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SEC Must Stop The Latest Effort To Impede Whistleblowers

Law360, New York (May 13, 2013, 12:56 PM ET) -- Since Congress established the whistleblower-reward program at the U.S. Securities and Exchange Commission through passage of the Dodd-Frank Act in 2010, we have witnessed the steady drum beat of criticism by management attorneys and the companies they represent that the SEC whistleblower program rewards "bounty hunting" employees who try to benefit from potential violations by reporting problems to the SEC instead of reporting them internally and allowing their companies to investigate and correct the problems. This criticism ignores the very painful reality for many faced with the dilemma of reporting fraud and other securities violations by publicly traded companies or remaining silent: without significant financial incentives, few individuals will incur the often career-derailing professional, reputational and personal risks that go with disclosing such misconduct.

Efforts by companies and corporate counsel to restrict the class of employees covered by the program have failed, as have efforts to require employees to exhaust reporting requirements in-house before availing themselves of the legal protections and potential rewards that are available through the SEC. It is not surprising, then, that companies and their counsel are now trying to achieve indirectly through severance and settlement agreements in employment cases what the SEC has made clear they cannot do: impede would-be whistleblowers from providing information to the commission about potential securities violations. Such provisions — which are routinely requested of employees — seriously undermine the SEC's efforts to use the whistleblower-reward program as a critical tool in the commission's enforcement of the nation's securities laws and the SEC should act decisively to prohibit such agreements.

Introduction: Incentivizing and Protecting Whistleblowers

The clear intent of Congress in establishing the SEC whistleblower-reward program was to incentivize individuals to come forward with information about violations of securities laws and the Foreign Corrupt Practices Act. Section 922 of the Dodd-Frank Act also established strong anti-retaliation protections for individuals who report such misconduct. The SEC went a step further when promulgating regulations to govern the program, explicitly making it unlawful to interfere with the efforts of such individuals to provide information to the commission. Rule 21F-17(a) provides:

> No 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 (other than agreements dealing with information covered by § 240.21F-4(b)(4)(i) and § 240.21F-4(b)(4)(ii) of this chapter related to the legal representation of a client) with respect to such communications.
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> 17 C.F.R. § 240.21F-17(a).

Unlike the separate anti-retaliation provision, this rule comes into play when a company attempts to block or deter an individual from providing information to the commission and cooperating in its investigation of that information. The rule is often violated well before an individual experiences actionable retaliation.

Technical Compliance with the Rule

The majority of the individuals we represent before the commission have obtained information about possible securities violations through their employment with the companies whose conduct is the subject of their tips, or sometimes through their employment with related companies. As a number of SEC officials involved in the whistleblower program have noted in public statements, the overwhelming majority of these employee-whistleblowers first report the same securities violations to their companies' management and when their responses were not properly addressed they then report their concerns to the SEC. As a result of their internal reporting and/or of management's learning or suspecting that the employee has also gone to the SEC, many of these whistleblowers experience retaliation for raising their concerns, and they are often involuntarily separated from their employment as a result. Some are demoted, others get fired, and some just find themselves being suddenly criticized, marginalized or ignored in ways that make it clear that the decision to speak out about wrongdoing has placed their careers in danger despite years of exemplary job performance.

Whether the company terminates the employee as an act of retaliation, the employee "voluntarily" resigns, or the employee departs later for some unrelated reason, many of these employees end up entering into separation agreements with their former employers in order to obtain severance or other benefits. Such agreements routinely require that employees release any legal claims against the company in exchange for whatever benefits the company provides.

While most employers, and certainly their counsel, understand that they cannot insist on the inclusion of settlement terms that would expressly prevent a current or former employee from communicating with the SEC, employees are regularly presented with severance agreements requiring them to represent and agree that they "ha[ve] not and will not share non-public, proprietary or otherwise confidential information of the company with any third party." Most employers will agree to modify such a prohibition with language such as, "Nothing in this agreement shall be construed to prevent the employee from communicating with, or participating in an investigation by, any government or law enforcement entity." Despite the broad understanding that an employer cannot expressly prohibit an employee from communicating with the commission, however, the qualifying language that some employers include in severance or separation agreements still allows the employee to communicate with the commission only if compelled to do so, which is clearly inconsistent with the new SEC rule. The following is commonly seen in employer-proposed agreements:

- Employee agrees that he will not use or disclose any Company information at any time subsequent to the execution of the Agreement, except as required by law. Company information does not include information or knowledge which Employee is required to disclose by order of a governmental agency or court after timely notice of the order has been provided to the Company.

