WHISTLEBLOWER WAIVER ALARMS THE SEC

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FINANCIAL CRISIS-ERA WHISTLEBLOWER laws – protecting and sometimes paying bounties to those who report suspected wrongdoing to US regulators – provide a steady pipeline of tips to the Securities and Exchange Commission (SEC). The SEC in turn is a vigorous guardian of whistleblower rights and is committed to keeping lines of communication unimpeded.

In theory, this is not surprising. Firms likely understand they can be punished by the agency for firing or demoting a securities law whistleblower, regardless of whether the whistleblower reports his or her concerns internally or to the SEC.

But the agency also polices more subtle deterrents. A string of SEC actions, including one last month against a global investment manager, are built around terms in such routine employer-employee communications as confidentiality agreements, separation agreements, codes of ethics and employee handbooks.

Stripped to its essence, the SEC's theory is that strongly worded corporate confidentiality terms – once set out in an employee document – can leave employees unclear as to their rights. Faced with such a term, the agency reasons, employees may feel barred from reporting anything outside the firm, even legally protected whistleblower communications.

There are also examples of more concerning language. The SEC sanctioned a firm for requiring its employees to contractually waive their rights to whistleblower bounties.

In most of these suits, the SEC stipulates it is unaware of any intentional misconduct or actual harm. It need not find instances in which current or former employees were dissuaded from communicating with the SEC or in which action was taken against employees. Put plainly, the SEC believes contractual language alone is enough to state the case.

Industry reaction to the practical implications of that position has been mixed.

Most firms at least collected examples of their confidentiality terms and considered how they might be read. Likewise, many rewrote terms for use going forward, adding 'savings language' to agreements or in their code of conduct specifying that employee whistleblower rights are not affected.

Dealing with older agreements and former employees is more complicated. Some firms make almost blanket outreach to fix them. Others go back on a case-by-case basis. Still others decide that their population of potentially concerning older agreements (basically meaning those without saving clauses), is small and lack extreme language, so can be left as is.

The mixed reactions probably reflect both different facts and views of the issue. Firms can have vastly different numbers of older agreements and resources to deal with them. Firms also use confidentiality terms in different ways. For example, the first high-profile case brought by the SEC in this area involved restrictions on disclosure in the course of an internal investigation – presumably when whistleblower rights might be a live concern.

To date, settlement sums required by the SEC have been modest, generally $100,000 to $400,000. That said, the pain extends beyond the headline financial number and includes unwelcome media coverage, defence costs, subpoenas and depositions and other intrusions on the business.

It's also possible that SEC settlement demands increase over time as the agency concludes firms should be on notice of its position. Given that risk, last month's case may prompt a fresh round of rethinking.