ALERTS

New CFTC Rules Formalize Whistleblower Protections for Employees of Hedge Fund Managers and Other Registrants

May 26, 2017

On May 22, 2017, the U.S. Commodity Futures Trading Commission amended and supplemented several CFTC regulations to strengthen anti-retaliation protections for whistleblowers under the Commodity Exchange Act. These amendments, in general, make the CFTC's whistleblower protections consistent with those afforded by Securities and Exchange Commission rules and reinforce the need for private fund managers that are registered as commodity pool operators or commodity trading advisors to take affirmative steps to avoid violating federal regulations regarding whistleblowing.

Section 748 of the 2010 Dodd-Frank Act amended the Commodity Exchange Act by adding a new Section 23, titled "Commodity Whistleblower Incentives and Protection,"[1] which directed the CFTC to establish an incentive program that would reward whistleblowers who voluntarily provide the CFTC with information leading to successful enforcement actions for violations of the CEA. The CFTC subsequently adopted whistleblower protection provisions, in Part 165 of the CFTC Rules, as part of a broader rulemaking effort to implement the bounty program envisioned in Section 23 of the CEA.

On May 22, 2017, the CFTC adopted several amendments to Part 165, including several changes intended to prevent frustration of the CFTC's promotion of whistleblower reporting efforts through employer

enforcement of confidentiality and similar agreements.[2] The main changes resulting from these amendments are:

- *Non-Waiver*: Rule 165.19 was amended to state that the CFTC's whistleblower protections "may not be waived by any agreement, policy, form, or condition of employment, including by a predispute arbitration agreement." It goes on expressly to invalidate any predispute arbitration agreement that requires arbitration of a dispute relating to a whistleblower report.

- *Protected Communications*. Rule 165.19 also was amended to prohibit any person (not only CFTC registrants) from taking any action "to impede an individual from communicating directly with the [CFTC's] staff about a possible violation of the Commodity Exchange Act, including by enforcing, or threatening to enforce, a confidentiality agreement or predispute arbitration agreement with respect to such communications."

- *Enforcement Authority and Standing*. New Rule 165.20 and Appendix A to Part 165 make it clear that both the CFTC and private litigants have the authority to bring an action against an employer who retaliates against a whistleblower (which anti-retaliation sanction applies even if the whistleblower does not qualify for a bounty under the CFTC whistleblower incentive program).

The Release points out that these amendments reverse earlier CFTC positions regarding the ability of the Commission to bring an action for a retaliatory employer's actions against a whistleblower:

By adopting proposed Rule 165.20(b), the Commission is confirming its decision to revise its 2011 interpretation that it lacks the statutory authority to bring an enforcement case against an employer that violates the anti-retaliation prohibition in Section 23(h)(1) [of the Commodity Exchange Act]. The 2011 interpretation failed to fully consider the statutory context of Section 23 and other CEA provisions. … Although Section 23(h)(1)(B) provides a private right of action, nothing in that sub-section purports to limit the Commission's general enforcement authority or suggests that the private right of action is exclusive.[3]

The CFTC stated that one of its goals is to "encourage whistleblowers to report [evidence of corporate wrongdoing] internally," noting that the CFTC whistleblower rules: (i) allow a whistleblower to retain eligibility for a

bounty after reporting internally and (ii) include, as factors that may increase the amount of an award, whether and the extent to which a whistleblower reported the possible violations through internal legal or compliance procedures or assisted any internal investigation concerning the reported violation; however, the CFTC adopted these new and amended rules because it felt that it would be inconsistent for the Commission to encourage internal reporting by whistleblowers and not extend to them anti-retaliation protections to the extent the CEA permits. To do so would place whistleblowers who report internally in a worse position than whistleblowers who do not report internally prior to reporting to the Commission, forcing whistleblowers to choose between reporting internally first in the hopes of increasing any award or foregoing reporting internally in order to preserve anti-retaliation protections.

The applicability of these amendments to private fund managers that are registered with the CFTC as commodity pool operators or commodity trading advisors is clear, and the steps that these registrants should take are substantially similar to the steps recommended under recent whistleblowing cases involving investment advisers registered with the U.S. Securities and Exchange Commission.

In *In re KBR, Inc.*:[4] KBR, as part of its settlement with the SEC, agreed to pay a $130,000 fine and, as a remedial measure, agreed to amend its confidentiality agreements to add the following carve-out:

Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures[.][5]

The SEC later brought a series of enforcement actions against companies for including provisions in severance agreements that the SEC determined could be interpreted to impede employee whistleblowing activity. Provisions the SEC indicated were problematic included non-disparagement and confidentiality provisions, provisions requiring an employee to waive the right to any monetary recovery in connection with

filing a charge with a government agency, and provisions requiring an employee notify the company before providing information to the SEC.[6]

In the wake of the CFTC rulemaking, managers registered with the CFTC should review (to the extent they have not yet done so as a result of SEC enforcement actions and guidance) employment, separation and settlement agreements; employment and compliance polices; and codes of conduct and amend any provisions in these agreements and policies that could be read to be a waiver of or an impediment to a whistleblowing report to the CFTC. These agreements and policies should make clear that whistleblowing activity is permitted without notice to or authorization by the manager. In addition, managers should ensure that their internal reporting procedures are robust.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] Codified at 7 U.S.C. § 26.

[2] Whistleblower Awards Process, RIN 3038-AE50 (May 22, 2017) (the "Release").

[3] Release, at page 26.

[4] *See*, e.g., *In re KBR, Inc.*, Exch. Act Release No. 74619 (April 1, 2015).

[5] *In re KBR, Inc.*, at 3.

[6] *See SRZ Client Alert*, "SEC Whistleblower Update: New Enforcement Actions for 'Chilling' Language in Severance Agreements" (Dec. 22, 2016).

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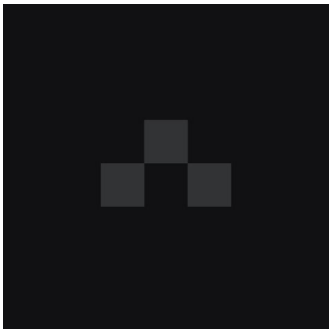

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