Hiring to Firing Podcast* — Navigating Employment and Separation Agreements: Lessons From Al Pacino's *Serpico
Hosts: Tracey Diamond and Evan Gibbs
Guests: Sheri Adler and Mary Weeks

Tracey Diamond:

Welcome to *Hiring to Firing*, the podcast. I'm Tracey Diamond, labor and employment attorney at Troutman Pepper, and I'm here with my co-host, Evan Gibbs. Together, we tackle all employment and HR issues, from hiring to firing. Today, we're joined by our partners, Sheri Adler, a member of our executive compensation team, and Mary Weeks, from our business litigation group. Sheri and Mary, Hi, so nice to have you here. Why don't you introduce yourselves?

Sheri Adler:

Thanks so much, Tracey. It's great to be on the podcast. I'm Sheri Adler, a partner in our employee benefits and executive compensation practice, based in Philadelphia. I counsel clients on all types of executive and director compensation arrangements, and I focus on public company arrangements and related SEC disclosures. I also provide support on the compensation and benefits aspects of corporate transactions, like mergers and acquisitions.

Mary Weeks:

Hi everyone, and thanks for having us. I'm Mary Weeks, a partner in our business litigation section here in Troutman Pepper. I co-lead the firm's securities, corporate governance, and D&O defense litigation group. My practice is primarily in the areas of securities litigation, SEC enforcement, and government investigations.

Evan Gibbs:

All right. We asked Sheri and Mary to join us today to talk about the SEC's recent focus on provisions on employment and separation agreements that the SEC felt discouraged potential whistleblowers from voluntarily contacting the agency about securities law violations. In light of this focus, Sheri and Mary have developed top 10 tips for drafting and revising these agreements to ensure that they're compliant. And I can tell you, from my perspective, this is an issue that often gets overlooked or minimized by some attorneys. So I think this is a really good, timely topic.

Tracey Diamond:

Yeah, I agree Evan. I think that it's been business as usual, where clients have been using the same form of agreement for many years, and they really need to take notice of the fact that the SEC is looking at this, both for not only public companies, but also private companies because it really changes the way their agreements are written, and they need to make some serious changes.

Given that we're talking about the rights of whistleblowers, we thought, as always, that we'd take a movie or a TV show to kick off our discussion. Today, the movie that we chose is the classic movie, *Serpico*, starring a very young Al Pacino. It was really fun seeing Al Pacino at such a young age, and he really is such an incredible actor. Pacino plays Frank Serpico, a New York City cop who sought to blow the whistle on widespread corruption in the department. Serpico is basically ignored, or pushed away with empty promises. Let's start off by listening to a clip of a conversation between him and his police captain, Captain McClain.

Captain McClain:

My God, Frank, this is confidential.

Frank Serpico:

He's a police officer, I thought maybe he could sit in.

Captain McClain:

No, absolutely not.

All right. All right. Frank, I notified Commissioner Delaney about everything you told me. He wants you to stay right where you are and continue to collect information. Then you'll be his eyes and his ears. He said he was delighted that, quote, a man of integrity had surfaced, unquote.

Frank Serpico:

When do I hear from him?

Captain McClain:

Well, he said he'd reach out to you when the time comes.

Frank Serpico:

Reach out? See, now my situation's pretty sticky up there. I mean, what am I supposed to do? Just wait for him to-

Captain McClain:

You must have patience, Frank.

Frank Serpico:

Yeah, but it's pretty sticky.

Captain McClain:

When a man like the commissioner says he'll get in touch with you, he'll get in touch with you. Goodbye, son. God bless you.

Tracey Diamond:

Serpico finally discloses to Captain McClain that he has gone outside the department to report the corruption, to quote, outside agencies. And he does this because he's so frustrated that nobody's really taking him seriously. Let's listen to a clip of what happens next.

Captain McClain:

Good to see you again, Frank.

Frank Serpico:

I'm finished.

Captain McClain:

What's wrong?

Frank Serpico:

I can't take it anymore. I got to get out. If I have to go back to uniform, I'm going back to uniform. I can't wait for Delaney to call and I can't play their game anymore. I'm right in the middle. I can't take it, right?

Captain McClain:

You mean to say the commissioner didn't get in touch?

Frank Serpico:

No, he didn't get in touch with me. Not a word. No investigation, no undercover work, nothing.

Captain McClain:

I had no idea, Frank.

