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Insights

EMPLOYMENT AGREEMENTS IN THE SEC'S CROSS-HAIRS: WHAT EMPLOYERS SHOULD DO NOW

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Over the past several months, the U.S. Securities and Exchange Commission ("SEC") has concluded several aggressive enforcement actions related to supposed violations of Rule 21F-17 under the Securities Exchange Act of 1934, as amended (the "Rule"). The Rule prohibits any person from taking action to "impede" an individual from communicating directly with the SEC regarding possible securities law violations, including by "enforcing, or threatening to enforce, a confidentiality agreement… " In the most recent actions, the SEC took the position that certain employers' agreements, which included provisions very similar to those that many employers include in their standard templates, run afoul of the Rule.

The SEC has made clear that enforcement of the Rule remains at the top of its agenda. In fact, the Director of the SEC's Division of Enforcement warned that companies with contractual provisions similar to those discussed below "should take … seriously their obligations to ensure that they don't impede whistleblowers from contacting the Commission." Employers should understand the provisions at issue, review their own template agreements and policies, and take action.

Takeaway #1: Do not require an employee to seek permission before contacting the SEC.

In one of the SEC's recent enforcement actions, the target paid a *$10 million* civil penalty for, among other things, including the following provisions in its employment and severance agreements:

> **Employment Agreements:** The SEC took issue with two provisions of employment agreements signed at the time of hire.
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> Employees were prohibited from disclosing "Confidential Information" *absent* (a) permission from the employer, or (b) "as may be required by any applicable law or by order of a court of competent jurisdiction, a regulatory or self-regulatory body, or a governmental body or a court order/subpoena…"
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> The term "Confidential Information" was defined broadly enough that it could reasonably include *any* information gained in the course of employment that could be damaging to the

company.

Taken together, the SEC found these provisions violated the Rule. The SEC took the position a "carve out" excluding court orders from these confidentiality obligations was not enough, and that the documents *must* contain an *affirmative* statement that employees are permitted to share information with the SEC regarding possible securities law violations without notice or approval.

> **Separation and Release Agreements:** Employees signed severance agreements reminding them of the restrictions in their employment agreements (discussed above) and confirming that they had not filed any complaints with any governmental agency, department, or official. If employees did not sign the severance agreement's related release, they would not be eligible to receive deferred compensation and other benefits, sometimes worth millions of dollars.
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> The Employee represents and warrants to the Company that the Employee has not made, filed or lodged any complaints, charges, or lawsuits or otherwise directly or indirectly commenced any proceeding against any member of the [Company] and/or any Covered Persons and Entities with any governmental agency, department, or official; any regulatory authority; or any court, other tribunal, or other dispute resolution body.

Even the employer's substantial remedial measures—like emailing all employees who had signed a severance agreement and its related release and advising them they were allowed to communicate with the SEC—was insufficient to avoid a significant penalty.

Takeaway No. 2: Do not require an employee to provide advance warning prior to reporting any violation.

One of the separation agreements in question required employees to provide *one* business day's advance notice before making a complaint to an administrative agency so that the employer could "take all steps it deems to be appropriate to prevent or limit the disclosure." The aim of this provision was to potentially seek a protective order to guard the company's trade secrets and proprietary information from being disclosed in public.

The SEC found the provision had the potential to impede whistleblowing and imposed a penalty despite the agreement including an *explicit* "carve out" for SEC whistleblowing: "Nothing in this Release prevents me from . . . giving truthful testimony, or truthfully responding to a valid subpoena, or communicating or filing a charge with government or regulatory entities (such as the Equal Employment Opportunity Commission, National Labor Relations Board, Department of Labor, or Securities and Exchange Commission.)"

Takeaway No. 3: Employees must be permitted to receive an SEC monetary "bounty" for their reports of securities violations, and an employment agreement cannot prohibit them from receiving monetary compensation.

Two provisions from two different employment agreements regarding compensation resulting from reporting unlawful conduct drew the attention of the SEC:

> "These [governmental] agencies have the authority to carry out their own statutory duties by investigating charges or claims, issuing determinations, filing lawsuits in their own name or taking other action authorized by statute. You retain the right to participate in any such action, but not the right to recover money damages or other individual legal or equitable relief awarded by any such governmental agency."

> "Nothing in this Section shall be construed or deemed to interfere with any protected right to file a charge or complaint with any applicable federal, state or local governmental administrative agency charged with enforcement of any law, or with any protected right to participate in an investigation or proceeding conducted by such administrative agency. You are however waiving your right to any monetary recovery or other individual relief in connection with any charge or complaint filed by you or anyone else."

The SEC charged that this language interfered with former employees' right to receive monetary whistleblower rewards, or "bounties," in connection with providing information to the SEC related to securities law violations. Notably, nothing about these restrictions prohibits an employee or former employee from reporting—only receiving compensation for the report. The SEC held that did not matter, because the loss of the opportunity from a bounty constituted an unlawful impediment.

Takeaway No. 4: Use caution when including representations as to prior reporting.

An employer's severance agreement included the following representation:

> Employee represents and acknowledges [t]hat Employee has not filed any complaint or charges against [Employer], or any of its respective subsidiaries, affiliates, divisions, predecessors, successors, officers, directors, shareholders, employees, representatives or agents (hereinafter collectively "Agents"), with any state or federal court or local, state or federal agency, based on the events occurring prior to the date on which this Agreement is executed by Employee."

The agreement also contained language that an employee could not sign the agreement until *after* the termination date. Because of the potential "gap" between when an employee learned of an SEC violation, and signing the agreement making the representation, the SEC concluded this could impede a potential whistleblower from reporting complaints to the SEC based on information they learned *between termination and execution of the agreement*.

Where an employer must provide a review period after the employee receives the draft severance agreement (e.g., a state with recent laws providing a 14-day review for certain employment agreements), the SEC's ruling could put employers in a bind between SEC compliance, state law compliance, and the practical realities of terminating an employee with severance benefits.

Action Items and Final Thoughts

Companies should review their employment agreements (both templates and previously executed agreements) and policies to ensure that they:

- expressly allow current and former employees to share information with the SEC regarding possible securities law violations;
- do not require employees to provide notice to the employer or obtain its consent before reporting potential legal violations; and
- do not restrain current and former employees to receive monetary recovery (an SEC "bounty) in connection with providing information to the SEC related to securities law violations.

Further, the SEC's rulings make clear that they do not apply to agreements only on a going forward basis—even agreements signed years ago could form the basis of an order finding an employer violated the Rule. Employers should consider whether, and how, to notify applicable parties (including former employees) that they are not prohibited from reporting complaints or sharing information with the SEC about potential securities law violations. Moreover, although most of these cases have been aimed at public companies, it is clear that the SEC views the rule as applicable to private companies as well.

More broadly, these SEC rulings are the latest in a series of rebukes of language in employment agreements by state and federal authorities. For example, in February 2023, the National Labor Relations Board challenged an employer's right to include in a severance or other employment agreement confidentiality and non-disparagement provisions that, in its estimation, would "chill" or discourage an employee from filing an unfair labor practice charge. Moreover, a number of state regulatory authorities have also been busy passing new statutory restrictions on broad confidentiality provisions in employment agreements. Employers should review their agreements and policies carefully to avoid liability, and consult with counsel regarding steps that may be appropriate to address language in existing employment and severance agreements.

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