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SEC and CFTC Step-Up Enforcement of Whistleblower Protection in Confidentiality Agreements

Many companies in recent years have revised the templates they use for confidentiality agreements with employees to include exceptions meant to satisfy the requirements of Securities and Exchange Commission ("SEC") Rule 21F-17, which prohibits any person from taking action "to impede an individual from communicating directly with the Commission staff about a possible securities law violation." A seminal case was brought by the SEC against KBR Inc. in 2015, followed by a slew of other settlements across industries over the next several years.[1] After a quiet period, we have now seen a series of new actions and settlements focusing not only on confidentiality agreements with employees, but also on a wide variety of other things that can be construed as an "impediment" to whistleblowing activity, including confidentiality requirements set forth in compliance manuals, codes of conduct, and employee handbooks; training materials; employee affirmations and certifications; third party vendor agreements; and even settlement agreements with adversaries in litigation. In this memorandum, we provide a brief summary of the history of enforcement in this area (including a new settlement announced just last week by the Commodities Futures Trading Commission ("CFTC")), the broader trend of expanded enforcement, and tips for companies to ensure compliance going forward.

The SEC Prohibits Impeding Communications with the Commission, Including Through Confidentiality Agreements

Passed in the wake of the 2008 financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the federal securities laws to, among other things, include a section on "Whistleblower Incentives and Protection," which was designed to "encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees."[2]

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[1] *See In re KBR, Inc.*, Exchange Act Release No. 74619 (Apr. 1, 2015), https://www.sec.gov/files/litigation/admin/2015/34-74619.pdf; *see also In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Exchange Act Release No. 78141 (June 23, 2016), https://www.sec.gov/files/litigation/admin/2016/34-78141.pdf; *In re BlueLinx Holdings, Inc.*, Exchange Act Release No. 78528 (Oct. 10, 2016), https://www.sec.gov/files/litigation/admin/2016/34-78528.pdf; *In re Health Net, Inc.*, Exchange Act Release No. 78590 (Oct. 16, 2016), https://www.sec.gov/files/litigation/admin/2016/34-78590.pdf; *In re Anheuser-Busch InBev SA/NV*, Exchange Act Release No. 78957 (Sep. 28, 2016), https://www.sec.gov/files/litigation/admin/2016/34-78957.pdf; *In re NeuStar, Inc.*, Exchange Act Release No. 79593 (Dec. 19, 2016), https://www.sec.gov/files/litigation/admin/2016/34-79593.pdf; *In re SandRidge Energy, Inc.*, Exchange Act Release No. 79607 (Dec. 20, 2016), https://www.sec.gov/files/litigation/admin/2016/34-79607.pdf.

[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S. Code); *see also* Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Securities Exchange Act Release No. 34-64545, 76 Fed Reg. 34300, 3451 (June13, 2011).

Pursuant to this mandate, in 2011, the SEC adopted Rule 21F-17, which provides that "[n]o 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."[3] The SEC has stated that "[a]ssistance and information from a whistleblower . . . can be among the most powerful weapons in [its] law enforcement arsenal."[4]

The Expanding Scope of Rule 21F-17 Enforcement

The first major Rule 21F-17 enforcement sweep started in 2015 and included ten settlements largely targeting confidentiality agreements with employees that ether expressly forbade communications with the Commission or otherwise imposed financial consequences (such as liquidated damages) in connection with such communications. The SEC's hallmark case was brought against KBR Inc. in April 2015 and targeted form agreements that the company used at the time to enforce confidentiality in connection with internal investigations.[5] The language of the agreement in question expressly prohibited discussing the content of any investigative interview (including to government agencies or regulators) without prior authorization from KBR.[6] While the amount of the settlement was far from record-breaking ($130,000), the case drew substantial media attention due to its novelty and put companies on notice of their own potential exposure.[7]

The KBR enforcement action was followed by nine others in which the SEC took similar aim at confidentiality agreements and severance agreements between employers and employees. Some examples of allegedly non-compliant provisions included those:

- prohibiting employees from communicating any "confidential information" externally, whether through an explicit prohibition of such communications, or by failing to include a carve-out for government-related disclosures;[8]
- specifically prohibiting employees from "disparaging, denigrating, maligning, or impugning" the company to the SEC and other regulators;[9]
- requiring employees to seek approval from the company before speaking to regulators;[10]
- requiring employees to notify the company upon receiving any subpoena or other legal process;[11]

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[3] *See* SECURITIES AND EXCHANGE COMMISSION, *Regulation 21F* (last accessed June 18, 2024), https://www.sec.gov/about/offices/owb/reg-21f.pdf.