Frank Serpico:

Well, captain, I think it's only fair to tell you I've been to outside agencies. I'm going to go to more if I have to.

Captain McClain:

What outside agencies? Holy Mother of God. Frank, we wash our own laundry around here. Now you could be brought up on charges for this.

Frank Serpico:

I always thought so, but the reality is so-

Captain McClain:

We do not wash our own laundry. It just gets dirty. You are in trouble.

Frank Serpico:

I don't care if I'm in trouble. I don't care who gets it anymore, including myself because if I have to go to outside agencies, somebody to hear my story, where am I going to go?

Captain McClain:

You hear me, Serpico, stay away from-

Frank Serpico:

Where am I going to go?

Captain McClain:

You just wait until you hear from me.

Frank Serpico:

I've been waiting for a year and a half.

Captain McClain:

I'm going to get back to you, Frank.

Frank Serpico:

But where am I going to go?

Tracey Diamond:

In real life, the SEC takes the rights of employees to blow the whistle on securities law violations very seriously, particularly in recent years, and has gone after companies whose agreements do not carve out the rights of employees to participate or receive a monetary award for whistleblowing activities. Before we delve into that, however, Mary, let's start with you. Can you please explain the legal background as to where these whistleblower rights are even coming from?

Mary Weeks:

Yes. Happy to, Tracey. So Section 21F of the Dodd-Frank Act of 2010 provides for protections and incentives for whistleblowers reporting possible violations of federal securities laws. There are significant financial incentives for whistleblowers. In 2011, the SEC prescribed its rules relating to whistleblower activity under the rule, and the rule said that no one can take any action to impede a potential whistleblower from coming forward, and that includes by restricting disclosures under a confidentiality agreement. The SEC has enforced the rule violations through as many as 21 enforcement actions since about 2015, and five of those alone were settled via cease and desist orders in 2023.

Tracey Diamond:

So five in just the last year, huh?

Mary Weeks:

Yeah, it's definitely ramping up.

Tracey Diamond:

I should note that Frank Serpico did not receive a large monetary award for whistleblowing back in the day. I think the movie takes place in the 1970s. In fact, just the opposite. After he went to the New York Times with his story, he gets transferred to a dangerous narcotics department and during a drug raid, his partners hold back at a critical moment, questionably because of their dislike of him, and by doing that, they put him in harm's way and he actually was shot in the face, and this is based on a true story. After a long recovery, he testifies about police corruption before the Knapp Commission. Let's listen to a piece of his testimony as portrayed in the movie.

Frank Serpico:

Through my appearance here today, I hope that police officers in the future will not experience the same frustration and anxiety that I was subject to for the past five years at the hands of my superiors because of my attempt to report corruption. I was made to feel that I had burdened them with an unwanted task. The problem is that the atmosphere does not yet exist in which an honest police officer can act without fear of ridicule or reprisal from fellow officers. Police corruption cannot exist unless it is at least tolerated at higher levels in the department. Therefore, the most important result that can come from these hearings is a conviction by police officers that the department will change. In order to ensure this an independent permanent investigative body dealing with police corruption like this commission is essential.

Evan Gibbs:

Given the SEC's focus on agreements that restrict an employee from blowing the whistle, what are some drafting tips, Mary and Sheri, that a company should consider to avoid getting into trouble with the SEC?

Sheri Adler:

The first tip is that when an agreement has a standard provision that states that the employee can't disclose confidential information, it should also have a carve-out saying that the employee is not restricted from reporting possible violations of securities law to governmental agencies under whistleblower protection laws.

You want to state in the carve-out also that the employee doesn't need to go seek approval from the company before reporting a whistleblower claim and it doesn't need to go notify its employer after the fact either. This makes sense, right? The SEC's view is that if an employee has to notify the employer about reporting to the SEC, that employee is going to think twice about coming forward to the SEC. In other words, the notice requirement could have a chilling effect on employees seeking to come forward and therefore, according to the SEC, it's prohibited.

Tracey Diamond:

Is it sufficient for a carve-out to state that the agreement does not restrict the disclosure of confidential information pursuant to a formal legal process such as to a subpoena or a court order?

Evan Gibbs:

Yes. We see that a lot of times in a lot of agreements.

Sheri Adler:

And unfortunately not, and that is one of the pitfalls that we have seen is that some agreements have that, but the SEC has said that doesn't go far enough because it still wouldn't allow the employee to come forward voluntarily to report to the SEC. So, our second tip in all of this is just make sure that when you have your whistleblower carve-out, that it also allows for voluntary reporting.

