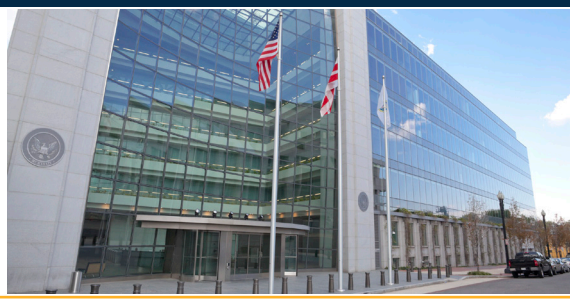
STRADLEY RONON

Client Alert | February 5, 2024

SEC Brings First Settled Enforcement Action Finding Client and Customer Release Agreement Contravened the Whistleblower Rule



On January 16, 2024, the U.S. Securities and Exchange Commission (SEC) settled an administrative proceeding against J.P. Morgan Securities (JPM), finding a violation of the SEC's whistleblower rule, Rule 21F-17(a) under the Securities Exchange Act of 1934 (Exchange Act).[1] JPM neither admitted nor denied the Commission's findings and agreed to pay an $18 million civil penalty. The case has implications for companies whose client and customer settlement and release agreements contain confidentiality clauses.

The SEC's Whistleblower Rule

Rule 21F-17(a) was promulgated pursuant to the "Securities Whistleblower Incentives and Protection" section of the Dodd-Frank Act (which amended the Exchange Act). The rule provides in part that "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 … with respect to such communications."[2]

What the SEC Found

According to the Order, for a period of more than three years, when settling a claim from certain advisory clients and brokerage customers for monetary relief valued at more than $1,000, JPM required the client or customer to sign a confidential release agreement containing a broad confidentiality provision. The confidentiality provision also included a carve-out provision stating that the client or customer and its lawyers are "neither prohibited nor restricted from responding to any inquiry about this settlement or its underlying facts by FINRA, the SEC or any other government entity or self-regulatory organization, or as required by law."[3] However, the Order states that "notwithstanding this statement [i.e., the carve-out], the terms of the release prohibited clients [and customers] from affirmatively reporting to the Commission staff in violation of Rule 21F-17(a), which is intended to

---

[1] See press release 2024-7, U.S. Sec. & Exch. Comm'n, "J.P. Morgan to Pay $18 Million for Violating Whistleblower Protection Rule" (January 16, 2024) and *In the Matter of J.P. Morgan Securities*, Exchange Act Release No. 99344 (January 16, 2024) (Order). The Order also censures JPM and requires it to cease and desist from committing or causing any violations of Rule 21F-17(a).

[2] 17 C.F.R. § 240.21F-17(a); see also Order at ¶ 5.

[3] Order at ¶ 8.

'encourag[e] individuals to report to the Commission.'"[4] As a result, the SEC concluded that JPM violated Rule 21F-17(a), which the Order characterizes as prohibiting "any person from taking any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation."[5]

This is the first settled SEC enforcement action aimed at a confidentiality provision in an agreement with a client or customer.[6] Since 2015 (four years after the whistleblower rule took effect), the Commission has issued 17 other settled orders enforcing Rule 21F-17(a), all of which involve provisions in agreements with, or policies and procedures governing, employees.[7]

Reassessing Confidentiality Clauses

As the Order notes, JPM's release agreement specifically permitted settling clients and customers to respond without limitation to any governmental or regulatory authority inquiry. The agreement, however, did not address whether a client or customer was also permitted to report possible violations of the federal securities laws without prompting if the client or customer wished to do so.

JPM has now revised the agreement in question to address the SEC's findings.[8] In addition, JPM notified its clients and customers that had previously received the agreement to confirm that they are not prohibited from voluntarily communicating with any governmental or regulatory authority.[9]

In light of the Order and the SEC's previous enforcement actions concerning the whistleblower rule, companies with confidentiality clauses in their agreements with employees, clients or customers should consider assessing whether those provisions conform to the SEC's interpretation of Rule 21F-17(a) and revising any provisions that may not do so. In addition, companies may want to evaluate the practicalities and benefits of contacting employees, clients and customers subject to potentially limiting confidentiality clauses to clarify that such clauses do not prohibit them from voluntarily reporting potentially violative conduct to any governmental or regulatory authority.

---

[4] Id. (quoting "Securities Whistleblower Incentives and Protections Adopting Release," Release No. 34-64545, § II.P.C ¶ 2 (June 13, 2011)). The Order notes that, even though, in many instances, JPM separately reported the underlying dispute to the Financial Industry Regulatory Authority (FINRA), such self-reporting did not override the SEC's concern that the confidentiality language ran afoul of Rule 21F-17(a). Id. at ¶ 9.

[5] Id. at ¶ 10.

[6] In a litigated action, the U.S. District Court for the Southern District of New York found a private company to have violated the whistleblower rule by conditioning the return of investor money on the investors' signing of confidentiality agreements that prohibited them from reporting potential securities law violations to law enforcement and later suing to enforce the prohibition when certain investors reported the company's alleged fraud to the Commission. SEC v. Collector's Coffee, No. 19 Civ. 4355 (VM), 2021 WL 5360440 (S.D.N.Y. November 17, 2021).

[7] For example, in the last month of its fiscal year 2023, the SEC resolved three such matters. See *In the Matter of D. E. Shaw & Co.*, Exchange Act Release No. 98641 (September 29, 2023) (finding a violation where D. E. Shaw required new employees to sign agreements that prohibited them from disclosing "confidential information" to anyone outside of the company unless authorized by the company or required by law); *In the Matter of CBRE*, Exchange Act Release No. 98429 (September 19, 2023) (finding a violation where CBRE required employees, as a condition of receiving separation pay, to represent that they had not filed a complaint against CBRE with any federal agency); and *In the Matter of Monolith Resources*, Exchange Act Release No. 98322 (September 8, 2023) (finding a violation where Monolith Resources required certain departing employees to waive their rights to monetary whistleblower awards).

[8] Order at ¶ 12.

[9] Id. at ¶ 13.

It is important to note that the requirements of Rule 21F-17(a) are not limited to SEC-regulated entities and public companies. The SEC underscored this point last September when it settled an enforcement action sanctioning a privately held energy and technology company for using separation agreements that required certain departing employees to waive their rights to monetary whistleblower awards.[10]

Gregory D. DiMeglio
202.419.8401 | gdimeglio@stradley.com

Frederic M. Krieger
212.540.4568 | fkrieger@stradley.com

Alexandra Romano
215.564.8788 | aromano@stradley.com

[10] See Monolith. See also press release 2023-172, "SEC Charges Privately Held Monolith Resources for Using Separation Agreements That Violated Whistleblower Protection Rules" (September 8, 2023) (quoting SEC Regional Director Jason Burt that: "Both private and public companies must understand that they cannot take actions or use separation agreements that in any way disincentivize employees from communicating with SEC staff about potential violations of the federal securities laws.").