[4] *See* SECURITIES AND EXCHANGE COMMISSION, *Office of the Whistleblower* (last accessed Oct. 13, 2023), https://www.sec.gov/whistleblower.

[5] *See In re KBR, Inc.*

[6] *Id.*

[7] *See In re SandRidge Energy, Inc.*; *In re The Brink's Company*, Exchange Act Release No. 95138 (June 22, 2022), https://www.sec.gov/files/litigation/admin/2022/34-95138.pdf.

[8] *See In re BlueLinx Holdings, Inc.*; *In re Anheuser-Busch InBev*; *In re NeuStar, Inc.*; *In re SandRidge Energy*.

[9] *See In re NeuStar, Inc.*

[10] *See In re Merrill Lynch*; *In re BlueLinx Holdings, Inc.*

[11] *Id.*

- requiring employees to waive the right to receive whistleblower awards from the SEC.[12]
- requiring employees to affirm they would not voluntarily cooperate with any governmental agency;[13]
- imposing liquidated damages upon any confidentiality breach without carve-outs for communications with the SEC; and[14]
- imposing forfeiture of severance payments upon any confidentiality breach without carve-outs for communications with the SEC.[15]

The SEC subsequently expanded the reach of its enforcement through two more recent cases, one in 2019 and another in 2023. The first case, *SEC* v. *Collector's Coffee*, targeted confidentiality provisions in a share purchase agreement that the company entered with outside investors. This enforcement action led to an opinion from Judge Victor Marrero in the Southern District of New York holding that Rule 21F-17 covers "any individual" (not just employees), laying some groundwork for continued expansion of the SEC's enforcement prerogative:

> The statutory definition of "Whistleblower" refers to "any individual" and is not limited to those persons in an employee-employer relationship. And while certain portions of Section 21F provide anti-retaliation protections specific to those whistleblowers who are employees, nothing in the statute's text nor the supporting documents indicates that Congress intended to protect only those whistleblowers who are employees. Instead, as the SEC persuasively points out, the statute allows eligibility for whistleblower status, and the various incentives and protections that come with that status, to extend beyond the employer-employee relationship. . . . Thus, Rule 21F-17's application to "all persons" is consistent with the statutory definition of Whistleblower as "any individual."[16]

Similarly, in *SEC* v. *GPB Capital*, the SEC targeted confidentiality provisions in consulting and transition agreements entered into with former employees who would be continuing to work for the company as contractors.[17]

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[12] *See id.*; *In re Health Net, Inc.*; *In re BlackRock, Inc.*, Exchange Act Release No. 79804 (Jan. 17, 2017), https://www.sec.gov/files/litigation/admin/2017/34-79804.pdf; *In re HomeStreet, Inc. and Darrell van Amen*, Exchange Act Release No. 79844 (Jan. 19, 2017), https://www.sec.gov/files/litigation/admin/2017/34-79844.pdf.

[13] *See In re SandRidge Energy, Inc.*

[14] *See In re Anheuser-Busch InBev*.

[15] *See In re NeuStar, Inc*.

[16] *See SEC* v. *Collector's Coffee*, 2021 WL 3082209, at *2 (S.D.N.Y. July 21, 2021). Judge Marrero ultimately ruled in favor of the SEC on the Rule 21F-17 cause of action on summary judgement, finding that "[t]he undisputed facts show that (1) the Defendants entered into confidentiality agreements with investors that expressly prevented them from communicating with the SEC regarding securities laws violations and (2) the Defendants actually sued to prevent such communications and advertised those suits in order to chill further communication. These are undoubtedly 'action[s] to impede' communications, especially where the Rule explicitly prohibits 'enforcing, or threatening to enforce' such agreements." Decision and Order, *SEC* v. *Collector's Coffee*, No. 19-cv-04355 (Nov. 17, 2021), ECF No. 976. A jury trial on the remaining counts began on December 5, 2023. Order, *id.* (Nov. 7, 2023), ECF No. 1377. The jury returned a guilty verdict on December 13, 2023. *See* Gurbir S. Grewal,, *Statement on Jury's Verdict in Trial of Mykalai Kontilai and Collectors Coffee Inc.*, SECURITIES AND EXCHANGE COMMISSION (Dec. 14, 2023), https://www.sec.gov/news/statement/20231214; *see also* Transcript of Dec. 13, 2023 Proceedings, *SEC* v. *Collector's Coffee*, No. 19-cv-04355 (S.D.N.Y. Dec. 26, 2023), ECF No. 1489.

