

SEC AGAIN CRACKS DOWN ON COMPANIES THAT RESTRICT WHISTLEBLOWERS

TIME TO FIX TEMPLATE AGREEMENTS AND NOTIFY FORMER EMPLOYEES AND OTHERS THAT BANS ON REPORTING SEC VIOLATIONS OR MONETARY AWARDS WON'T BE ENFORCED.

Sep 13, 2024

WHAT HAPPENED

As discussed in our [December 15, 2023 client alert](#), the SEC has waged an aggressive effort to enforce alleged violations of the whistleblower protection rule. On September 9, 2024, the SEC announced [settled charges](#) resulting in cease-and-desist orders and more than \$3 million in civil penalties from seven public companies, showing that it remains focused on such violations. The latest cases include charges involving agreements with contractors and consultants, as well as employees.

TAKEAWAYS

Companies should review their template agreements and policies and consult with counsel regarding steps that may be appropriate to address language in existing agreements and policies. These can include, among others, employment, compensation, severance, contractor, consulting and similar agreements and policies. As discussed in our [December 15, 2023 client alert](#), companies should ensure that such documents:

- Expressly allow current and former employees, contractors and consultants to share information with the SEC regarding possible securities law violations.
- Do not require employees, contractors or consultants to provide notice to the company or obtain its consent before reporting potential legal violations.
- Do not restrain current and former employees, contractors or consultants from receiving monetary recovery (an SEC "bounty") in connection with providing information to the SEC related to securities law violations.

- Use caution when requiring representations by an individual in a severance agreement relating to complaints or charges against the company.

These points are relevant to existing agreements – not just future ones. As evidenced by SEC enforcement actions, even agreements signed years ago can form the basis of an order finding an employer violated the SEC rules. As a result, companies should consider notifying relevant parties (such as former employees, contractors or consultants) that they are not prohibited from reporting complaints or sharing information with the SEC about potential securities law violations.

Although recent cases have been aimed at public companies, the SEC views the rule as applicable to private companies as well.

DEEPER DIVE

On September 9, 2024, the SEC announced settled charges against seven public companies for using employment, separation, and other agreements that violated the SEC's whistleblower protection rule (1934 Act Rule 21F-17) which prohibits actions to impede whistleblowers from reporting potential misconduct to the SEC. To settle the SEC's charges, the companies took remedial actions and also agreed to pay more than \$3 million combined in civil penalties. They also agreed to cease and desist from future violations of the rule.

The SEC believes that provisions barring reports of potential violations of securities laws or requiring waiver of related monetary awards constitute impediments to participation in the SEC whistleblower program and violate Rule 21F-17(a). In its view, these types of provisions impede individuals from communicating directly with SEC staff about possible securities law violations.

TYPES OF VIOLATIVE PROVISIONS; SIZE OF PENALTIES

The penalties ranged from \$19,500 to \$1,386,000, evidently based on the number of agreements and nature of the provisions and, in one case, the company's weak financial condition:

Acadia Healthcare Company, Inc., agreed to pay a \$1,386,000 civil penalty.

- From 2019-2023, the company entered into 98 agreements, including employment agreements, separation agreements, retention agreements and settlement agreements, that required employees to waive their right to recover a monetary award for participating in an investigation by a government agency.
- From 2019 to 2023, the company entered into an additional 56 separation and settlement agreements that required employees to waive their right to file a complaint with any federal government agency.

a.k.a. Brands Holding Corp. agreed to pay a \$399,750 civil penalty.

- From 2019-2021, the company entered into three employment agreements and two severance agreements that required employees to waive their right to recover a monetary award for participating in an investigation by a government agency.
- From 2019-2023, the company entered into an additional 35 severance agreements that allowed departing employees to participate in government whistleblower programs but required them to waive their right to recover a monetary award.
- In 2020, the company entered into a severance agreement that required a departing employee to waive his right to file a complaint with any federal government agency.

AppFolio, Inc., agreed to pay a \$692,250 civil penalty.

