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Calif. gives firms free rein on rep exit forms

By Dan Jamieson

July 18, 2005

IRVINE, Calif. - Employment lawyers in California are attempting to counteract a recent state appeals court decision that gives broker-dealers total legal immunity for what they write on U-5 termination forms.

The U-5 termination form is used to report details about why a broker left a firm.

The California decision means a firm would be free to file a false U-5 against a California-based rep who might be leaving for a competitor, blowing a whistle, or complaining about discrimination, plaintiffs attorneys said. The ruling could also affect brokers outside California who work for a broker-dealer based in the state.

The controversial decision by a California court of appeals in May "gives absolute immunity to statements in U-5s," said Peter Rukin, an employment lawyer at Rukin Hyland Doria & DuFrane LLP in San Francisco. Because it is a published case, Mr. Rukin said, it can be cited as a precedent.

Mr. Rukin is working on behalf of the California Employment Lawyers Association to have the state's Supreme Court "de-publish" the case so it could no longer be used as a legal authority.

Public record

De-publishing is a California procedural device that allows the Supreme Court to look at a case without granting a formal petition for review. If a case presents interesting issues, but is not the type of case the court wants to act on, it may agree to de-publish it.

In addition to disclosing on the U-5 form why a broker was terminated, broker-dealers must also view a rep's U-5 as part of the hiring process, so any negative information on a U-5 can inhibit employment opportunities. What's more, U-5 information becomes part of a broker's public record.

"Our concern is that in arbitration, firms could argue that the arbitrators have to apply state law," Mr. Rukin said. "And now, for California brokers, there's no relief for malicious or defaming statements" made on U-5 forms."

It creates a "clear path for BDs to load up the language on the U-5, and retain customers" by putting a rep out of business, said Michael Blumenfeld, a securities and employment lawyer at Freeman Freeman & Smiley, Los Angeles. "It pretty much ensures that the rep's license transfer is going to get held up."

But Joe Floren, a defense lawyer at Morgan Lewis, San Francisco, called the decision "very good news for the brokerage industry." He said that the issue of U-5 immunity has been "litigated over and over and over again. This ruling creates some certainty. There shouldn't be any more fights over this in California."

Since firms are required to file

U-5 information with regulatory agencies and are under more pressure than ever to report disciplinary information, Mr. Floren believes the industry needs immunity. Few broker-dealers will falsify negative filings, he said, because that only invites regulatory inquiries and customer complaints.

Mr. Blumentfeld, who sues firms on behalf of brokers, said that he hasn't yet seen any fallout from the case but that he expects firms will not be as willing to talk to him to ensure even-handed U-5 language.

Mr. Rukin filed his de-publishing request last Thursday. Wells Fargo and the court of appeals had 10 days to from then to respond. Mr. Rukin said the state Supreme Court would probably decide within a few months whether to preserve the ruling.

The ruling arose from a case filed by a former Wells Fargo Investments broker, Marco Fontani, who sued the firm after it terminated him in October 2002.

Lawyers say the Fontani decision contradicts several federal court cases that held brokerage firms liable if they make false statements on U-5 forms and do so in bad faith - a so-called qualified privilege.

But the California appeals court ruled that since the filing of a U-5 was an issue of public interest and was part of an official proceeding, "the document is absolutely privileged" under California law.

Mr. Rukin said he believed it was the first time a California appeals court looked at the issue of U-5 immunity. In his request to de-publish the decision, he said that the Fontani case was "based on wrong factual assumptions in the absence of a sufficient evidentiary record." He argued that a U-5 is simply an administrative function, not an investigative document.

About a decade ago, the securities industry made a big push for an NASD arbitration rule to provide absolute immunity. Washington-based NASD proposed a qualified standard instead, but the SEC never acted on that proposal due to concerns about overriding state defamation laws.

In 2002, a state law-drafting group, the Chicago-based National Conference of Commissioners on Uniform State Laws, also approved a qualified standard as part of a package of suggested state laws.

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