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ANALYSIS

SEC Attacks Non-Disclosure Agreements

The SEC recently issued imposed significant and costly sanctions against companies that require employees to sign non-disclosure agreements containing certain language either limiting employees from disclosing company confidential information without company approval, or representing that they have not filed complaints with government entities.

By Philip M. Berkowitz | November 08, 2023 at 10:00 AM

The Securities and Exchange Commission (SEC) has recently issued imposed significant and costly sanctions against companies that require employees to sign non-disclosure agreements containing certain language either limiting employees from disclosing company confidential information without company approval, or representing that they have not filed complaints with government entities.

Language of this nature may not appear to be entirely out of place in separation agreements and employment agreements. The SEC has held, however, that the agreements at issue violated the law insofar as they may have impeded employees from communicating with the SEC.

SEC Rule 21F-17 provides:

(a) 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 [attorney-client privileged] 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.

(b) 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.

The SEC recently fined a global investment and technology firm 10 million dollars for violating Rule 21F-17. *In re D. E. Shaw & Co*, S.E.C. Administrative Proceeding File No. 3-21775 (Sept. 29, 2023). There, an employment agreement included a provision prohibiting disclosing "confidential information" unless authorized by the company or required by law or an order of a court or other regulatory or governmental body, without any exception for voluntary communications with the Commission concerning possible securities laws violations. Confidential information included, among other things, any information gained in the course of employment that could reasonably be expected to be deleterious to DESCO if disclosed to third parties.

In addition, from approximately August 2011 to June 2023, the company required roughly 400 employees to sign releases upon departing the company that affirmed they had not filed any complaint with any governmental agencies. The release language was a part of departing

employees' receipt of additional payouts that, in some instances, totaled millions of dollars.

The SEC's order noted that at least one former employee was discouraged from communicating with SEC staff due to the employment agreement and release provisions. According to the SEC, the plain language of the provisions impeded current and former employees from filing whistleblowing complaints with the SEC about potential securities violations.

The SEC noted that while the company had revised its policies and employment agreement in 2017 and 2018 to clarify that the language did not bar disclosure to governmental agencies regarding violations of the law, nevertheless it did not change the language of the release until June 2023, during the pendency of the SEC investigation.

The order in that case came only 10 days after another SEC order that imposed remedial sanctions against a national commercial real estate firm for its use of separation-agreement provisions that the SEC asserted violated the SEC's whistleblower protection in Rule 21F-17. *In Re CBRE*, S.E.C. Administrative Proceeding File No. 3-21675 (Sept. 19, 2023). There, the agreement provided in relevant part:

Employee represents and acknowledges [t]hat Employee has not filed any complaint or charges against CBRE, or any of its respective subsidiaries, affiliates, divisions, predecessors, successors, officers, directors, shareholders, employees, representatives or agents (hereinafter collectively "Agents"), with any state or federal court or local, state or federal agency, based on the events occurring prior to the date on which this Agreement is executed by Employee.

In addition to mandating revisions to the separation agreement, the SEC imposed a $375,000 civil monetary sanction. These harsh sanctions were issued despite the fact that the company had immediately cooperated with the government. Indeed, the order identifies the company's extensive cooperation efforts as the critical rationale for not pursuing an even larger civil penalty against the company.

According to the SEC, the offending language impeded the company's employees' ability from communicating directly with the SEC and participating in the SEC's whistleblower program. The agreement also contained language that barred the employees from executing the separation agreement prior to their termination date.

So, "read together," the two provisions required the employee contractually to represent that the employee had not filed a complaint about (i) any events that occurred at any time during the employee's entire employment and before the employee's termination, or (ii) any events that occurred after termination but before the signing of the separation agreement.

"Carveout language" will not help provisions like those above. In 2015, the SEC brought its first enforcement action under Rule 21F-17. There, the offending separation agreement included the following language: "Nothing in this Agreement shall be construed to prohibit Employee from filing a charge with or participating in any investigation or proceeding conducted by the . . . the Securities and Exchange Commission, the Department of Justice, or a comparable federal, state or local agency."

The SEC found this language to be “prospective in application and therefore did not remedy the impeding effect” of the separation agreement.

For separation and settlement agreements with releases, employers typically need to secure a representation that the individual does not have a pending claim of discrimination, harassment or retaliation, to determine if certain state-required language under recent #MeToo laws need to be added. This would appear to be permissible, as it does not include a representation that the individual has not filed “any complaint or charges.”

Further, to address the SEC’s objection that the disclaimer applied only prospectively, it would be prudent to expand the disclaimer for protected rights make clear that no prior company action or policy prohibits cooperation with government agencies.

If the SEC initiates an enforcement action, plan to cooperate. The SEC cites cooperation as a significant factor in resolving a Rule 21F-17 enforcement action.

In light of these renewed enforcement efforts, employers should review their separation agreements, non-disclosure agreements, employment agreements, and any confidential business information policy or requirement for any language that might run afoul of Rule 21F-17, or that could be construed to “impede” whistleblowers from contacting the SEC.

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