

## SAC Survey of SRO Defamation Awards

### *How Prevalent and How Successful Are Defamation Claims in SRO Arbitration?*

Defamation claims in securities arbitration have been making news. In the 90's, belt-tightening in bad cycles and recruiting disputes in good times have lent to terminations and turnovers spiced with acrimony. Several of the larger trading and institutional firms have opted against retailing in some or all product areas. Bad investments and flawed products have burned out some brokers' "books" and mergers have led to culling and greater selectivity. Moreover, strategic shifts, from sales to marketing, from stressing transactions to building assets, signal a potential sea-change in the occupational mortality rate for the commission broker.

Add to that mix increased scrutiny by the states of transferring brokers, greater visibility of Form U-5 statements, SEC pressure following the "rogue" broker study, and SRO concerns about the "recidivist" broker; one begins to see the "squeeze" faced by firms and brokers as regulatory disclosures upon termination and re-registration complications both jeopardize the broker's livelihood and threaten the firms with legal liability.

We try to treat the many aspects of this problem area throughout this edition. There is, of course, our feature article by Linda Brooks and Joel White. Our "In Brief" section discusses a case of state regulatory excess in the Amato matter and a brand new class action on behalf of disaffected Prudential brokers. Stuart Bompey's article, reviewed in "Articles & Cases" offers advice about defamation arbitrations. Here, in an attempt to offer additional insight, we review the Awards which have issued in intra-industry disputes involving defamation claims over an almost five-year period from May 1989 through the end of 1994.

#### **Methodology & Caveats**

Our review is basically statistical, rather than analytical. The focus is upon the primary SRO arbitration fo-

runs, NASD and NYSE, from which all but a handful of the Awards have issued. Our Survey Charts present the results in aggregate form, broken out in Chart I, by forum, and in Chart II, by the top ten states (based on number of Awards). The included Awards reflect claims of defamation made by brokers and, occasionally, by members or managers against brokers.

For instance, there were four Awards, among the 153 defamation Awards isolated on the SAC Award Database, in which both sides in an intra-industry dispute made defamation claims. We treat these four Awards as though the dual claims constituted separate Awards in our Survey Charts, so that the total number of Award results tabulated is 157.

There are also Awards where brokers have alleged defamatory statements against customers (e.g., in *Advest v. Olaik*, SAC ID #8909007, a broker won \$189,000 against a customer on defamation claims). We have excluded these customer-related Awards from the Survey, as our focus targets industry disputes generally and Form U-5-related Awards in particular.

#### **Defamation Counterclaims**

Claims of defamation arise as original claims in arbitration and, sometimes, as counterclaims in response to claims from the opposing party. For instance, a branch manager in *Bender v. Shearson*, SAC ID #9401100, charged defamation in response to various claims by a terminated broker, and won \$7,500 on his counterclaim. More often, brokers will respond to claims for amounts owed by former employers with defamation counterclaims. We include such counterclaims in the Survey and, because they represent a different dynamic as counterclaims, we present these counterclaim results separately in Chart I, the Forum Chart. In these instances, the amounts claimed and

awarded derive from the counterclaim, not the "main" claim in the dispute.

We also, by necessity, included the full amount of the dollars claimed and awarded in the Survey Charts, with one exception. In *Prescott Ball & Turben v. Kanuth*, SAC ID #8912058, \$38.23 million was awarded to a single individual on a complex counterclaim, but \$1 million was specifically allocated to a defamation claim. In that case, we used the full claim amount of almost \$68 million in our Survey Charts (because the amount claimed for defamation was not specified), but only \$1 million in the Total Award column.

Counterclaims were the vehicle for raising the defamation issue more than a quarter of the time. There were 86 counterclaims among the 153 intra-industry Awards surveyed. Of these 86 counterclaims, 46 were counterclaims of defamation brought in response to the claims of an initiating party (usually a BD-Claimant). We found that 18 of the 46 defamation claims involved purportedly defamatory statements specifically related to the Form U-5 process. One caveat here — the information supplied in Awards about counterclaims, particularly in NYSE Awards, is often cryptic, sometimes non-existent. Thus, Awards revealing defamation claims may also have involved Form U-5 problems that were not detailed in the Award summary.

