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SEC on the Lookout for Whistleblower Restrictions

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Whistleblowers are a big deal at the Securities and Exchange Commission, providing critical leads for some of the agency's biggest cases. For that reason, whistleblower protection is also a big deal at the SEC. Over the last 18 months, the SEC has filed seven whistleblower protection cases alleging efforts by both public and private companies to impede whistleblowers from sharing information with SEC staff. These cases have generated stout fines totaling more than $30 million.

The SEC's whistleblower protection efforts show no signs of slowing. Just this year, for instance, the SEC has brought two cases that push the boundaries of the whistleblower protection rules. In one case, the SEC claimed that a participant in an alleged Ponzi scheme promised investors he would help return their money if they retracted statements previously provided to SEC staff. According to the SEC, this violated SEC Rule 21F-17(a), which prohibits taking "any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation." But by the SEC's own admission, these investors had already communicated with SEC staff. So this seems to be an expansion of the rule's scope or at least creative application of the rule to address what the SEC viewed as obstructive conduct.

The SEC's other case is potentially more troubling. There, a financial services firm executed settlement agreements with clients that required them to keep the settlement terms and underlying facts confidential. According to the SEC, while the agreements allowed clients to respond to regulator inquiries, they did not expressly allow clients to affirmatively report information to the SEC. The SEC claimed that this omission violated Rule 21F-17(a), even though there were no allegations that anyone was actually dissuaded from reporting to regulators or that the firm tried to prevent such a report. The SEC's enforcement director nonetheless asserted in a press release that these contracts "forced certain clients into the untenable position of choosing between receiving settlements ... and reporting securities law violations to the SEC." In any event, this case highlights the SEC's seemingly dogmatic view that contractual confidentiality terms are infirm under Rule 21F-17(a) unless they explicitly authorize reports to the SEC.

It appears that the SEC may now be conducting an enforcement sweep focused on employment and separation agreements for public company executives. While it is unclear what precisely will catch the SEC's attention, it seems likely that the agency is scouring confidentiality, cooperation and nondisparagement terms in publicly filed executive agreements, looking for language — or the absence of language — offending its expansive view of "impeding whistleblowers" under Rule 21F-17(a). Judging from prior SEC enforcement cases, this could include terms requiring executives to obtain preapproval from the company before communicating with regulators, precluding them from accepting monetary whistleblower awards or limiting their ability to participate in SEC investigations. And the SEC may also question confidentiality and nondisparagement provisions that fail to explicitly authorize reports to regulators.

Given the SEC's ongoing vigilance

in this area — and the heightened fines it is seeking for violations — public companies would be wise to consider whether their employment, separation and settlement agreements and policies expressly permit reports to the SEC and whether other language might be viewed by the SEC as otherwise inhibiting an individual's ability to be an SEC whistleblower or to cooperate with an SEC investigation. While these efforts may not wholly preclude an SEC inquiry, they can help the company avoid expensive SEC enforcement action.

David Peavler is a Securities Litigation & SEC Defense partner in the Dallas office of Jones Day.

Evan Singer is a Securities Litigation & SEC Defense partner in the Dallas office of Jones Day.

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