The SEC's Office of the Whistleblower leadership have made clear that they intend to aggressively enforce the rule against impeding whistleblowers, and we expect to see an enforcement action in the future that will go a long way toward deterring the most flagrant violations of the rule. However, companies and their counsel have devised indirect ways to try to achieve the same result of deterring whistleblowers from making tips to the SEC.

Indirect Impediments and Disincentives to Whistleblowing

Increasingly, employees have been presented with language in severance agreements and settlement agreements that impose on whistleblowers one or both of the following types of restrictions: (1) the requirement that the whistleblower renounce the right to receive any award the SEC might make as the result of a successful enforcement action; or (2) the requirement that an employee disclose to the company all past or future communications with any third party, including government agencies, and/or that the employee agree to cooperate with the company in any ensuing investigation. We believe that these types of provisions violate SEC Rule 21F-17(a) and/or (b), and the commission needs to send a clear signal to employers and employees to that effect.

The Requirement to Forego a Whistleblower Reward

The primary purpose of the whistleblower reward program is to incentivize individuals to come forward with information concerning securities or FCPA violations about which the SEC would not otherwise know. Settlement provisions that require an employee to waive the right to recover monetary compensation in connection with any action brought by an administrative agency against the company removes the incentive Congress established for a would-be whistleblower to come forward. The following are examples of settlement provisions we have encountered:

- Employee agrees not to accept, recover, or receive any back pay, damages, or any other form of relief that may arise out of or in connection with any administrative remedies pursued independently by any other person or any federal, state, or local governmental agency or class represented.

- In the event that any agency, self-regulatory organization (SRO) or court assumes jurisdiction of any lawsuit, claim, charge or complaint on Claimant's behalf, or purports to bring any legal proceedings against the Company, on Claimant's behalf, he promptly will request that the agency, SRO or court withdraw from or dismiss the lawsuit, claim, charge, or complaint with prejudice, and in any event, he waives his right to any form of recovery or relief in any such proceedings on his behalf.

These provisions reflect a practice that predates the Dodd-Frank Act. Employers have for some years included such language in severance and settlement agreements with employees to prevent the employee from accepting a settlement payment, releasing all claims, and then recovering additional damages or relief from the defendant as a result of a class action brought by another employee or an enforcement action brought by the Equal Employment Opportunity Commission. This practice grew out of case law and EEOC policy prohibiting employers from requiring employees to waive their right to file charges with the EEOC in light of the EEOC's mission of enforcing the nation's anti-discrimination laws, but allowing employees to waive their right to further recovery from the employer after agreeing to settle their individual claims. See EEOC Guidance on "Understanding Waivers of Discrimination Claims in Employee Severance Agreements" (Apr. 4, 2009), Sec. III., available online at http://www.eeoc.gov/policy/docs/qanda_severance-agreements.html.

Some of the proposed terms may just reflect a continuation of the practice regarding the EEOC, and terms such as the third provision above, which focuses on actions brought "on the claimant's behalf," should not be interpreted to prevent recovery based on an enforcement action brought by the SEC on behalf of the United States government. Nevertheless, such terms, which appear today in the majority of agreements that employees who receive severance or settlement payments sign upon leaving their employment, may

impede the employee from submitting information to the SEC by making the employee believe, even if incorrectly, that he or she is required to forego the right to recover an award from the SEC.