[17] *See SEC* v. *GPB Capital Holdings, Inc.*, No. 21-cv-00583 (S.D.N.Y. Feb. 4, 2021), ECF No. 1 (alleging that the company "included language in certain of its separation and consulting or transition agreements to impede former employees from communicating directly with the Commission"). The case has been stayed while the Defendants appeal the appointment of a receiver. *See SEC* v. *GPB Capital Holdings, Inc.*, No. 21-cv-00583 (S.D.N.Y. Dec. 7, 2023), ECF No. 186; *SEC* v. *GPB Capital Holdings, Inc.*, No. 21-cv-00583 (S.D.N.Y. Dec. 21, 2023), ECF No. 192.

Other examples of the expanding scope of SEC enforcement include actions involving confidentiality provisions contained in:

- compliance manuals, codes of conduct, and employee handbooks;[18]
- annual compliance training or training materials;[19]
- agreements to settle disputes with former employees;[20]
- employee affirmations;[21]
- annual employee acknowledgements of internal codes and policies;[22] and
- separation agreements that integrate all prior confidentiality agreements signed by the departing employee.[23]

Given these recent precedents, companies should ensure that appropriate messaging is contained in all relevant policies, templates and agreements. Consistency is key in this regard, as reflected in the recent enforcement action against Guggenheim Securities, where the SEC took issue with broad confidentiality provisions in manuals and employee training materials, even though the company included clear exceptions for SEC whistleblowing in its overarching Code of Conduct.[24] The SEC took this action while acknowledging there was no evidence of any specific instance in which an employee was prevented from communicating with SEC staff about potential violations, stating that such demonstrable harm is not a prerequisite to a violation.

Other recent enforcement actions have been similarly expansive, focusing not only on companies' written agreements and policies, but also on the statements and conduct of management. For example, the SEC has brought enforcement actions related to (i) alleged threats in company meetings to terminate employees who communicate with the SEC,[25] (ii) limiting or removing an employee's access to company computer systems, and monitoring the employee's emails for clues about his potential whistleblowing, following suggestions by the employee that he might disclose alleged securities law violations to the SEC,[26] and (iii) urging third party investors to retract statements they previously made to the SEC.[27]

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[18] *See In re Guggenheim Securities, LLC*.

[19] *Id.*

[20] *See In re The Brink's Company*.

[21] *See In re CBRE Group, Inc.*; *In re D.E. Shaw & Co*.

[22] *See In re D.E. Shaw & Co*.

[23] *Id.*

[24] *See In re Guggenheim Securities, LLC*.

[25] *See SEC* v. *Crumbley*, No. 16-cv-0172 (N.D. Tex. Jan. 21, 2016), ECF No. 1, https://www.sec.gov/files/litigation/complaints/2016/comp23453.pdf.

[26] *See In re David Hansen*, Exchange Act Release No. 94703 (Apr. 12, 2022); *SEC* v. *Rogas*, No. 20-cv-07628 (S.D.N.Y. Nov. 22, 2022), ECF No. 79, https://www.sec.gov/files/litigation/complaints/2022/comp25583.pdf.

[27] *SEC* v. *Sanchez*, No. 24-cv-00939 (S.D. Tex. Mar. 14, 2024), ECF No. 1, https://www.sec.gov/files/litigation/complaints/2024/comp-pr2024-35.pdf.

Another Regulator Enters the Scene

The SEC is now no longer alone in the policing of allegedly overbroad confidentiality requirements, following the case of In re Trafigura Trading LLC, in which the CFTC for the first time brought an enforcement action against a commodities firm for allegedly violating 17 C.F.R. § 165.19(b), the CFTC's equivalent to SEC Rule 21F-17.[28] According to the CFTC's Order, the company required its employees to sign employment agreements, and requested that former employees sign separation agreements, which included broad non-disclosure provisions that prohibited the sharing of confidential information with third parties, without any carve-out language expressly permitting communications with law enforcement or regulators.[29] While the overall size of the settlement ($55 million) is attributable to other alleged violations unrelated to whistleblower protections, the case clearly indicates that another regulator will be scrutinizing companies in this area and should serve to remind companies to bring their agreements, templates, training materials, and other communications about confidentiality into compliance with applicable regulations.

Consequences of SEC Enforcement

Fines and settlements in SEC enforcement actions based solely on Rule 21F-17 violations had remained generally consistent over the years, ranging from $200,000 to $400,000, until *In re D.E. Shaw & Co.* was resolved for $10 million. In that case, the SEC alleged that the company (i) used confidentiality agreements that lacked any carve-out for protected communications with regulatory bodies; (ii) required affirmations in severance agreements that departing employees had not filed any complaints with government agencies; (iii) only partially revised some documents (internal policies) to comply with the Rule, but not others (employments agreements and severance agreements); (iv) failed to revise other non-compliant materials during the pendency of the SEC's investigation; and (v) actually impacted at least one former employee's willingness to communicate with the Commission.[30] While the alleged conduct in D.E. Shaw may have been somewhat more egregious than other recent cases, the SEC's complaint did not include any novel allegations or a clear explanation of why the settlement amount exceeds other seemingly comparable enforcement actions by so much.

