Securities Industry Association

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May 20, 1998

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Re: File No. SR-NASD-98-18; Release No. 34-39892

Dear Mr. Katz:

We are writing on behalf of the Legal and Compliance Division and the Federal Regulation Committee of the Securities Industry Association ("SIA")[1] in response to the SEC's request for comment on the proposed rule change by the National Association of Securities Dealers ("NASD") regarding qualified immunity in arbitration proceedings for statements made on Forms U-4 and U-5. Proposed new Rule 1150 would establish a national, uniform standard of qualified immunity from arbitration proceedings filed against member firms with respect to statements they make on Forms U-4 and U-5.

The SIA believes that Proposed Rule 1150 helps to strike an appropriate balance between encouraging candid and accurate disclosure by member firms on Forms U-4 and U-5 and allowing member firms to defend themselves against frivolous actions alleging that statements made on such Forms are defamatory. The SIA is supportive of the proposal's suggestion to establish a uniform, national standard of qualified immunity for arbitration proceedings. Although such a standard does not represent any enhanced legal protection for member firms in the sense that this is the standard applied in most parts of the country, it should eliminate future litigation over the existence and appropriate level of immunity afforded a member firm in any particular arbitration proceeding around the country.[2] This in turn could be helpful to meet the common goal of regulators and broker-dealers of identifying "rogue brokers" and keeping them out of the securities industry.

We strongly agree with the proposed rule that the standard of proof for proceedings involving claims that Form U-4 or U-5 disclosures are defamatory should be one of clear and convincing evidence rather than a preponderance of evidence. We believe that the NASD correctly judged that the preponderance of evidence standard of proof is so low that it will not have the effect of discouraging frivolous litigation, or the threat of frivolous litigation, relating to statements made on Forms U-4 or U-5. Moreover, the clear and convincing standard is well-established in many states. Attached is a partial list of some of the state case law and statutes that apply the "clear and convincing" standard to overcome a qualified defamation privilege.

In addition, we believe that the proposal should provide qualified immunity from any legal action based upon the language contained in the Form U-4 or U-5, not simply defamation actions. In an effort to circumvent the proposed qualified immunity standard, associated persons could seek to challenge statements made on Forms U-4 or U-5 on other legal grounds. We believe that the proposal should be expanded to cover such claims.

We appreciate the attention that the SEC and NASD staffs have devoted to this issue and the opportunity you have afforded us to comment on the proposal. The undersigned are, of course, available to discuss this matter further with the SEC staff at its earliest convenience.

Sincerely,

Robert C. Errico
President, Legal and Compliance Division

Lee B. Spencer, Jr.
Chairman, Federal Regulation Committee

attachment

cc:
The Honorable Arthur Levitt, Chairman;
The Honorable Norman S. Johnson, Commissioner;
The Honorable Isaac C. Hunt, Jr., Commissioner;
The Honorable Paul Carey, Commissioner;
The Honorable Laura S. Unger, Commissioner;
Richard R. Lindsey, Director, Division of Market Regulation;
Catherine McGuire, Associate Director and Chief Counsel, Division of Market Regulation;
Colleen P. Mahoney, Acting General Counsel;
Christopher P. Gilkerson, Assistant General Counsel;

Robert T. Greene, Assistant General Counsel;
Linda D. Fienberg, Executive Vice President and Chief Hearing Officer, NASD- Regulation, Inc.;
Elisse B. Walter, Executive Vice President and Chief Operating Officer, NASD-Regulation, Inc.;
John M. Ramsey Vice President and Deputy General Counsel, NASD-Regulation, Inc.;
Jean I. Feeney, Assistant General Counsel, NASD-Regulation, Inc.

Footnotes:

[1] The Securities Industry Association brings together the shared interests of nearly 800 securities firms, employing more than 380,000 individuals, to accomplish common goals. SIA members including investment banks, broker-dealers, and mutual fund companies are active in all markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans and accounts for $270 billion of revenues in the U.S. economy.

[2] In fact, in New York the Notice's proposal of qualified immunity provides less protection than the absolute immunity provided under state law. See Culver v. Merrill Lynch & Co., Inc., 94 Civ. 8124 (LBS), 1995 U.S. Dist. Lexis 10017 (S.D.N.Y. July 17, 1995). As the SEC's release correctly notes, although the SIA believes that the proposed rule represents an acceptable compromise on this issue, a number of its member firms believe that statements made in Forms U-4 and U-5 should be protected by absolute immunity.

Attachment:
Examples of Cases and Statutes Applying "Clear and Convincing" Burden of Proof to Overcome a Qualified Privilege.

California.

