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SEC Focuses on Confidentiality Provisions and Whistleblower Rule Compliance

Time to Review Confidentiality Agreements and Policies

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originally published by *Corporate Compliance Insights* on November 29, 2016

The SEC's Office of Compliance Inspections and Examinations (OCIE) recently issued a risk alert advising that it is examining registrants' compliance with the whistleblower provisions of the Dodd-Frank Act. The notice follows recent enforcement actions brought by the Commission against public companies and registrants arising from confidentiality provisions in employee agreements and separation agreements that do not specifically carve out reporting potential violations to the SEC. The Commission views any restrictive language in confidentiality provisions which does not explicitly carve out an employee's right to report potential violations to the SEC as potentially chilling whistleblowers' willingness to come forward with such information. The OCIE alert highlights the importance for registrants and any other entity subject to SEC jurisdiction to review their policies, procedures, employment and separation agreements and other documents to ensure they are compliant.

The Dodd-Frank Act Whistleblower Provisions and SEC Rule 21F17

Following the financial crisis, the Dodd-Frank Act was enacted, and, among other things, it authorized the SEC to establish an Office of the Whistleblower and to provide monetary awards to whistleblowers of 10 to 30 percent of the sanction collected in any action. The purpose of the whistleblower provisions was to incentivize whistleblowers possessing credible information about federal securities law violations to report those violations to the SEC. Since the Act's establishment, the SEC has awarded over $100 million to 34 whistleblowers, including individual awards as high as $30 million. During this time, the SEC has received over 10,000 tips from whistleblowers.

The Dodd-Frank Act also prohibited retaliation by employers against individuals who provide the Commission with information about possible securities violations. In implementing this provision of the law, the SEC adopted Rule 21F-17 of the Securities Exchange Act of 1934, which provides that "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."

Perhaps more notable than the number of awards the SEC has issued or the tips the SEC has received is that, since Rule 21F-17's inception, the SEC has brought several cases alleging violations of the Rule, thus highlighting the need for employers to ensure that their policies, procedures and agreements do not run afoul of the Rule and are not viewed as hindering whistleblowers from coming forward to the SEC. All of the SEC cases alleging violations of Rule 21F-17 concerned language in confidentiality provisions which, in the SEC's view, either could have or did have a chilling effect on whistleblowers coming forward and reporting potential violations to the SEC.

Language Within Confidentiality Provisions that the SEC Viewed as Violative

The specific confidentiality provisions that the SEC found ran afoul of the rule were the following:

- Prohibiting employees from disclosing information regarding the company to anyone without notice and/or clearance from the company's legal counsel.
- Requiring that an employee pay the company $250,000 if the employee violated the confidentiality provision, which prohibited disclosure of confidential information without a specific carve out for reporting to a government agency.
- Requiring that employees agree that, if the employee files a charge with an administrative agency, including the SEC, the employee waives any right to a monetary recovery in connection with that action.
- Including in severance agreements a waiver and release clause that, while not prohibiting a former employee from participating in a government investigation, prohibits that former employee from filing an application or accepting a whistleblower award from the Commission.

The OCIE alert highlights the remedial steps taken in these enforcement actions, which included:

- Revising documents to make clear that nothing contained in those documents prohibits employees or former employees from voluntarily communicating with the Commission or other authorities regarding possible violations of law or from accepting a Commission whistleblower award;
- Providing general notice to employees, or notice to employees who signed restrictive agreements, of their right to contact the Commission or other authorities; and
- Contacting former employees who signed severance agreements to inform them that the company does not prohibit them from communicating with the Commission or seeking a whistleblower award.

Not surprisingly, given these recent enforcement cases, OCIE goes on to state that it is citing deficiencies and making referrals to the SEC's Division of Enforcement when examining registrants' compliance with Rule 21F-17.

Conclusion

As the OCIE risk alert states, registrants should review and evaluate their compliance manuals, codes of ethics, employment agreements, severance agreements and other documents to ensure they could not be deemed to violate Rule 21f-17. This includes reviewing prior severance agreements with former employees for which a confidentiality provision may still be applicable. Although the risk alert is targeted at registrants, public companies subject to the provisions of Rule 21F-17 should do the same. As OCIE states in its release, and in line with the Commission's "broken windows" approach, the staff is referring potential violations to the Division of Enforcement.

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