#### **The Survey Charts**

##### **The Forum Chart**

Twenty-three of the 46 defamation counterclaims were sustained to some degree, a 50% win rate, and \$2.43 million was awarded to counterclaimants. Of the 111 "Main" claims asserted, which included charges of defamation, \$13.7 million was awarded to Claimants in 73 of the instances (66% win rate). At NYSE, where 83 of the 157

*cont'd on page 6*

**DEFAMATION SURVEY** *cont'd from page 5*

claims were tried, the win rate for Claimants was higher than the norm (72%) and lower for Counterclaimants (46%). The largest NYSE Claimant award was \$750,000 (*Roffman v. Janney Montgomery*, SAC ID #9011001) and the largest Counterclaimant award was \$270,700 (*Fahnestock & Co. v. Waltman*, SAC ID #8911217).

Fewer of the defamation Awards were NASD-sponsored. While many of the NASD Awards in our Survey were subscriber-contributed, we can claim a complete sample only from October 1, 1993 forward. That was the date NASD began making intra-industry Awards publicly available. Sixty-nine of the 157 defamation award results were NASD-issued. The win rate

for Claimants was 58% and for Counterclaimants 59%, much less of a difference than at NYSE. The largest NASD Claimant award was \$1.8 million (*Berkeley v. PWI*, SAC ID #9011122) and the largest Counterclaimant award was \$1.0 million (*for defamation only: PBT v. Kanuth, supra*).

Overall, \$6.2 million of the \$13.7 million in monetary awards flowed from NYSE Awards, while \$6.8 million came from NASD Awards. NASD Awards were also higher in average amount awarded, \$183,000 versus \$117,000 at NYSE. There were three NASD Awards in the Survey, where \$1 million-plus monetary awards were granted (*Berkeley; Glennon v. DWR* - \$1.7 million

(SAC ID #9310044); and *Kanuth*). Excluding these Awards makes the average NASD Award less than \$70,000.

In terms of recovery on the claims, note that, as to NYSE Awards, only about two-thirds of the compensatory amounts claimed relate to the "Main" claim Awards (where the defamation claim is brought by Claimant), while nearly 90% of the amounts awarded go to these Claimants. At NASD, the results are similar. The compensatory claims for Claimants are less than half of the amounts claimed by Counterclaimants, yet Claimants are awarded nearly three-quarters of the award monies. Smaller recoveries and lower win rates may indicate, as one possible explanation, that somewhat less

**Chart I - Distribution by SRO Forum**  
(May 1989 thru Dec. 1994)

SRO Forum	No. of Awards	No. Win Awards	Total Amt Claimed (\$000 omitted)	Tot. Comp. Claimed (\$000 omitted)	Total Amt Awarded (\$000 omitted)	Related Comp. Clmd (\$000 omitted)	Win/Loss Percentage (Col. 2/Col.1)
<b>NYSE</b>	83	54	197,564	168,000	6,214	109,651	65%
Main	61	44	144,820	115,256	5,577	97,483	72%
C/C	22	10	52,744	52,744	637	12,168	46%
<b>NASD</b>	69	40	305,773	225,339	6,770	118,924	58%
Main	47	27	143,030	62,596	4,977	38,251	58%
C/C	22	13	162,743	162,743	1,793	80,673	59%
<b>ALL SROs</b>	157	96	508,973	397,974	13,696	231,595	62%
Main	111	73	292,871	181,872	11,266	138,754	66%
C/C	46	23	216,102	216,102	2,430	92,841	50%

Tot. Comp. Claimed = Compensatory damages as claimed by the aggrieved party, aggregated for all surveyed Awards.  
Related Comp. Claimed = Compensatory damages as claimed by the aggrieved parties, aggregated for all "win" Awards

credibility attaches to claims filed in response to claims already made.

**The State Chart**

Our State Chart lists the top ten

states, in terms of number of Awards dealing with defamation claims in intra-industry disputes. These 10 states account for 129 of the 157 award results, or 82% of the whole. New York

and California together account for almost half of the total. The win rate on defamation claims in New York, where absolute immunity on Form U-5 filings

*cont'd on page 7*

**DEFAMATION SURVEY** *cont'd from page 6*

is generally viewed as current state law (see, Brooks-White article), is slightly higher than the overall average of 62%.

The highest win rate, based on the selected situs for our surveyed Awards, appears in District of Columbia-based Awards. An astounding 100% win rate is reflected. Admittedly, there are only

five Awards in this category (one of which was the *Kanuth* Award), but the results stand out nonetheless (see, also, the Brooks-White article on DC law).