Copp v. Paxton, 52 Cal. Rptr. 2d 831, 844 (Ct. App. Ca. 1st Dist. Div. 1, 1996). To overcome a "limited purpose public figure" qualified privilege, plaintiff "has the burden of proving by *clear and convincing evidence* that [defendant sent defamatory writing] with knowledge of its falsity or with reckless disregard of its truth or falsity." (Emphasis added).

Maryland.

Title 5, Sec. 423 of the Maryland Code provides employers with a presumption of good faith when they provide information about a former employee to a prospective employer; the presumption is lost where the

employee can prove by clear and convincing evidence that the employer acted with actual malice. *See* Rabinowitz v. Oates, 955 F. Supp. 485, 488 (D. Md. 1996) (applying Maryland law, court granted summary judgment, finding that plaintiff failed to produce *"clear and convincing evidence*" of malice to overcome qualified privilege for communication related to employment). (Emphasis added).

New Jersey.

Erickson v. Marsh & McLennan Co., Inc., 117 N.J. 539, 565, 569 A.2d 793, 806 (Sup. Ct. N.J.1990) New Jersey Supreme Court held that, in order to overcome a privilege by "an employer responding in good faith to specific inquiries of a third party regarding the qualifications of an employee", "proof of malice in the context of a qualified privilege must be established by *clear and convincing evidence*. . . . *Indeed, the imposition of a lesser burden of proof would fail to adequately protect the interests underlying the privilege*."(Emphasis added).

New York. [1]

Sweeney v. Prisoners' Legal Services of New York, Inc., 84 N.Y.2d 786, 792, 647 N.E.2d 101, 104 (Ct. of App. N.Y. 1995). Held that, to overcome qualified privilege for correspondence between prisoners' rights organization and prison superintendent concerning conduct of corrections officer, plaintiff "was therefore obliged not only to establish that the statement was false, but also prove by *clear and convincing evidence* that it was published by defendants with 'actual malice.'" (Emphasis added).

Haywood v. University of Rochester, 209 A.D.2d 1021, 619 N.Y.S.2d 443 (App. Div. 4th Dep't 1994), rearg. denied, 1995 WL 42463 (1995). Held that, in attempting to overcome qualified privilege for memorandum relating to employee's discharge, plaintiff failed to "establish by *clear and convincing evidence* defendants' knowledge of the falsity of the statements or reckless disregard in determining their truth." (Emphasis added).

Texas.

Duffy v. Leading Edge Products, Inc., 44 F.3d 308, 312-13 (5th Cir. 1995). Held that, under Texas law, to overcome a privilege regarding a "communication on a subject in which the author or the public has an interest, or with respect to which the author has a duty to perform to another owing a corresponding duty," "*only clear and convincing proof* will support recovery . . . . Negligence, lack of investigation, or failure to act as a reasonably prudent person are insufficient to show actual malice." (Emphasis added).

Schauer v. Memorial Care Systems, 856 S.W.2d 437, 449 (Ct. of App. -- Houston 1993). Finding that "accusations or comments about an employee by her employer, made to a person having an interest or duty in the matter to which the communication relates, have a qualified privilege", court granted summary judgment. Plaintiff "has not offered the required '*clear and convincing affirmative proof*' to overcome [defendant's witness's] affidavit and establish actual malice." (Emphasis added).

Virginia.

Southeastern Tidewater Opportunity Project, Inc. v. Bade, 246 Va.273, 435 S.E.2d 131 (Sup. Ct. Va. 1993). The Virginia Supreme Court held that " '[a] qualified privilege [privilege for communication written in the context of an employment relationship] is lost if a plaintiff proves *by clear and convincing evidence* that the defamatory words were spoken with common-law malice.' " (emphasis added) [quoting Smalls v. Wright, 241 Va. 52, 55, 399 S.E.2d 805, 808 (Sup. Ct. Va. 1991)].

State of Washington.

Lillig v. Becton-Dickinson, 105 Wash.2d 653, 658, 717 P.2d 1371, 1374 (Sup. Ct. Wash. 1986). Finding that a qualified privilege applied to a written statement in a personnel file by a supervisor about an ex-employee's conduct, the Washington Supreme Court held that "[p]roof of an abuse of a qualified privilege must be established by *clear and convincing evidence* showing the defendant's knowledge or reckless disregard as to the falsity of the statement." (Emphasis added).

Footnote:

[1] New York law provides absolute immunity for statements on Form U-5. Culver v. Merrill Lynch & Co., Inc., 94 Civ. 8124 (LBS), 1995 U.S. Dist. Lexis 10017 (S.D.N.Y. July 17, 1995). The standard articulated in the New York cases cited herein was applied in contexts outside employment in the securities industry and provides less protection than that state currently provides to statements on Form U-5.