Evan Gibbs:

Companies, of course, they want to protect as much of their confidential information as they possibly can. Are they able to at least limit the type of confidential information that can be disclosed by a whistleblower?

Sheri Adler:

Evan, in the absence of concerns about attorney-client privilege, confidential information should really be viewed as fair game when it comes to an employee reporting a possible securities law violation, and the carve-out should be drafted broadly to account for this. And that's our tip three.

Tracey Diamond:

Sheri, companies have gotten into hot water with the SEC. I understand that for including language and a release of claims, which is quite common, where the employee represents that

the employee hasn't previously filed any charges or complaints against the employer. What really is the issue with this sort of language?

Sheri Adler:

Tracey, the SEC essentially sees that language as a required notification to the company after the fact that a whistleblower claim was brought, because the employee has to report to the employer, no, I haven't brought anything in the past. And as we spoke about before, the SEC views it as problematic if the employee has to notify the employer after the fact that it brought a claim because that could really chill the whistleblowing activity in the first place.

So although this is very common language in releases, really want to make sure that you add language to the section of the release stating that that representation doesn't apply to whistleblower claims. And that's our tip four.

Evan Gibbs:

We now know the agreements need to clearly give the employee the right to come forward with a claim to the SEC, but can employers require in a separation agreement that as a condition of receiving severance, the employee must waive their right to a monetary award from the SEC under the whistleblower program?

Sheri Adler:

No. The SEC has come down on a number of companies who have tried to limit the whistleblower's activity to collect a monetary award in connection with a whistleblower claim. And so that's our tip five is not to restrict the whistleblower's ability to collect a monetary award under an agreement.

Evan Gibbs:

And that's interesting because this is acceptable in other areas of the law. For example, under the EEOC's guidance, an employee can waive their right to a monetary recovery for bringing an EEOC claim even though they can't legally limit the employee's right to bring the claim.

Tracey Diamond:

I think of all the tips, this is the one that surprised me the most because we do really see typically in these forms of agreement under the covenant, not to sue language, the carve-out for the right of an employee to bring an EEOC charge or a charge with a similar state agency, but there's always language that talks about how the employee's precluded from getting any kind of monetary relief. So this seems to be one really big exception here where an employee still has the ability to go to the SEC and even get a monetary award despite that covenant not to sue.

Evan Gibbs:

Yeah, I agree. This is standard language that we see in a lot of agreements. This really is standard. Every company that says, here's our template, check it out. I mean, this isn't all of them.

Tracey Diamond:

See, Evan, we actually agree about something. That's a rare thing. That's right.

Evan Gibbs:

That's right. It happens.

Sheri Adler:

I even agree with you guys because the idea right behind this is we're giving you a severance package, here are your separation benefits, here's your termination pay. But in exchange, we don't want you to be able to still go out and collect other monetary awards by using claims against us.

Tracey Diamond:

It does make sense from the company's standpoint, but from the SEC standpoint, we don't care what you've gotten in severance. We still want the employees to have a right to come up to us as whistleblowers, and we want to be able to incentivize you as an employee to do that.

Sheri Adler:

Right. The idea is it's not waivable by contract according to the SEC, right? The SEC has been very clear that these financial incentives for whistleblowers are just an integral part of the program, and that is a big incentive for why people will come forward in the first place and report these possible violations to the SEC. And so in their view, taking this away is just disincentivizing whistleblowers and undermining the whole rule.

Tracey Diamond:

Really interesting. All right. We have the top five tips so far. What else do you have for us, Sheri?

Sheri Adler:

We've been talking about money, right? We've been talking about monetary awards, but tip six has to do with the opposite, which is monetary penalties. In this one, the SEC hadn't pursued enforcement actions against companies who impose monetary penalties in their documentation on an employee when the employee breached an overbroad confidentiality provision that would restrict protected whistleblower activity.

This is really what we think of as our double whammy provision. You don't want to have an agreement that has an overbroad confidentiality provision in the first place that would prevent someone from coming forward to the SEC, and you certainly don't want to add onto that by then also penalizing them monetarily if they breach that overbroad confidentiality provision.

Tracey Diamond:

Yeah. I know of some clients in particular who always want to include or always wanted, I should say, to include liquidated damages provisions because it's so important to them that their confidential information remains confidential. I hope everybody's listening in, no liquidated damages provisions anymore.