- In 2021 and 2023, the company entered into two employment agreements that required employees to waive their right to recover a monetary award for participating in an investigation by a government agency.
- In 2022, the company entered into one settlement agreement that, while expressly allowing a former employee to participate in government whistleblower programs, required him to waive his right to recover a potential monetary award.
- From 2020 to 2023, the company entered into 68 consulting services agreements that prohibited contractors from voluntarily providing information about the company's business operations to government agencies and required that contractors notify the company of any legally compelled disclosure of such information.

IDEX Corporation agreed to pay a \$75,000 civil penalty.

- In 2020, the company entered into a separation agreement that required a departing employee to waive his right to recover a monetary award for participating in an investigation by a government agency. Although the agreement expressly allowed participation in government whistleblower programs, it also required the departing employee to waive his right to a potential award.
- In 2020 and 2021, the company entered into two settlement agreements that allowed former employees to participate in government whistleblower programs, but also required them to waive their rights to recover potential monetary awards.

LSB Industries agreed to pay a \$156,000 civil penalty.

- From 2019-2023, the company entered into 16 agreements that required employees to waive their right to recover a monetary award for participating in an investigation by a government agency, although otherwise still expressly allowing participation in government whistleblower programs.

- These included general release agreements that contained award-waiver provisions, as well as an employment agreement and several severance and change-in-control agreements that required employees to execute a separate agreement containing an award-waiver provision following the end of their employment.

Smart for Life, Inc. agreed to pay a \$19,500 civil penalty.

- In 2022, the company entered into a separation agreement that required a departing employee to waive his right to recover a monetary award for participating in an investigation by a government agency. Although the agreement expressly allowed participation in government whistleblower programs, it also required the departing employee to waive his right to a potential award.
- In 2023, the company entered into another separation agreement that, while expressly allowing the departing employee to participate in government whistleblower programs, required her to waive her right to recover a potential monetary award.
- The SEC noted that in its most recent 10-Q, the company reported it had cash of \$8,890 and had sustained recurring losses and had a deficiency in working capital of approximately \$11.4 million and a net loss for the nine months ended September 30, 2023 of \$12.8 million, which it stated raised substantial doubt about its ability to continue as a going concern. In light of that financial position, the SEC limited its civil penalty to \$19,500.

TransUnion agreed to pay a \$312,000 civil penalty.

- From 2019–2023, the company entered into 29 agreements that required senior employees to waive their right to recover a monetary award for participating in an investigation by a government agency, although otherwise expressly allowing participation in government whistleblower programs.
- These included general release agreements that contained award-waiver provisions, as well as severance agreements and transaction incentive agreements that required senior employees to execute a separate agreement containing an award-waiver provision following the end of their employment with the company.
- From 2022-2023, the company entered into three consulting agreements that prohibited individual contractors from voluntarily providing information about its business operations to government agencies and required that these contractors notify the company of any legally compelled disclosure of such information.

PROVISIONS NEVER ENFORCED BY COMPANIES

The SEC acknowledged that it was unaware of any instances in which any of the companies took action to enforce these provisions or in which the affected party declined to speak with the SEC about potential violations of securities laws.

REMEDIAL ACTIONS – REVISION OF CONTRACTS; NOTIFICATION OF AFFECTED PARTIES

After being contacted by SEC staff, the companies revised their internal agreement templates, adding language affirmatively advising relevant parties that they are not prohibited from disclosing information to any governmental or regulatory authority, or collecting any related incentive awards.

In the case of Acadia, before being contacted by the SEC, the company revised some of its relevant internal agreement templates to remove certain violative provisions and affirmatively advise employees that they are not prohibited from disclosing information to any governmental or regulatory authority, or from collecting any related incentive awards. After being contacted by the SEC, the company applied these changes to the rest of its agreement templates.

Additionally, the SEC required each of the companies to use reasonable efforts to notify the relevant parties that their employment, severance or other agreements do not in any way limit their ability to contact SEC staff or to obtain an award in connection with information they provide.

RELATED PRACTICE AREAS

- Securities & Corporate Governance
- Employment & Labor
- Employee Benefits & Executive Compensation

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