Among the top five states, New York and California had the most Awards; yet, it is Florida (75%) and Pennsylvania (71%) which display the highest overall win rates. Moreover,

Pennsylvania, while fifth in the numbers tally, ranks third in terms of dollars awarded, almost \$1 million. California ranked lowest among the top five in sustaining defamation claims. In California and Texas both, defamation seemed to fare most poorly as a counterclaim (38% and 34% win rates, respectively).

*cont'd on page 8*

## Chart II - Distribution by Top Ten States

(May 1989 thru Dec. 1994)

Top Ten States	No. of Awards	No. Win Awards	Total Amt Claimed (\$000 omitted)	Tot. Comp. Claimed (\$000 omitted)	Total Amt Awarded (\$000 omitted)	Related Comp. Clmd (\$000 omitted)	Win/Loss Percentage (Col. 2/Col.1)
New York	49	31	209,848	170,673	4,802	82,872	64%
California	26	12	66,211	45,484	1,453	3,385	47%
Texas	12	8	22,249	22,249	573	17,203	67%
Florida	8	6	6,364	5,777	245	5,215	75%
Penn.	7	5	6,373	6,373	999	4,273	71%
Mass.	6	2	15,150	15,150	51	1,900	34%
Okla.	6	3	4,573	4,210	305	2,300	50%
Wash. DC*	5	5	69,791	69,791	1,328	69,791	100%
Mich.	5	2	6,436	6,436	172	5,536	40%
Ohio	5	3	15,660	10,460	586	5,359	60%
All States	157	96	508,973	397,974	13,696	231,595	62%

Tot. Comp. Claimed = Compensatory damages as claimed by the aggrieved party, aggregated for all surveyed Awards.  
Related Comp. Claimed = Compensatory damages as claimed by the aggrieved parties, aggregated for all "win" Awards.

\* In the tally for DC-based Awards, *Prescott Ball v. Kanuth*, SAC ID #8912058, accounts for \$67.4 million of the amounts claimed and \$1.0 million of the total amount awarded.

**DEFAMATION SURVEY** *cont'd from page 7***Additional Measurements****Form U-5/Defamation**

Not all of the defamation Awards in our Survey related to statements made on the Form U-5 Notice of Termination. *Glennon* was more of a retaliatory discharge case and *Kanuth* was primarily a breach of contract case. It is not feasible to isolate Awards with scientific precision into U-5 and non-U-5 categories, because summaries are often inadequate; yet, the attempt was important to us for several reasons. For one thing, defamation defenses differ when Form U-5 regulatory statements are not involved in the claim. This could affect results. Secondly, reformation of the Form U-5 is frequently as valuable to the claiming broker as monetary damages. We selected those Awards which displayed definite U-5 allegations from among the total universe of 153 industry-related defamation cases.

We found 57 such Awards. In 39 of the cases, the allegations of Form U-5 defamation appeared in the “main” claim; the other 18 were pled by way of counterclaims. The 39 “main-claim” Awards revealed nine outright losers and 30 instances (77% win rate) in which some relief was granted to Claimants. That relief at times was solely non-monetary relief, by way of reformation (i.e., Arbitrator-ordered amendment) of the Form U-5. At times, the relief was solely monetary (either because reformation was not requested or the request was denied). Still other instances disclosed a combination of monetary relief and reformation. Reformation requests were granted in 23 of the 39 “main-claim” Awards.

The remaining Awards had allegations of defamatory Form U-5 statements in the counterclaims. Unlike the generally poorer showing for counterclaims vs. main claims in the overall universe of 153 Awards, in this subcategory counterclaims of defamation fared just as well. Fifteen of the 18 counterclaims (83%) brought monetary and/or non-monetary relief to the grievant. When reformation of the Form U-5 was

requested (in 11 instances), it was granted 77% of the time.

Overall, this subcategory of the defamation Awards displays a very high win rate. If, though, one ignores the cases in which reformation was the sole relief granted on the defamation claim, there would only be 32 favorable Awards among the 57 — or a revised win rate of 56%.

