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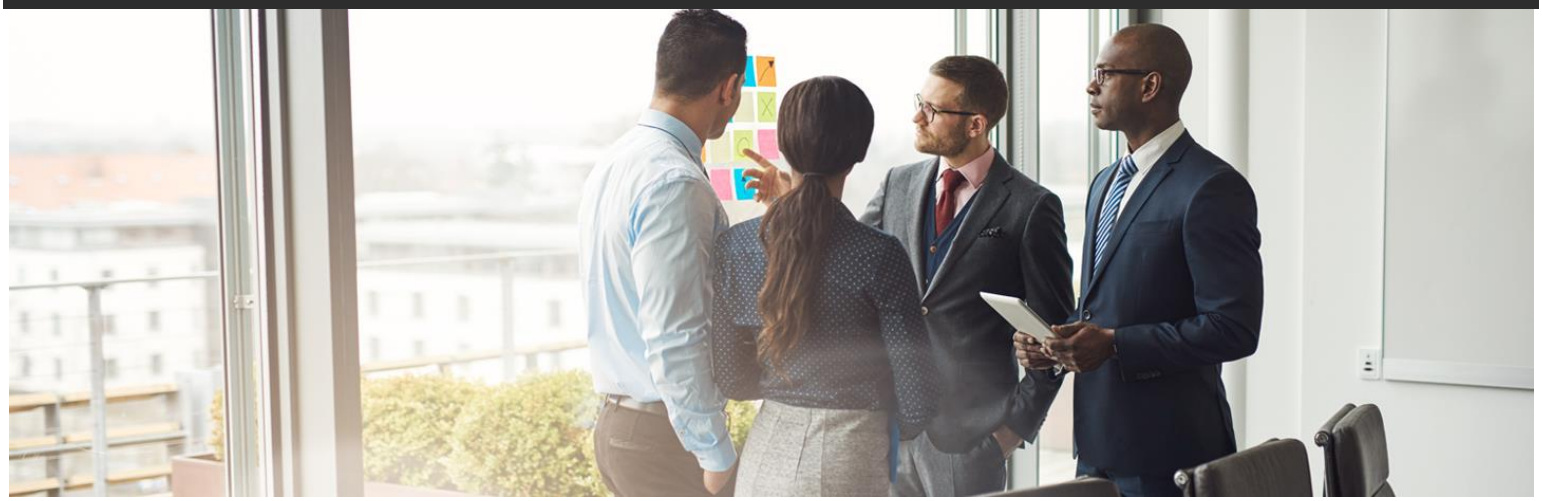

October 2023

SEC Broadens Scrutiny of Employment and Separation Agreements Under Whistleblower Rule

In September 2023, the Securities and Exchange Commission (SEC) announced three separate enforcement orders reflecting a renewed interest in and scrutiny of provisions in employment agreements and separation agreements. These three settled cases resulted in cease-and-desist orders, fines, and other sanctions against a registered investment adviser, a public company, and a privately held company in connection with provisions in employment and separation agreements the SEC deemed violated Rule 21F-17(a), which protects against actions taken to impede whistleblowers. In one case, the SEC imposed a $10 million penalty against an investment adviser in part based upon a standard "Confidential Information" provision contained in employment agreements the adviser required new employees to sign as part of the onboarding process. These orders reflect not only a broad range of provisions and practices that the SEC views as impeding securities law whistleblowers, and a broad range of employers, but also a broad scope of time: the orders address conduct dating back to the rule's initial adoption in August 2011.

Rule 21F-17(a) under the Securities Exchange Act of 1934 provides: "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement…with respect to such communications." In past years, the SEC has taken action under the rule primarily against securities registrants (including broker-dealers and registered investment advisers), public companies, and other companies directly involved in securities markets, and frequently involving direct actions impeding whistleblowers. In September 2023, however, the SEC took action involving employment agreements or

practices it believes may tend to discourage whistleblowers, even if no employees were shown to have been impeded or deterred from communicating to the SEC staff about a possible securities law violation:

- On Sept. 29, 2023, the SEC imposed a cease-and-desist order and $10 million penalty against a registered investment adviser that, between August 2011 and April 2019, required new employees to sign employment agreements that prohibited them from disclosing "Confidential Information" to anyone outside of the company unless authorized by the company or required by law or an order of a court or other regulatory or governmental body, without any exception for voluntary communications with the Commission concerning possible securities laws violations. In addition, the company required approximately 400 of its departing employees to sign general releases and agreements affirming that they had not filed any complaints with any governmental agency, department, or official in order to receive deferred compensation and other benefits that were sometimes worth millions of dollars. Departing employees who did not execute general releases and agreements were provided with exit letters that specified "all provisions of your Employment Agreement…shall remain in full force and effect," and this included the provision prohibiting disclosure of Confidential Information unless such disclosure had been authorized by the company. The SEC found that the company's employment agreements, written releases, and related practices raised impediments to employees from engaging in whistleblowing.
- On Sept. 19, the SEC imposed a cease-and-desist order and $375,000 penalty on a public company for having entered into separation agreements since 2011 that required employees to represent they had not filed any complaint or charges against the company with any state or federal court, state, or federal agency. In 2015, the company added carve-out language to its agreements indicating that nothing in the agreement prohibited the employee from filing a charge with or participating in an investigation or proceeding by the EEOC, NLRB, SEC, DOJ, or comparable federal, state, or local agency. The SEC found, however, that because the carve-out was prospective in application, it did not remedy the impeding effect of the employee representation.
- On Sept. 8, the SEC imposed a cease-and-desist order and a penalty of $225,000 on a privately held LLC that, between February 2020 and March 2023, entered into 22 separation agreements that stated "nothing in this agreement is intended to limit in any way your right or ability to file a charge or claim with any federal, state or local agency," but the agreement also took away an employee's right to recover a monetary award for filing a claim with, or participating in an investigation or action by, a governmental agency. The Commission held "the agreements raised impediments to participation in the Commission's whistleblower program by having the employees forego the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations."

Given the wide scope of these orders, all companies, even those not directly involved in the securities markets, should consider reviewing their employment, separation, and similar employment-related agreements and practices to ensure nothing could be construed as discouraging securities law whistleblowing. In particular, the agreements should expressly carve out communications with the SEC from any confidentiality clauses or similar restrictions, contain no affirmation relating to filing a complaint with any governmental agency department or official, and contain no restriction upon receipt of whistleblower awards. The SEC is prepared to act against any company relating to any provision or practice it believes tends to discourage contact about possible securities law violations. Although this GT Alert summarizes recent developments under the federal securities laws, employers may also be subject to other federal or state laws or regulations with similar whistleblower protections. For example, in March 2023 GT reported on a ruling from the National Labor Relations Board (NLRB) that severance agreements with broad – yet common – confidentiality and non-disparagement provisions are unlawful

because of their chilling effect on employees' exercise of their rights under the National Labor Relations Act (NLRA), including the right to disclose that the employer had violated the NLRA, to file charges or assist with NLRB investigations, and to discuss the terms of the severance agreement or prior employment with former coworkers.

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