Sheri Adler:

I don't think we're saying you can never have liquidated damages provisions or no penalties. I think the idea is just if your provision is overbroad, so you have to allow people to go forward to the SEC and report their whistleblower claims. If you just have liquidated damages if they otherwise breach their confidentiality provision, I don't think the SEC has any issue with that. It's just that you can't tell someone, you can't go to the SEC with a whistleblower claim and you can't punish someone for doing so.

Tracey Diamond:

Okay? So you can have a liquidated damages provision, but it better have a carve-out for your ability as an employee to go to the SEC if you're a whistleblower. Is that right?

Sheri Adler:

So I think if your agreement is drafted broadly enough, so it says you cannot disclose the company's confidential information. However, you are allowed to come forward and disclose confidential information to the SEC under whistleblower protection laws. You don't have to give notice to anyone, et cetera, et cetera. So you have a really good whistleblower carve-out, it's strong, and the SEC can't take issue with that. Then I don't see an issue with saying later, by the way, if you breach the confidentiality provision, you have to pay liquidated damages. You haven't done anything because it is not a breach of the confidentiality provision to go to the SEC with a whistleblower claim.

Mary Weeks:

I think you're right, Sheri, and that's especially true if there is a cross-reference in the agreement making clear say that the not overly broad provision allows you to go forward. That's the most important part.

Tracey Diamond:

Okay, so we spent a lot of time on confidentiality provisions. Mary, let's turn to you. What tips do you have outside of the realm of confidentiality?

Mary Weeks:

Yeah, and I think this is actually going to tie in well with the point we were just making about cross-referencing. Our last four tips really go towards taking a broad, holistic and consistent approach to compliance with the rule. It's not just about looking at the confidentiality provision at

the beginning of the agreement and making sure that that was broad enough, but that anything else that would weigh on that is also in compliance with the rule.

For example, an overbroad, non-disparagement or cooperation provision. The SEC has charged certain companies for rule violations when a non-disparagement clause is so broad that it impedes whistleblowers from communicating with the SEC. Back to that touchstone of the employee needs to be able to understand that they have a right to contact regulators without breaching an agreement, and that includes a non-disparagement clause.

So one way to do that would be as simple as having the non-disparagement provision of an agreement cross-reference the whistleblower carve-out that you appropriately did back with respect to some of our earlier tips. Again, it's just sort of looking at each agreement and saying holistically, have I put anything in this agreement that does not track with what we've already said, is the ability to contact the SEC without any penalty.

Evan Gibbs:

So, at that point, I think it's good to note here, under the McLaren Decision that came out from the National Labor Relations Board last year, at least with respect to non-supervisory employees, non-disparagement provisions aren't allowed as they go beyond your typical standard for a defamation claim. In other words, if false statements that are made with knowledge of their falsity or reckless disregard for the truth. I think that's a good tie in at that point.

Mary Weeks:

Yeah, and I will apologize in the interest of time, I suppose I really looped seven and eight in together. Tip number eight, setting aside non-disparagement clauses, it really covers just any clause that you have in an agreement, whether that be an employment agreement. We can talk about some of the kinds of agreements that are affected here. It's not just separation agreements. It can really be across the spectrum of an organization and all of their agreements and policies in place.

Tracey Diamond:

Mary, what I think I've been hearing you say is that it's really important within an agreement to ensure that there's internal consistency. That one provision in the agreement isn't contradicted by another provision in the agreement, which makes a whole lot of sense. Now, what about companies that have a whole bunch of agreements outside of the separation agreement realm? What's your tips with regard to a multitude of agreements?

Mary Weeks:

This can be a very complex area, especially when, as you mentioned, there are these large global companies with various subsidiaries, numerous legal or compliance departments, each having different responsibilities and having to focus on the interplay between these agreements and that they're all honoring this carve-out. Companies can deal with this by establishing ongoing compliance programs that have oversight mechanisms to monitor and review agreements and internal policies, specifically looking for provisions that could run afoul of this

rule. So first, we need organizations to apprise themselves of the rule and then to apply it across an organization in a broad-based manner.

Tracey Diamond:

Are there particular agreements or documents that companies should more heavily scrutinize than others?

Mary Weeks:

Yeah, I would say there are some easy targets, agreements and documents that just abound in organizations and could potentially be overlooked. Typical examples that this would include are confidentiality agreements, consulting agreements, employment agreements, separation agreements, and severance agreements. I think that is the bread and butter of where these tips are really going to apply. But any release of claims and also any employee handbook, various corporate policies, whether it be your code of conduct, even your insider trading policy. And finally, corporate training materials and information that you are disseminating to your employees in writing, that is a hot spot to make sure that you're complying with these rules as well.

