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VIA EMAIL

To Our Investment Adviser Clients and Other Friends:

Re: **SEC Cracks Down on Whistleblower-Impeding Language**

Rule 21F-17(a) of the Securities Exchange Act ("Rule 21F-17") prohibits any person from taking action to impede an individual from communicating directly with the SEC about possible securities law violations. As noted in our 2015 Client Alert regarding an SEC enforcement action against an adviser whose employee confidentiality agreements included improperly restrictive language, the SEC has historically concentrated its focus on employment agreements and severance agreements for language that violates Rule 21F-17. Recently, the SEC has been strengthening whistleblower protections by assessing higher penalties, expanding the types of agreements it will review for violations of Rule 21F-17 and expanding who it targets for enforcement of Rule 21F-17 violations.

In 2023 and early 2024, the SEC levied significant civil penalties in settled administrative proceedings against advisory firms that used agreement language that violated Rule 21F-17, including $10 million against D. E. Shaw and $18 million against J.P. Morgan. D. E. Shaw had required employees sign employment agreements that prohibited the disclosure of confidential information to anyone outside of the company, without an exception for voluntary communications with the SEC concerning possible securities laws violations. In addition, departing employees were required to sign a release to receive certain deferred compensation and benefits, affirming that the employee had not filed any complaints with any governmental agency. Although the firm later revised its policies and issued clarifications to employees that they were not prevented from communicating with the SEC and other regulators, the SEC still faulted D. E. Shaw for failing to amend its employment and release agreements to expressly provide the carve out.

J.P. Morgan had required retail clients who received a credit or settlement over $1,000 to sign a release that included a confidentiality clause preventing the clients from disclosing the existence of the release and potential violations of securities laws to the SEC, unless the client was responding to an inquiry from the SEC. The SEC found that this restriction violated Rule 21F-17 because it did not allow voluntary communications with regulators regarding potential securities law violations. The J.P. Morgan action is noteworthy because it signals the SEC is expanding its focus to client agreements, whereas previous enforcement actions for Rule 21F-17 had focused on employment agreements, employee severance agreements and non-disclosure agreements in connection with internal investigation interviews. Further, the $18 million unprecedented penalty amount for a standalone Rule 21F-17 violation shows the SEC's prioritization of Rule 21F-17 violations.

Also in 2023, the SEC imposed a $225,000 civil penalty against Monolith Resources LLC, a privately-held energy and technology company, for requiring departing employees to waive their rights to monetary whistleblower awards. This action underscores that Rule 21F-17 applies to all entities, and not only to public companies or registered investment advisers. The penalty took into account the company's remedial actions, including notifying former employees who had signed the improper separation agreements that the agreements did not prevent them from receiving whistleblower awards.

Although the enforcement actions described above relate to language in agreements, Rule 21F-17 also applies to language in internal policies and procedures and training materials. In light of these recent actions, public companies, private companies, broker-dealers, investment advisers and other financial services entities should consider reviewing their compliance policies, employment agreements, independent contractor agreements, separation agreements, vendor agreements, client agreements and any other agreements that include confidentiality requirements, for language that may violate Rule 21F-17. To the extent a firm's agreements include a prohibited clause or do not expressly permit voluntary disclosure to regulatory authorities, firms should (1) notify such contract counterparties of their rights to contact regulatory authorities and (2) update such forms.

Finally, employers should consider consulting with counsel before taking any action against employees who could claim they have engaged in protected whistleblower activity, given the recent trend to expand whistleblower protections by the SEC, as described above, and the recent Supreme Court precedent in *Murray v. UBS Securities, LLC.* In the *Murray* case, the Supreme Court unanimously held that an employee may prove a whistleblower retaliation claim under the Sarbanes-Oxley Act without showing that the employer acted with retaliatory intent. As a result of the ruling, employees of publicly traded companies who allege whistleblower status will have an easier time pursuing retaliation claims against employers.

Please contact one of the Shartsis Friese attorneys in the Investment Funds & Advisers Group if you have any questions about Rule 21F-17 violations.

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