

SEC IMPOSES PENALTY ON EXECUTIVE OF PRIVATE COMPANY FOR WHISTLEBLOWER RETALIATION

On April 12, 2022, the Securities and Exchange Commission ("SEC") issued a settled order finding that the respondent, David Hansen, had improperly retaliated against a whistleblower. The SEC found that Hansen, a co-founder of a privately held tech company, had violated Rule 21F-17(a) of the Securities Exchange Act of 1934 ("Exchange Act") which prohibits retaliation against whistleblowers that impedes communication with the SEC. The SEC asserted jurisdiction notwithstanding the fact that Hansen's company had never issued registered securities and entered bankruptcy in October 2020. In addition, the SEC did not find that the retaliation was directed at preventing the whistleblower from providing information to the SEC. Previous SEC enforcement actions relating to protection of whistleblowers have primarily focused on the use of severance clauses and confidentiality agreements that limit an employee's right to speak to the SEC or recover whistleblower incentives. Thus, this action represents a considerable expansion of the SEC's enforcement focus with respect to whistleblower protections.

BACKGROUND

In 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The Dodd-Frank Act expanded preexisting whistleblower protections under the Sarbanes-Oxley Act of 2002, which established a comprehensive whistleblower program consisting of financial incentives and protection from retaliation for those who report potential violations of federal securities laws to the SEC.

The SEC, pursuant to its authority under the Dodd-Frank Act, promulgated Rule 21F-17 in 2011. Rule 21F-17(a) states that "[n]o 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."

The SEC has largely pursued enforcement actions pursuant to Rule 21F-17(a) targeting employers for requiring employees to sign confidentiality or similar agreements interfering with the employees' right to speak with the SEC.¹ The SEC has also pursued enforcement actions pursuant to Rule 21F-17(a) on behalf of investors where a respondent attempted to prevent investors from communicating with the SEC by conditioning the return of investor funds on a confidentiality agreement prohibiting investors from communicating with the SEC and other agencies about possible securities violations.²

SEC ORDER AND COMMISSIONER PEIRCE'S DISSENT

The SEC's April 12, 2022 Order (the "Order") states that Hansen was a co-founder of NS8, Inc. ("NS8") and held various positions throughout his time at the company, including Chief Information Officer. NS8 was a technology company offering fraud detection and prevention software, and neither it nor its securities had ever been registered with the SEC.

According to the SEC's findings, an NS8 employee became concerned about potentially falsified data regarding NS8's number of paying customers, including data that served as the basis for investor communications. In July 2019, the employee submitted a tip to the SEC through counsel. Subsequently, the employee raised these concerns to Hansen and informed Hansen that, unless the company addressed his allegations, he would reveal such concerns to the company's "customers, investors, and any other interested parties." Hansen responded that the employee should raise these issues with his supervisor or to the CEO. The employee informed his supervisor of his concerns later that day, and the supervisor in turn called Hansen, who then informed the CEO.

According to the SEC's findings, Hansen and the CEO subsequently took several retaliatory actions. First, the CEO removed the employee's administrator access privileges. Second, Hansen informed the CEO that he could remotely access the employee's laptop and view his screen in real-time, stating "I can watch what he is doing if we care," and Hansen also accessed the employee's computer password. Third, Hansen left the employee's password and computer in the CEO's office. Fourth, the employee's personal passwords were used to access various personal accounts on his NS8-issued laptop.³ Fifth, the CEO fired the employee later that week. The SEC found that Hansen violated Rule 21F-17(a) and imposed a cease-and-desist order on future violations and a penalty of \$97,523.

Commissioner Hester M. Peirce wrote in a statement dissenting from the Order that the Order failed to "explain what, precisely, Mr. Hansen did to hinder or obstruct direct communication between the NS8 Employee and the [SEC]." Peirce argued that Hansen's conduct did not establish a Rule 21F-17(a) violation because the Rule was intended solely to limit retaliation that impeded a whistleblower's access to the SEC. She noted that the employee's complaint to

¹ See, e.g., Complaint, *SEC v. GPB Capital Holdings, LLC* (E.D.N.Y. 2021) (No. 1:21-cv-00583).

² See, e.g., *SEC v. Collector's Coffee, Inc.*, No. 1:19-cv-04355-LGS-GWG (S.D.N.Y. 2020).

³ There is no finding in the Order as to whether Hansen or the CEO were in fact responsible for this conduct.

the SEC had already been filed and that there was no evidence that Hansen knew that the employee had provided information to the SEC or that his retaliatory efforts were directed at preventing that communication. Additionally, she noted that it is plausible that Hansen had legitimate concerns regarding the employee's threat to disclose confidential information to "customers, investors, and any other interested parties" when he sought to limit the employee's access to systems.

TAKEAWAYS

The Order signals an aggressive stance by the SEC to enforce the anti-retaliation protections for whistleblowers under Rule 21F-17(a) not only where there is evidence of direct interference with SEC complaints but also in cases in which the employer is not aware of any SEC contact nor directly hinders access to the SEC. Moreover, the Order does not address whether the SEC would have had jurisdiction to pursue any enforcement action against NS8 or its executives based on the employee's tip. Thus, the jurisdictional nexus appears to turn solely on the fact that the whistleblower made a complaint to the SEC, regardless of whether that tip was actionable. This action may portend further expansive enforcement of Rule 21F-17(a) not only with respect to covered behavior but also with respect to privately held companies. Thus, public and private companies should consider strengthening their anti-retaliation policies in light of this action.

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