**Award Frequency**

While there exists a perception, fed perhaps by a small group of fairly spectacular Awards, that the frequency and size of defamation Awards are intensifying, the statistics are not persuasive. As to growing size, the *Kanuth*, *Berkeley*, and *Glennon* Awards are all more than two years old. In January 1995 (outside our survey period), the largest Award involving defamation was rendered. Compensatory damages of \$625,000 and \$1.2 million in punitive damages were imposed by an all-industry, Tampa-based, NASD Panel (*Ulrich v. Eaton Vance Distrs.*, NASD ID #93-00281). Then, this past July, a Clearwater, FL, NYSE Panel charged Prudential Securities \$327,100 on claims of defamation, fraud and breach of fiduciary duty, in connection with the firm’s limited partnership problems (*Betty Allen v. PruBache*, NYSE ID #1994-004253).

To assess whether the number of defamation Awards may be on the rise, we reviewed only the NYSE Award figures. Industry-related NASD Awards only became publicly available commencing two years ago. NYSE, on the otherhand, has been issuing intra-industry Awards for public consumption since May 1989. NYSE also has a higher percentage of its docket, historically, dedicated to industry-related matters. NYSE has issued between 12 and 14 defamation Awards each year since 1990, except in 1992, when the number rose to 22. While more matters in this genre may be arising and getting settled, the stream of actual Awards in this area over the last five years remains relatively steady.

**Exemplary Damage Awards**

Given the vitriolic nature of defamation disputes, particularly where wrongful termination or discrimination claims are intermixed, the actors involved often operate at a high level of intensity. One might expect that the explosive ingredients for “wanton,” “malicious,” and “outrageous” conduct would appear with some greater frequency in this genre of disputes than in the usual customer case and, as a consequence, that punitive awards might sometimes result.

As a matter of fact, we found that 10 of the 153 Awards in our Survey period included punitive relief, four each at NASD and NYSE and two at other SROs. In our survey of all punitive damage Awards in SRO arbitration, 6 SAC 11&12(13), we found that punitive sanctions were exacted in only about 2% of the surveyed Awards. In this category, however, the use of this extraordinary tool more than triples in frequency.

Most illustrative of the personal nature of these cases is the fact that Arbitrators have awarded emotional distress damages in three of the Awards in our small universe of 153 Awards. Among the nearly 15,000 Awards in SAC’s Award Database, there are only four others where relief for infliction of emotional distress has been granted.

**Conclusion**

Defamation cases in arbitration are a natural outflow of both the competitive and regulatory dynamics in the securities industry. While there are state laws that accord brokerage firms either qualified or absolute privileges for statements made in response to regulatory requirements and inquiries, there is also a high incidence of grievants achieving some form of relief. This will be interpreted by some as an indication that arbitrators are willing to ignore the law. If one declines to make that assumption, the likely explanations become the potential existence of defamatory statements outside the regula-

*cont'd on page 9*

**DEFAMATION SURVEY** *cont'd from page 8*

tory context, which appears probable in many of the disputes surveyed. It may be, too, that the threshold standards for liability, i.e., the presence of malice in the qualified privilege situation, were proved, in the view of the arbitrators.

In any case, there are some spectacular instances of "strong messages" from individual Arbitration Panels, where liability was found. A number of the Awards surveyed reach six and seven figures. Reformation of the U-5 statements was a common remedial tool, where the defamatory allegations related to inaccurate regulatory filings. We found as well a relatively high incidence of punitive damage sanctions. The highest damage Award in SRO arbitration history, *PBT v. Kanuth*, lies in this genre. Among total damages assessed of \$38.2 million, there was \$1 million in punitive damages, \$1 million in emotional distress, and \$1 million in express defamation damages.

*Kanuth* not only illustrates the range of damage remedies arbitrators are willing to exercise against abuses in these

angry, post-termination situations. It also demonstrates that defamation itself, while a serious and independent cause of action, is only one of the by-products of the competitive strain and emotional reactions that characterize employment disputes. Poorly handled situations breed defamation claims and damages will more likely flow where severance of the employment relationship is clumsy, hasty or insensitive.

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**SECURITIES ARBITRATION COMMENTATOR**

- Editor and Publisher: Richard P. Ryder, P.O. Box 112, Maplewood, N.J. 07040. Business Office: 6 1/2 Highland Place, Maplewood, N.J. 07040 (201) 761-5880. FAX No. (201) 761-1504. Copyright © 1995 Securities Arbitration Commentator. No part of this publication may be reproduced in any manner without the written permission of the publisher.

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