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Securities Litigation/Labor & Employment/
Employee Benefits & Executive Compensation ADVISORY ■

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Plaintiffs' Bar Leveraging Increased SEC Scrutiny of Nondisclosure and Other Agreements with Employees

As we have discussed in previous advisories (available here and here), over the past two years the Securities and Exchange Commission (SEC) Office of the Whistleblower has applied increased scrutiny to various forms of employment agreements that the SEC contends violate SEC Rule 21F-17, which prohibits taking "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." This initiative has led to a number of SEC enforcement actions against employers, several of which have resulted in consent orders imposing fines and other penalties.

Employers covered by the Sarbanes–Oxley Act (SOX)[1] may confront a related challenge as the securities litigation plaintiffs' bar seeks to leverage the SEC's heightened focus on Rule 21F-17. Over the past several months, a number of publicly traded companies have received letters from plaintiff securities attorneys that demand that the company amend its employment agreements and packages to comply with Rule 21F-17. The companies have been targeted by these attorneys who have located arguably noncompliant agreements in the companies' SEC filings. Because private parties have no standing to enforce SEC rules and regulations, the letters have instead been framed as shareholder derivative demands based on claims that the officers and directors of the targeted companies have violated their fiduciary duties to shareholders by entering into agreements that allegedly violate SEC rules. The demand letters seek revisions to the allegedly deficient employment agreements. Once the company has confirmed it has made the necessary changes, a demand is then made for attorneys' fees as compensation for the benefit the shareholder and its counsel purportedly provided to the company.

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[1] SOX covers any "company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(d)) including any subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company, or nationally recognized statistical rating organization (as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c), or any officer, employee, contractor, subcontractor, or agent of such company or nationally recognized statistical rating organization…." 18 U.S.C. § 1514A(a). Additionally, the U.S. Supreme Court has held that SOX covers certain private contractors doing work for publicly held companies, and prohibits such private companies from retaliating against employees who report suspected SOX violations by the company their employer contracts with. *See Lawson v. FMR LLC*, 134 S. Ct. 1158, 1161, 188 L. Ed. 2d 158 (2014).

There are a number of reasons that such demands may be without merit. Employers, however, should be aware of this new tactic and that its use will likely increase throughout the year. Employers would be well-advised to take precautionary measures to review and, as necessary, revise their confidentiality and non-disparagement agreements, as well as severance and release agreements, with a view toward eliminating any language that could be construed as a possible violation of Rule 21F-17. Such language would include terms that could be interpreted to improperly restrict employees' communications with the SEC regarding suspected securities violations—e.g., terms that might subject employees to termination, discipline, and/or legal action for reporting allegations of unlawful conduct to the SEC; terms that waive an employee's right to receive a whistleblower reward; or terms that require pre-notice to the employer, or approval from the employer, before the employee can permissibly share information regarding suspected legal violations with the SEC. Alston & Bird can help your company make sure that your agreements are compliant with the SEC's current interpretation of its whistleblower rules and to provide advice if your company receives a demand from shareholders' counsel.

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