SEC Targets Severance Agreements that Silence Whistleblowers

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PRACTICES Government Audits and Investigations, Labor and Employment

Protecting and encouraging whistleblowers is a priority for the enforcement division of the U.S. Securities and Exchange Commission ("SEC") as well as the SEC's Office of the Whistleblower. The SEC recently announced enforcement actions against two companies for their use of restrictive clauses in severance agreements that, according to the SEC, impeded whistleblowers under Rule 21F-17 of the Securities Exchange Act of 1934. Rule 21F-17 was promulgated under the Dodd-Frank Act as a means to prohibit employers from interfering with an employee's right to report potential securities laws violations to the SEC.

These recent enforcement actions and other ongoing investigations serve as a reminder that the SEC is taking an aggressive approach to interpreting and enforcing Rule 21F-17. Public companies and SEC registrants—including investment advisers, funds, and broker-dealers—should review any confidentiality provisions, such as those contained in severance agreements, and consider whether they contain restrictions that could be viewed as having a chilling effect on potential whistleblowers' ability to report to the SEC.

Protecting Whistleblowers

Rule 21F-17 provides in relevant part 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." Before this month, the SEC last brought an enforcement action under Rule 21F-17 on April 1, 2015, targeting a Houston-based company for including impermissible restrictions in confidentiality agreements signed by witnesses during internal investigations. See our coverage of that enforcement action. The first enforcement action followed a "sweep" of investigations to review confidentiality agreements executed by public companies and regulated entities to identify potential violations of Rule 21F-17.

These more recent actions also concern contractual language in employment-related agreements that, in the SEC's view, would have a chilling effect on potential whistleblowers. It appears that these latest enforcement actions similarly resulted from the SEC's sweep.

BlueLinx Holdings

On August 10, 2016, the SEC announced that BlueLinx Holdings Inc. ("BlueLinx"), an Atlanta-based building products distributor, settled charges that it violated Rule 21F-17 by requiring departing employees to sign severance agreements that restricted their ability to communicate securities law violations to the SEC and waived their right to collect any whistleblower awards should they ever report misconduct.

According to the BlueLinx order, the severance agreements violated Rule 21F-17 in two respects. First, many of the agreements contained provisions prohibiting employees from disclosing confidential information unless compelled to do so by law or legal process. Even then, employees

were required to notify, and in some cases obtain consent from, BlueLinx's legal department before disclosing any confidential company information. Because the severance agreements did not provide an exception for voluntary disclosures to the SEC, the SEC concluded that BlueLinx "forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits."

Second, the severance agreements required departing employees to waive any "right to any monetary recovery" in connection with any complaint or charge filed with an administrative agency. According to the SEC, this restriction "removed the critically important financial incentives" that encourage whistleblowers to come forward. On the whole, the SEC concluded that these restrictions impeded individuals from communicating directly with the SEC about possible securities law violations and violated Rule 21F-17.

Without admitting or denying the allegations, BlueLinx agreed to pay a $265,000 civil penalty. In addition, BlueLinx agreed to amend its severance agreements and notify former employees who signed the previous agreements that they are not restricted from providing information to the SEC and are not prohibited from accepting any award they may receive as a result of their whistleblowing.

Health Net, Inc.

In a similar action, the SEC announced on August 16, 2016 that Health Net, Inc. ("Health Net"), a California-based health insurance provider, settled charges that it violated Rule 21F-17 when, like BlueLinx, it required departing employees to sign severance agreements that waived their right to a whistleblower award. According to the Health Net order, although the departing employees were not restricted from filing charges or "participating in any investigation or proceeding before any federal or state agency, or governmental body," the departing employees "waive[d] any right to any individual monetary recovery . . . based on any communication by Employee to any federal, state, or local government agency or department."

According to the SEC, the use of this provision "directly targeted the SEC's whistleblower program" and "undermined the purpose of [the whistleblower provisions], which is to encourage individuals to report to the Commission." Without admitting or denying the allegations, Health Net agreed to pay a $340,000 civil penalty. In addition, Health Net agreed to notify former employees who signed the severance agreements that they are not prohibited from seeking and obtaining a whistleblower award.

Outlook and Recommendations

The SEC's investigative sweeps and its focus on restrictive provisions in employment agreements are continuing and show no signs of slowing. Pursuant to these sweeps, the SEC is requesting that public companies and regulated entities produce confidentiality agreements, severance agreements, codes of conduct, and other employment-related documents so that the staff can analyze compliance with the whistleblower provisions of the Exchange Act and, above all, to identify potential candidates for enforcement actions if such companies have provisions impeding whistleblowers.

In light of these sweeps and the SEC's aggressive stance in Rule 21F-17 enforcement cases, companies should closely evaluate their policies and employment agreements—particularly any confidentiality or severance agreements—to determine whether those agreements could be construed as an impediment to potential whistleblowers. Companies must balance the need to

protect sensitive information with the requirement that they not stifle whistleblowing. They must also incentivize the type of internal reporting that promotes a robust culture of compliance while not impeding external disclosure to the SEC. An explicit exclusion for SEC reporting, like the provision in the SEC's order against BlueLinx, may be the best way to achieve that balance.

For more information, please contact one of the Haynes Boone attorneys listed below: