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WHISTLE-BLOWERS

BNA Insights: SEC Settlements Put Severance Agreements Under Increased Scrutiny



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The Securities and Exchange Commission (SEC) recently announced settlements with two companies for using severance agreements that allegedly violated Rule 21F-17. [Order Instituting Cease-And-Desist Proceedings, In the Matter of BlueLinx Holdings, Inc., No. 3-17371 (SEC Aug. 10, 2016) (BlueLinx Order).] Rule 21F-17 provides that “[n]o person may take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement.” [17 C.F.R. § 240.21F-17(a).] The rule is part of the SEC’s whistleblower program, which provides significant monetary incentives to individuals in exchange for information regarding potential securities violations.

The first settlement, which was announced on August 10, 2016, involves a cease-and-desist order against Atlanta-based building products distributor BlueLinx Holdings Inc. [BlueLinx Order at ¶ 1.] Among other things, the SEC’s order alleged that BlueLinx used severance agreements that required outgoing employees to waive their rights to monetary recovery should they file a charge or complaint with the SEC or other federal agencies. [*Id.* at ¶ 14.] The SEC’s second settlement, an-

nounced yesterday, involves allegations that California-based health insurance provider Health Net, Inc. used severance agreements expressly requiring outgoing employees to waive their ability to obtain SEC whistleblower awards. [Order Instituting Cease-And-Desist Proceedings, In the Matter of Health Net Inc., No. 3-17396 (SEC Aug. 16, 2016) (Health Net Order).] Each company settled the SEC’s charges by paying monetary penalties in the amount of \$265,000 and \$340,000, respectively, and agreeing to a number of undertakings. [BlueLinx Order at ¶ 6; Health Net Order at ¶ 4-5.]

Both settlements are the latest examples of the SEC’s continued focus on employee confidentiality provisions and the agency’s broad application of the whistleblower protection rules.

BlueLinx

BlueLinx’s Problematic Language

From at least August 2011, when the SEC’s whistleblower rules took effect, BlueLinx used severance agreements that prohibited employees from sharing the company’s confidential information but included no exemption for voluntary communications with the SEC or other regulatory or law enforcement agencies. [BlueLinx Order at ¶ 7.] Instead, most of BlueLinx’s severance agreements permitted employees to share confidential information only when compelled to do so by

law and then only after first notifying the company. [Id.] For example, the company's termination agreements contained the following provision:

Employee has not and in the future will not use or disclose to any third party Confidential Information, unless compelled by law and after notice to BlueLinx. * * * If the Employee has any question regarding what data or information would be considered by BlueLinx to be information subject to this provision, the Employee agrees to contact BlueLinx's Legal Department in writing for written clarification.

[Id. at ¶ 8.]

According to the SEC's order, BlueLinx amended the release provisions in each of its severance agreements in June 2013 to expressly permit reporting to the SEC but included a requirement that employees waive the right to any monetary recovery in connection with any complaint filed with the SEC. [Id. at ¶ 14.] BlueLinx's release language stated:

Employee further acknowledges and agrees that nothing in this Agreement prevents Employee from filing a charge with . . . the Equal Employment Opportunity Commission, the National Labor Relations Board, the Occupational Safety and Health Administration, the Securities and Exchange Commission or any other administrative agency if applicable law requires that Employee be permitted to do so; however, Employee understands and agrees that Employee is waiving the right to any monetary recovery in connection with any such complaint or charge that Employee may file with an administrative agency.

[Id. (emphasis added).]

Around the same time, BlueLinx also revised a confidentiality clause in one form of its severance agreements to state:

[The Employee shall not] disclose to any person or entity not expressly authorized by the Company any Confidential Information or Trade Secrets . . . Anything herein to the contrary notwithstanding, you shall not be restricted from disclosing or using Confidential Information or Trade Secrets that are required to be disclosed by law, court or other legal process; provided, however, that in the event disclosure is required by law, you shall provide the Company's Legal Department with prompt written notice of such requirement in time to permit the Company to seek an appropriate protective order or other similar protection prior to any such disclosure by you.

[Id. at ¶ 13.]

The SEC concluded that these provisions impeded BlueLinx employees' participation in the SEC's whistleblower program. [Id. at ¶ 16-19.] According to the SEC, "[b]y requiring departing employees to notify the company's Legal Department prior to disclosing any financial or business information to any third parties without expressly exempting the Commission from the scope of this restriction, [the company] forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits." [Id. at ¶ 16.] The SEC further stated that "[r]estrictions on the ability of employees to share confidential corporate information regarding possible securities law violations with the Commission and to accept financial awards for providing information to the Commission, such as those contained in the Severance Agreements, undermine the purpose of Section 21F . . . and violate Rule 21F-17(a) by impeding individuals from communicating directly with the Commission staff about possible securities law violations." [Id. at ¶ 18.]

BlueLinx's Undertakings

As part of the settlement, BlueLinx agreed to amend its severance agreements to include the following provision:

Employee understands that nothing contained in this Agreement limits Employee's ability to file a charge or complaint with the Equal Employment Opportunity Commission, the National Labor Relations Board, the Occupational Safety and Health Administration, the Securities and Exchange Commission or any other federal, state or local governmental agency or commission ("Government Agencies"). Employee further understands that this Agreement does not limit Employee's ability to communicate with any Government Agencies or otherwise participate in any investigation or proceeding that may be conducted by any Government Agency, including providing documents or other information, without notice to the Company. This Agreement does not limit Employee's right to receive an award for information provided to any Government Agencies.

[Id. at ¶ 20.]

BlueLinx also agreed to make reasonable efforts to contact former employees who had executed severance agreements after August 12, 2011, to provide those employees with a link to the SEC's order, and to notify them that BlueLinx does not prohibit former employees from providing information to the SEC staff or from accepting SEC whistleblower awards. [Id. at ¶ 21.]

