Articles + Publications | September 23, 2024

Prioritize Document Review for SEC Whistleblower Rule Compliance

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If you have not recently reviewed your company's documents to ensure they comply with Securities and Exchange Commission (SEC) whistleblower protection rules, you should put it at the top of your to-do list. On September 9, the SEC announced settled charges against seven public companies for violating whistleblower protection rules, sending a clear message that this area continues to be a top priority for the agency. This came on the heels of a September 4 SEC order against three investment adviser firms for violating whistleblower protection rules.

Background

The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act ushered in expanded protections for whistleblowers reporting possible violations of federal securities laws (see Section 922 of the act). Under rules promulgated by the SEC implementing the statue, it is prohibited to impede individuals from communicating with the SEC about possible securities law violations (see Rule 21F-17(a)). The SEC has pursued more than 30 enforcement actions over the past decade pursuant to this rule, frequently pinpointing specific provisions in company documentation that the SEC views as having the effect of restricting whistleblowing activity. The SEC has demonstrated time and again that it will charge companies with rule violations on the basis of problematic documentation alone, even where there is no indication that any individuals were actually impeded from whistleblowing as a result of the restrictive provisions.

Broad Reach

The SEC has charged public and private companies alike with rule violations. Therefore, all companies should consider these rules when drafting provisions that could be viewed as limiting protected whistleblower activity. In addition, companies should think broadly about the types of documents that could be implicated. The SEC has taken issue with provisions in traditional employment arrangements (such as employee nondisclosure agreements and separation agreements) and consultant agreements, as well as in agreements with customers, investors, advisory clients, and brokerage customers.

Practitioner Observations

In the most recent wave of enforcement actions, the SEC has continued to take a hardline position against companies that require employees to waive their right to collect a monetary award for permitted whistleblowing activity. The SEC believes that companies should not be allowed to undercut the key financial incentive to

whistleblowing by requiring individuals to relinquish the right to seek these rewards. By bringing enforcement actions against a group of companies that, in the SEC's view, have all inhibited whistleblowers from coming forward by eliminating the financial incentive to do so, the SEC is emphasizing the significance that it places on these types of restrictive provisions.

An example of language that the SEC identified as problematic in a recent enforcement action was: "…to the fullest extent permitted by law, you agree that you are waiving the right to monetary damages or other equitable or monetary relief as a result of any charge, complaint, investigation, or proceeding."[1] One could argue that because this provision contains a qualifier stating that monetary awards are only waived "to the fullest extent permitted by law," the SEC should not take issue with it — after all, if waiving whistleblower awards are not permitted by law, then the waiver provision by its terms does not apply to those types of awards. However, this is not the SEC's view, and in fact, the SEC highlighted this language in the enforcement action as a violation of Rule 21F-17(a). As part of the remedial actions that the company took after being contacted by the SEC, the company revised its internal templates to affirmatively advise employees that they are not prohibited from collecting awards in connection with whistleblowing activity.

In addition to the risk of an SEC enforcement action for having agreements with language that the SEC believes to be in violation of Rule 21F-17(a), we are aware of plaintiffs' attorneys reviewing companies' SEC filings for examples of agreements with such language and then making demands on the companies to cease using such agreements. While technically there is no private right of action under the rule, the plaintiffs' attorneys often seek their attorney's fees and costs from the companies in exchange for making the companies aware that they should update their templates lest they become the target of an SEC enforcement action.

What to Do Now

Review your arrangements ASAP for compliance with SEC rules. Click here to read our prior client alert, which summarizes our top 10 tips for drafting whistleblower-compliant arrangements. You can also watch a recording of our one-hour webinar on the topic here. And of course, feel free to reach out to any of the authors of this alert for further assistance in drafting compliant arrangements.

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[1] See In the Matter of Smart for Life, Inc., File No. 3-22083 (Sept. 9, 2024).

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