ROPES & GRAY ALERT

Securities & Futures Enforcement

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SEC Whistleblower Enforcement Actions Related to Severance Agreements

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On August 30, 2016, the U.S. Securities and Exchange Commission ("SEC" or the "Commission") reaffirmed its commitment to its whistleblower program by issuing the second largest award in its five-year history. While admittedly less dramatic than this $22 million payment, however, the Commission's recent enforcement activity is similarly compelling evidence of the value that the agency places on its whistleblower program. Specifically, on August 10 and August 16, 2016, the Commission announced settlements with two companies based on language in employee severance agreements that discouraged employees from reporting possible securities law violations to the SEC, including by restricting the employees' ability to seek a monetary award from the SEC. These settlements reflect the Commission's broad interpretation of the whistleblower protection provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and its continuing focus on internal confidentiality and severance agreements as an enforcement priority.

I. RULE 21F-17

Consistent with its goal of promoting corporate transparency and accountability, Dodd-Frank amended the Securities and Exchange Act to include whistleblower incentives and protections. The Commission promulgated Rule 21F-17 on August 12, 2011 to prohibit employer conduct that impedes communications with the SEC about potential securities law violations, "including enforcing, or threatening to enforce, a confidentiality agreement." While SEC Chair Mary Jo White has emphasized that the rule is not "a sweeping prohibition on the use of confidentiality agreements," the Commission has taken an expansive view of its scope, using it to police any language that raises the mere possibility that tipsters will be discouraged from coming forward.

For example, in its first Rule 21F-17 enforcement action, the SEC brought charges against KBR, Inc. on April 1, 2015 for language in a confidentiality agreement that prohibited employees from discussing the details of interviews conducted in the course of an internal investigation without prior authorization from the company's general counsel. The SEC did not suggest that the stated purpose of the provision at issue – "to protect the integrity of the review" – was pre-textual or otherwise improper. Nor was there any evidence that KBR intended to enforce the provision or that it deterred any whistleblowing activity. Nonetheless, the Commission took the position that the provision violated Rule 21F-17 because it did not make an exception for an employee's right to communicate directly with the Commission about potential misconduct at the company. In addition to paying a $130,000 fine, KBR voluntarily amended its confidentiality agreement to explicitly acknowledge that nothing in the company's confidentiality agreement "prohibits [the employee] from reporting possible violations of federal law or regulation to any government agency or entity" without "the prior authorization of the Law Department [.]"

II. BlueLinx Holdings, Inc. ("BlueLinx")

On August 10, 2016, the SEC filed and simultaneously settled charges with BlueLinx concerning language that the company included in severance agreements with certain former employees. The severance agreement required employees to (i) refrain from sharing confidential information about BlueLinx that the employee learned while employed by the company unless compelled to do so by law or legal process; (ii) notify the company prior to disclosing information to any third parties and/or (iii) forego any monetary recovery in connection with any

"complaint or charge" that the employee may file with an administrative agency. The SEC took the view 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 . . . undermine the purpose of Section 21F, which is to 'encourage individuals to report to the Commission,' and violate Rule 21F-17(a) by impeding individuals from communicating directly with the Commission staff about possible securities law violations."

In addition to imposing a fine of $265,000, the settlement required BlueLinx to incorporate the following provision in all of its severance agreements, as well as in any other agreements with employees that include prohibitions on the use or disclosure of confidential information relating to the company:

Protected Rights. Employee understands that nothing contained in this Agreement limits Employees' 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 Employees' 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 Employees' right to receive an award for information provided to any Government Agencies.

III. HEALTH NET, INC. ("HEALTH NET")

On August 16, 2016, the SEC filed and simultaneously settled charges with Health Net alleging that the company's severance agreements required employees to relinquish their ability to seek whistleblower rewards in violation of Rule 21F-17. The severance agreements included language that explicitly targeted the SEC's whistleblower program, waiving the employee's "right to file an application for an award for original information submitted pursuant to Section 21F of the Securities Exchange Act of 1934." As part of a regular periodic review and update of its agreements, Health Net voluntarily deleted this language in June 2013 and added a provision clarifying that "[n]othing herein shall be construed to impede the employee from communicating directly with, cooperating with or providing information to any government regulator." However, the severance agreements retained general restrictions on the employee's ability to recover money in connection with a proceeding by "any federal, state, or local government agency or department," even as they recognized that the employee "may file charges and participate in any such proceeding." This provision was removed in October 2015.

The SEC acknowledged that there was no evidence that Health Net had ever tried to enforce any provisions in the severance agreement that could discourage whistleblowers from communicating with the Commission, or that any potential whistleblower was in fact silenced as a result of the provision. However, the SEC noted that the provisions undermined the purpose of Rule 21F-17 "by removing the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations." As part of the settlement, Health Net agreed to pay a $340,000 fine and to contact impacted former employees to inform them of the settlement and make clear that they are not prohibited from seeking and obtaining a whistleblower award from the SEC.

IV. RECOMMENDATIONS FOR EMPLOYERS REGULATED BY THE SEC

Given the SEC's broad interpretation of Rule 21F-17, employers regulated by the SEC would be well-advised to review their current confidentiality and severance agreements to ensure that there is no language that could potentially prohibit or discourage whistleblowers from communicating with the SEC. In the event that there is language restricting employees from communicating with third parties or from recovering monetary awards, legal counsel should be consulted about whether and how to revise the agreements to reflect evolving best practices in the industry and the SEC's recent focus on provisions that the agency believes may impede whistleblowing activity.

Employers should also consider reviewing previous confidentiality and severance agreements to identify potentially problematic language and consult with legal counsel to determine whether it may be advisable to take appropriate remedial measures.

For more information please contact your usual Ropes & Gray advisor.