Since the establishment of the SEC program, some employers and their counsel are insisting on language that more explicitly requires an employer to waive his or her right to receive an award from the SEC. We have seen a number of employers insist on the inclusion of language in settlement agreements that reads as follow:

- Employee hereby irrevocably assigns to the federal government, or relevant state or local government, any right Employee may have to any proceeds, bounties or awards in connection with any claims filed by or on behalf of the government under any laws, including but not limited to, the False Claims Act and/or the Dodd-Frank Act (and/or any state or local counterparts of these federal statutes or any other federal, state or local qui tam or "bounty" statute) against the Company. Employee also represents and promises that Employee will deliver any such proceeds, bounties or awards to the United States government (or other appropriate governmental unit).

The SEC must take a firm stand against contractual language purporting to require individuals to forego an award from the SEC, whether the language purports to require the waiver of "further recovery" or the assignment of any award. When an employee agrees to accept a settlement payment from the employer as full and fair consideration for a release of discrimination and other claims, there is no public-policy reason not to allow the employee to waive the right to further payment from the employer. The employee has received compensation from the employer for any harm the employer has caused the employee, and has specifically agreed not to receive additional payment for the same harm.

In the SEC whistleblower program, it is the government and not the employer that pays an award to the employee. The whistleblower's right to an award is a statutory right that has nothing to do with the legal dispute the employee settled with the employer. The right to an award is triggered by the SEC's recovery of more than $1 million from the company in an enforcement action, and although the amount of the award is tied to the amount the SEC recovers, the employer does not pay the award to the whistleblower or pay any additional moneys to the government to satisfy the SEC's obligation to the whistleblower. The award money comes from a fund that the SEC has established for that purpose. Moreover, the SEC pays an award to a whistleblower not as damages for harm the employer subject company has caused the employee (for which the employee has received payment), but rather to reward the employee for providing the commission with information that has led to a successful enforcement action that furthers the public good. Because the only benefit inuring to a company that obtains a waiver of an employee's right to recover an award from the SEC whistleblower program is to remove the whistleblower's incentive and thus to prevent or thwart SEC action against the company, deterring the employee from reporting to the SEC is clearly a company's only motivation for imposing the waiver on the employee. There is no legitimate justification for allowing companies to impede whistleblowers in this manner.

By prohibiting impediments that include "enforcing, or threatening to enforce, a confidentiality agreement," 17 C.F.R. § 240.21F-17(a), the SEC has already recognized the importance of preventing the chilling effect that employer actions can have on would-be whistleblowers. The commission should expand the language in Rule 21F-17(a) to make clear that employers also cannot impede an individual by extracting promises to waive, forego, or assign to someone else any award that the SEC issues as a result of a successful enforcement action.

The Requirement to Disclose or Refrain from Engaging in Communications with the

Government

Provisions that place various restrictions, limitations or conditions on departing employees' communications with the SEC should also be declared improper by the SEC. These provisions not only impede individuals from providing information to the commission, but also frustrate the SEC's ability effectively to investigate tips. Language along the following lines in employer-drafted agreements clearly impedes an employee's ability to go to the SEC with information:

- Employee represents that he has not filed any lawsuit, claim, charge, or complaint regarding the Company with any local, state, or federal agency, self-regulatory organization, or court.

An employee who has submitted information to the SEC cannot confidently make this representation because the TCR (Tip Complaint or Referral) form filed with the SEC can reasonably be considered a "complaint." In fact, the form itself requires the filer to answer a number of questions about his or her "complaint."

Faced with such language, an employee who has submitted a tip to the SEC Office of the Whistleblower must either refuse to sign the agreement and forego any severance or other benefit offered by the agreement, insist on a carveout for the SEC tip and effectively alert the employer to the likelihood that he has submitted one, or sign the agreement as is and risk having suit filed against him if the employer learns of the employee's tip. This provision also impedes the employee who has not filed a tip but who knows of potential securities violations and is weighing the pros and cons of reporting the same to the SEC. If the employee knows that the employer will require such a certification upon separation from the company, he will likely be deterred from providing information to the SEC because of the dilemma he will face upon his departure — an event which may come soon if, like many whistleblowers, he reports his concerns internally and encounters retaliation that forces him out of his job. In both situations, the employee is impeded in providing information to the SEC, and where the employee has submitted a tip and requests modification of the language quoted above, the SEC's investigative options are limited by the fact that the employer has learned that an investigation may be underway or forthcoming.