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[28] *In re Trafigura Trading LLC*, CFTC Docket No. 24-08 (June 17, 2024), https://www.cftc.gov/media/10791/enftrafiguratradingorder061724/download; *see also* COMMODITY FUTURES TRADING COMMISSION, *2017-10801* (last accessed June 21, 2024), https://www.cftc.gov/LawRegulation/FederalRegister/finalrules/2017-10801.html.

[29] The Order in the *Trafigura* case was accompanied by a concurring opinion from Commissioner Summer Mersinger, observing that the Commission appeared to be "regulating by enforcement" because companies were not explicitly on notice that confidentiality carve-outs are an affirmative obligation, and adding that legislative history did not support enforcing the regulation based on the existence of a confidentiality agreement alone, instead of the *attempted enforcement* of the confidentiality requirement. COMMODITY FUTURES TRADING COMMISSION, *Concurring Statement of Commissioner Summer K. Mersinger Regarding Settlement With Trafigura Trading LLC* (June 17, 2024), https://www.cftc.gov/PressRoom/SpeechesTestimony/mersingerstatement061724. Commissioner Caroline Pham abstained from voting on the basis that she "did not have sufficient evidence to determine there was a reasonable basis for the alleged charges," having only received a single job offer letter with the offending language that also contained "two savings clauses that voided any language that may violate any law or regulation." COMMODITY FUTURES TRADING COMMISSION, *Statement of Commissioner Caroline D. Pham Regarding Settlement Order with Trafigura Trading LLC* (June 17, 2024), https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement061724. Commissioner Pham also expressed concern that "commodity firms around the world that have no CFTC registration requirements, and other market participants" could be targeted using *Trafigura* as precedent. *Id.* Ultimately, these objections also demonstrate the broad potential for liability under the CFTC's regulatory framework.

[30] *In re D.E. Shaw & Co. L.P.*, Exchange Act Release No. 98641 (Sept. 29, 2023), https://www.sec.gov/files/litigation/admin/2023/34-98641.pdf.

Tips to Ensure Compliance with Federal Confidentiality Requirements

As a starting point, companies should review the confidentiality provisions in all employee agreements (and related templates), employee handbooks, codes of conduct and ethics, other policies, and training materials to ensure they contain express exceptions for communications with the SEC and other government agencies. While the appropriate language will vary from case-to-case, companies and their counsel can start by looking at useful examples from remedial measures described in some of the settlements discussed above. Companies would be well-advised to include in their review confidentiality agreements with third parties, including consultants, other vendors, transaction counterparties, and clients, especially in light of the recent enforcement trend discussed above.[31] Company management should also be mindful of any official or unofficial statements made to employees in team meetings, town halls, and other interactions about confidentiality and government interactions to ensure they do not knowingly or unwittingly violate either SEC Rule 21F-17 or the equivalent CFTC Regulation 165.19. Although in general companies may take a risk-based approach focusing on those agreements that present the most risk of genuinely undermining the objectives of the SEC rule or the CFTC regulation, in doing so companies should be aware that the staffers of both Commissions have now taken a very broad scope of both the SEC rule and the CFTC regulation, as well as their own enforcement strategies, such that virtually all statements about confidentiality are subject to scrutiny and present potential exposure for violations.

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If you have any questions about these matters or strategies for compliance with SEC Rule 21F-17 or CFTC Regulation 165.19, please do not hesitate to contact authors Brian Markley (Partner) at 212.701.3230 or bmarkley@cahill.com; or Elizabeth Wiseman (Associate) at 212.701.3888 or ewiseman@cahill.com; or email publicationscommittee@cahill.com.

[31] Other steps that companies have taken include: (1) contacting former employees who have signed separation and termination agreements; (2) posting internal and/or external notices of updated confidentiality provisions; (3) conducting an audit of all similar employment agreements or internal policies worldwide for all subsidiaries; (4) retraining compliance staff familiar with whistleblower requirements; (5) adding segments on confidentiality obligations and carve-outs to mandatory annual compliance programs; (6) creating a Notice regarding Whistleblowing Rights and providing all new employees with the Notice upon onboarding; and (7) creating new policies governing internal and external reporting of unethical conduct. *See, e.g., In re SandRidge Energy, Inc.*; *In re Guggenheim Securities, LLC*; *In re The Brink's Company*; *In re D.E. Shaw & Co.*; *In re Merrill Lynch; In re BlackRock, Inc.*; *In re CBRE Group, Inc.*