Tracey Diamond:

We've talked a lot about the employment context. Do you have any tips outside of the employment context where other types of agreements might be affected by this rule?

Mary Weeks:

Sure. I think it's important that you consider language in your third-party agreements. It may not be as obvious, but the SEC has charged companies with violating the rule by prohibiting investors from communicating with the SEC in a stock purchase agreement, for example. In our experience, individuals drafting agreements outside the employment space may be less mindful of these rules when drafting non-disclosure provisions for investors or acquirers. But the most recent cease and desist orders that we've seen including this year, have shown that there's more than one example of third-party agreements being targeted by the SEC with respect to a violation of the rule, and we think it may be an increasing focus as we move forward.

Tracey Diamond:

So this year, we're only barely into this year and we're already seeing enforcement actions. Guys, are there any other takeaways from the enforcement actions that we should make sure our listeners are aware of?

Sheri Adler:

One thing that I think is surprising to folks is that it really is and can be just about a documentary violation. It's clear from the enforcement actions that an individual doesn't actually have to be impeded from reporting in order for the SEC to charge a company with a rule violation. You know, on many of the actions, the SEC made it clear that it in fact had no evidence that any individual was actually impeded from whistleblowing activity, but nevertheless, it took issue with

the overly restrictive language in the company documentation, and this in and of itself was considered a serious violation of the rule.

So I think for companies where they really are focused on behavior and compliance and reporting, it's also really important to keep in mind that what your documents say in this case really do matter.

Tracey Diamond:

It's so interesting that you say that because I really think we're seeing this outside of this issue in employment generally, and what really comes to mind, Evan, I kind of toss this to you, is non-compete agreements. I'm starting to see more and more state statutes that are focusing on what the document says, even if there's no one that they're seeking to enforce the non-compete against. Is that what you're seeing too?

Evan Gibbs:

Yeah, that's right. Some states in particular have taken a very aggressive approach, and I think that's right. I think that's something clients need to really be thinking about because that's a real possibility.

Tracey Diamond:

I think the takeaway here is really look at your documents. Even if you have no intention of enforcing the prohibitions that you're putting in these documents, just having the language in the document itself could really land your company in hot water.

Sheri Adler:

That's right, and I think Tracey, the other piece too is just with so many rules coming down from so many different agencies, is the importance of working with the cross-collaborative team of lawyers like ourselves. We always consult with you in labor and employment, and you always consult with us. But I think it's ever-increasingly more important as there's just so many different rules, both at the state and federal level to keep track of.

Evan Gibbs:

And employee awareness of the rules too is really increasing. Somebody's signing some kind of release agreement. It's just not a surprise anymore when they've Googled and have serious questions for the client about this provision or that provision, and some of this stuff can come up in the Google search and it's not going to be a good look. Folks definitely need to…

Tracey Diamond:

Magic of the Google, and employees in general are more savvy and they're also quick to go out and bad mouth the company. So it's about your reputation as well.

Evan Gibbs:

Yeah, for sure.

Tracey Diamond:

So any final tips for us, guys?

Mary Weeks:

I think my final tip would just be to remind everyone of something you said at the beginning, Tracey, which is that these cover both private and public companies. The SEC has made clear that it will enforce this rule against private companies, and I think those companies and those of us who counsel those companies should just keep that in mind as we're discussing these issues.

Tracey Diamond:

Yeah, that's another really important one because I too often will hear employers think, oh, well, that doesn't apply to me. This is the SEC. It's just about public companies, and that's just not the case. We see that also with the rules that come down from the National Labor Relations Board. I'll hear clients say, oh, well, we don't have unions. We don't have to worry about that, and in fact they do.

So employers beware. These are super important top 10 tips here on making sure that you're in compliance, regardless if you're public or you're private, making sure that you're in compliance with SEC whistleblower laws in all of your documentation.

Sheri, Mary, thank you so much for joining us today on this episode of Hiring to Firing, with Mr. Pacino. You're in good company. Thank you so much to our listeners, for tuning in. Please take a look at our blog, HiringToFiring.Law, and sign up for our podcast. Subscribe so that you can listen and most easily get to all of our episodes and shoot us an email, tell us what you think. Thanks so much.