Health Net

Health Net's Problematic Language

In August 2011, Health Net amended its severance agreements to add new language to the section detailing an employee's "Waiver and Release of Claims." [Health Net Order at ¶ 7.] The new language specified that, while not prohibited by the severance agreement from participating in a government investigation, a former employee who executed the Waiver and Release of Claims was prohibited from filing an application for, or accepting, a whistleblower award from the SEC. [Id.] In particular, Health Net's amended Waiver and Release of Claims required an employee to waive "the right to file an application for award for original information submitted pursuant to Section 21F of the Securities Exchange Act of 1934." [Id. at ¶ 8.]

Another clause in Health Net's Waiver and Release of Claims provided that:

nothing in this Release precludes Employee from participating in any investigation or proceeding before any federal or state agency, or governmental body . . . however, while Employee may file a charge and participate in any such proceeding, by signing this Release, Employee waives any right to bring a lawsuit against the Company, and waives any right to any individual monetary recovery in any such proceeding or lawsuit or in any proceeding brought based on any communication by Employee to any federal, state, or local government agency or department.

[Id. at ¶ 10.]

According to the SEC's order, Health Net added these provisions in August 2011 after the SEC adopted Rule 21F-17. [Id. at ¶ 7.]

The SEC's order also alleges that Health Net removed the express language prohibiting employees from filing applications for SEC whistleblower awards in June 2013, and added an explicit exemption for reporting information to regulators. [Id. at ¶ 12.] The new exemption provided that "[n]othing herein shall be con-

strued to impede the employee from communicating directly with, cooperating with or providing information to any government regulator.” [Id.] However, Health Net’s revised Waiver and Release of Claims still required employees to waive their right to any individual monetary recovery in connection with such reports. [Id.] Health Net’s revised language specified that:

[N]othing in this Release precludes Employee from participating in any investigation or proceeding before any federal or state agency or governmental body . . . however, while Employee may file a charge, provide information, or participate in any investigation or proceeding, by signing this Release, Employee, to the maximum extent permitted by law . . . waives any right to any individual monetary recovery . . . in any proceeding brought based on any communication by Employee to any federal, state or local government agency or department.

[Id.]

The SEC’s order states that Health Net amended its severance agreements on October 22, 2015, to remove the problematic language described above. [Id. at ¶ 5.]

Notably, in the Health Net action, the SEC acknowledged that it found no evidence of any instances in which a former Health Net employee who executed the allegedly violative agreements did not communicate directly with Commission staff about potential securities law violations, nor did the SEC find any evidence that Health Net took action to enforce the waiver provisions or otherwise prevent such communications. [Id. at ¶ 13.] Nonetheless, the SEC concluded that both the 2011 and the 2013 provisions violated Rule 21F-17 by removing the financial incentive for Health Net’s former employees who executed these severance agreements to communicate with Commission staff concerning possible securities law violations at Health Net. [Id. at ¶ 13-14.]

Health Net’s Undertaking to Notify Former Employees

Health Net agreed to make reasonable efforts to contact former employees who signed the Waiver and Release of Claims from August 12, 2011 to October 22, 2015, and provide those employees with a link to the SEC’s order and a statement that “Health Net does not prohibit former employees from seeking and obtaining a whistleblower award from the Securities and Exchange Commission pursuant to Section 21F of the Exchange Act.” [Id. at ¶ 15.]

Companies Are Encouraged to Revisit Severance Agreements

For the past several years, the SEC has increasingly focused on confidentiality provisions, severance agreements and other employee-related agreements that potentially prevent employees from reporting legal violations to the Commission. The SEC brought its first ever enforcement action for a violation of Rule 21F-17 against KBR, Inc. in April 2015. [Order Instituting Cease-And-Desist Proceedings, In the Matter of KBR Inc., No. 3-16466 (SEC Apr. 1, 2015).] The KBR case, as well as statements by SEC officials since KBR, have made it clear that the agency interprets the language in Rule 21F-17 broadly and plans to continue focusing on potentially violative agreements. [For more detail and analysis on the KBR order, please see William McLucas,

Harry Weiss, *et al.*, “SEC Applies Whistleblower Interference Rule to Corporate Confidentiality Requirement,” WilmerHale Client Alert (Apr. 28, 2015).] Indeed, the SEC’s 2015 annual whistleblower report emphasized the Enforcement Division’s continued interest in confidentiality and other types of employee agreements that may interfere with a whistleblower’s ability to report potential wrongdoing to the SEC. [See William McLucas, Mark Cahn, *et al.*, “Four Things Companies Should Know About the SEC’s 2015 Whistleblower Report,” WilmerHale Client Alert (Nov. 24, 2015); see also SEC, 2015 Annual Report to Congress on the Dodd-Frank Whistleblower Program (Nov. 16, 2015), at p. 2 (“Assessing confidentiality agreements for compliance with Rule 21-F17(a) will continue to be a top priority for OWB into Fiscal Year 2016.”).] The *BlueLinx* and *Health Net* cases confirm this trend.

Companies that have yet to review existing severance agreements and other employee policies for compliance with the SEC’s whistleblower rules are encouraged to do so now. Provisions specifying requirements for former employees who are compelled to disclose company information by law or legal proceeding, release and waiver provisions, and other provisions commonly found in severance agreements should be reviewed to confirm that they are accompanied by a clear exemption for communications with the SEC. In light of the SEC’s focus on these provisions, even companies that have previously amended their severance agreements since the adoption of the SEC’s whistleblower rules are encouraged to revisit those agreements and other policies that contain confidentiality provisions for compliance with Rule 21F-17.

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