the Commission may need to consider whether to act.”).