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ALERT

Think Because You Are a Private Company the SEC Is Not Your Problem? Think Again (and review those separation agreements)

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What: Twice this month, the Securities and Exchange Commission (SEC) announced settled actions against entities for violating SEC Rule 21F-17(a) related to language in their separation agreements, including one against a privately held company.

Why it matters: While public companies understand that the SEC regulates certain aspects of their activities, private entities should be aware that an aggressive SEC can investigate and penalize them (and their executives), even if they are not directly involved in issuing securities. This is especially important as companies increase their Environmental, Social, and Governance (ESG) activities, and the SEC prepares to roll out its latest climate disclosure rules, which could implicate information private entities provide public companies for their disclosures.

SEC v. Monolith Resources, LLC

Since 2011, the SEC's Dodd-Frank Whistleblower Program has resulted in tens of thousands of whistleblower tips and over $1 billion in awards to successful whistleblowers. To encourage whistleblower reporting, the SEC included certain whistleblower protections in its Dodd-Frank rules, including SEC Rule 21F-17(a), which makes it illegal to put up "roadblocks" preventing or discouraging individuals from reporting potential securities violations to the SEC. As we have noted over the last few years,[1] the SEC's enforcement of Rule 21F-17(a) has become increasingly aggressive with each new action.

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On September 8, 2023, the SEC brought another settled administrative action for violating Rule 21F-17(a), this time targeting Monolith Resources, LLC, a privately-held 236-employee clean technology company based in Nebraska. According to the SEC's Order, from February 2020 – March 2023, Monolith's employee separation agreements had seemingly standard whistleblower language — "Nothing in this agreement is intended to limit in any way your right or ability to file a charge or claim with any federal, state, or local agency." However, the agreements also stated:

These [governmental] agencies have the authority to carry out their own statutory duties by investigating charges or claims, issuing determinations, filing lawsuits . . . . *You retain the right to participate in any such action, but not the right to recover money damages or other individual legal or equitable relief awarded by any such governmental agency*. (emphasis added).

The SEC objected to that language, finding it "raised impediments to participating in the Commission's whistleblower program by having the employees forego the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission's staff about possible securities law violations." At the same time, the Order noted that the provision only applied to twenty-two separation agreements, there was no evidence Monolith enforced the provision against a former employee, and no employee was prevented from contacting the SEC because of this language. Despite these mitigating factors and Monolith's cooperation throughout the investigation, the SEC fined Monolith $225,000.

Two Key Takeaways

Over a decade after the enactment of the Dodd-Frank Whistleblower Protection Act, companies still have language in separation agreements that — at least in the SEC's view — inhibits reporting potential securities law violations to the SEC. Moreover, as noted in the Monolith Order, language that purports to carve out government reporting from disclosure restrictions must be absolute, without any limitations on collecting awards or requirements that an employee certify they have not previously made a whistleblower report to the government. Public and private entities alike should proactively review their employment and separation agreements to help ensure the SEC does not interpret any reporting or disclosure provisions as impermissibly restrictive.

Perhaps more importantly, however, Monolith Resources is a reminder to *privately* held entities that SEC scrutiny is not limited to publicly traded companies, their officers and employees. The SEC believes its investigative authority extends to virtually anything and anyone. While it may be more obvious that a private company selling securities — as broadly as that term is defined — can run into SEC regulation, the Monolith case demonstrates that the SEC does not limit its enforcement activities to private entities directly engaged in purchasing or selling securities.

The SEC's authority to investigate and sanction individuals and privately held entities will become even more critical given the Commission's recent focus on ESG disclosures and the soon-to-be-released climate disclosure rules. As public companies seek to demonstrate their ESG *bona fides*, they may rely on information and disclosures from privately held partners up and down their supply chains. This reliance on private entity information may be further compelled if the SEC demands Scope 3 greenhouse gas (GHG) emission disclosures. If private suppliers provide data that publicly traded entities incorporate into their voluntary (or mandatory) ESG or GHG disclosures, the accuracy of that information could place private companies squarely in the sights of a very aggressive SEC Enforcement Division looking to bring ESG-related cases. To that end, all companies along the supply chain must ensure that ESG-related data furnished to publicly traded business partners is accurate and readily verifiable to ward off inquiries from the SEC and its ESG Task Force.[2]

[1] *See* https://www.wiley.law/alert-SEC-Annual-Whistleblower-and-Enforcement-Reports-Signal-Continued-Aggressiveness-in-2023-and-Beyond; https://www.wiley.law/alert-A-Client-Alert-About-Client-Alerts-SEC-Cites-Alerts-In-Issuing-400000-Fine-Related-to-Whistleblower-Protections; https://www.wiley.law/alert-SEC-Fines-Company-Gouging-Whistleblower-Protections-Severance-Agreements; https://www.wiley.law/alert-SEC-Whistleblower-Program-Demands-Attention-as-Awards-Increase

[2] https://www.wiley.law/alert-SEC-Enforcement-Related-to-ESG-Investing-Likely-to-Increase-in-2022