Some employers are also requiring departing employees to agree, either explicitly or in effect, to keep the employer informed of communications with the SEC and to cooperate with the company in any investigation by the SEC. We are seeing an increase in the following types of contractual provisions, through which the employer can limit or manage a whistleblower's participation in an SEC investigation:

- Employee will inform the Company within 10 days of receipt of a subpoena or inquiry requesting information relating to the Company and will cooperate with the Company in any investigation, regulatory matter, arbitration and/or any third-party lawsuit in which the Company is a subject or party.

- Employee agrees that he will assist and cooperate with the Company in connection with the defense or prosecution of any claim that may be made against or by the Company, or in connection with any ongoing or future investigation or dispute or claim of any kind involving the Company, including any proceeding before any arbitral, administrative, judicial, legislative, or other body or agency, including testifying in any proceeding to the extent such claims, investigations or proceedings relate to services performed or required to be performed by him, pertinent knowledge possessed by him, or any act or omission by him.

- If Employee is requested to respond to an inquiry or provide testimony before the Securities and Exchange Commission (SEC) about this Agreement or its underlying facts and circumstances, Employee (or his attorney) should fulfill his obligation to inform the Company of such request, as set forth in this agreement, only after Employee has responded to the inquiry or provided the testimony sought.

These provisions appear intended to, and have the effect of, ferreting out any communications an employee may have had with the SEC, forcing the employee to disclose the information he has provided to the SEC, and allowing the company to manage — and therefore to discourage — the employee's further communications with the commission under the guise of "cooperation."

Mandatory disclosure and cooperation with the employer in an SEC investigation, especially when those requirements apply to an individual who has submitted a tip to the commission and is a cooperating witness in its investigation, are inconsistent with free and open communication with the commission and contravene several SEC rules.

In addition to "impeding" the employee from "communicating directly" with the commission in violation of Rule 21F-17(a), such contractual terms allow the company to make an end-run around Rule 21F-17(b), which reads as follows:

> If you are a director, officer, member, agent, or employee of an entity that has counsel, and you have initiated communication with the Commission relating to a possible securities law violation, the staff is authorized to communicate directly with you regarding the possible securities law violation without seeking the consent of the entity's counsel.
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> 17 C.F.R. § 240.21F-17(b).

The purpose of this rule is to allow the SEC unfettered access to individuals who have come forward with information about potential securities violations. The commission places enough importance on not allowing employers to filter, manage or restrict its communications with a whistleblower to promulgate a rule that arguably bypasses state ethics rules against contact with represented parties. The SEC's rules ensuring direct communications between SEC staff and whistleblowers will have little effect if companies can require whistleblower to notify them of each and every inquiry from SEC and to cooperate with management in responding.

Contractual terms mandating disclosure and cooperation also impinge on the ability of individuals to submit tips to the SEC anonymously using the procedures set forth in Rule 21F-7(b). These procedures, which commission staff took great pains to design into the program and which will be critical to its success, will be rendered meaningless if companies are allowed to require whistleblowers to notify the company and cooperate every time the whistleblower or his counsel received an inquiry, possibly even an email or a telephone call, from SEC investigators.

In addition, such provisions hamper the commission's investigative techniques by making sure that the likely target of an investigation has notice of the investigation from its inception and before the SEC has formally notified anyone of its inquiry.

Conclusion

Employers' practices requiring employees or former employees to agree to settlement or severance provisions such as those described above pose a serious threat to the success of the SEC whistleblower program. Whether enforceable or not, the inclusion of such terms in

severance agreements and settlement agreements has a chilling effect on individuals who would provide information to the SEC about potential securities violations. For these reasons, the commission should promulgate a regulation or issue an opinion to combat these anti-SEC and anti-whistleblower tactics now, while the program is young. By issuing a regulation or an opinion clarifying the breadth of actions that the commission views as likely to "impede" communication with the commission, the SEC could stem the growth of an apparent effort to discourage whistleblowers from providing information to the commission, which is what Congress sought to incentivize through the SEC whistleblower-reward program that it established through the Dodd-Frank Act.

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