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SEC Takes Aim at Anti-Whistleblower Employment Agreements

By Bill Mateja and Jason Hoggan of Polsinelli – (Sept. 13, 2016) – On Aug. 15, the U.S. Securities and Exchange Commission issued its second fine in six days to an employer for drafting severance agreements that restricted former employees from collecting awards as whistleblowers. The fines – totaling $605,000 between the two companies – signify a continued, distinct shift toward enforcing rules against employment agreements that impede the SEC's whistleblower program.

Bill Mateja

Considering the SEC's enforcement activities have generally lagged from last year's record numbers, the Commission's new focus may give company counsel a strong incentive to reevaluate any confidentiality provisions that seek to prevent the unauthorized disclosure of company information to law enforcement.

The most recent fine was issued against health insurer Health Net Inc., which agreed to pay $340,000 to end allegations that it required departing employees to waive their right to receive compensation for providing tips to the SEC. On Aug. 10, Atlanta building products distributor BlueLinx Holdings, Inc. agreed to pay a $265,000 fine to cut off similar claims.

Although their companies operate in different industries, the orders against them show striking similarities, leaving the impression that these could be just the first of many actions that the SEC intends to bring to protect the rights of whistleblowers throughout the business world.

SEC's Whistleblower Program

In both cases, the SEC determined that the companies' confidentiality provisions ran afoul of Rule 21F-17, the federal law establishing the whistleblower program as part of the Dodd-Frank Act in August 2011.

Under the whistleblower program, individuals may collect between 10 and 30 percent of the total recovery when information they provide leads to an action recouping $1 million or more. The enforcement language in Rule 21F-17 states:

> "No 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."

While financial incentives are not specifically referenced in the enforcement language, both recent SEC settlement orders explain that such incentives are meant to encourage individuals to bring compliance matters directly to the attention of regulators and are "critically important" to the success of the program as a whole.

Jason Hoggan

The recent settlements represent the first time that a restriction on access to financial incentives was alleged to be an impediment to whistleblower communications under Rule 21F-17. However, they were not the first enforcement actions brought under that rule. Last year, following an investigative sweep to review confidentiality agreements executed by public companies, the SEC announced its first enforcement action under Rule 21F-17.

That action – brought in April 2015 against Houston-based engineering, procurement and construction company KBR, Inc. – alleged that ›

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the company included impermissible restrictions in agreements signed by witnesses who were interviewed during internal investigations. The confidentiality provision under scrutiny prohibited any discussion of the matters discussed in the interview "without prior authorization of [KBR's] Law Department," threatening disciplinary action and even termination for any unauthorized disclosure.

Notably, the action against KBR resulted in only a $130,000 penalty for agreement restrictions that were arguably broader than those used by either BlueLinx or Health Net. The SEC's investigative sweeps involving restrictive employment agreements, combined with a dramatic upward trend in penalties in recent actions, demonstrate the SEC's intent to encourage whistleblower reporting and respond aggressively to any apparent limitations on whistleblower rights.

SEC Action Against BlueLinx Holdings

According to the SEC's order issued on Aug. 10, BlueLinx executed approximately 178 severance agreements since September 2011, each of which violated Rule 21F-17 in one or two ways.

First, the agreements prohibited employees from disclosing any confidential company information unless compelled to do so by law or legal process. In June 2013, BlueLinx amended the agreements and went even further, requiring employees to notify BlueLinx's legal department prior to a required disclosure "to permit the Company to seek an appropriate protective order or other similar protection."

Second, while the amended agreements allowed for voluntary disclosures to the SEC or other agencies "if applicable law require[d] that [the employee] be permitted to do so," they required the employee to "waiv[e] the right to any monetary recovery" as a result of such voluntary reporting.

The SEC held that these restrictions "forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits," and also removed "critically important financial incentives" from the whistleblower process. As such, the SEC concluded that BlueLinx impeded the employees' ability to participate in the whistleblower program in supposed violation of Rule 21F-17.

In addition to imposing a $265,000 fine, the BlueLinx order specified SEC-approved language to include in their future agreements:

> "Protected Rights. 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."

SEC Action Against Health Net

In a similar order published on Aug. 16, the SEC alleged that Health Net violated Rule 21F-17 by requiring approximately 600 departing employees to waive their right to a whistleblower award. Unlike BlueLinx, Health Net allowed employees to provide information to the SEC and other agencies, but expressly required them to waive the right to apply for or accept a monetary reward from the SEC for providing such information under Rule 21F-17. ›

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While Health Net later amended their agreements to remove specific references to SEC whistleblower rewards in June 2013, it left in broader language waiving the employee's right to receive payments for participating in subsequent government investigations.

As in the BlueLinx action, the SEC conceded that it was unaware of any former Health Net employees who chose not to report potential securities violations, nor was the SEC aware of either company taking any action to enforce those provisions or otherwise prevent such communications. Indeed, it is unclear that either company actually violated Rule 21F-17, as neither company is alleged to have taken "action to impede" communication with the SEC.

Nevertheless, the SEC held that both versions of the Health Net severance agreements in question "directly targeted the SEC's whistleblower program 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."

Protecting Companies from Enforcement Actions

In light of the SEC's recent sweeps, along with their aggressive interpretation and enforcement of Rule 21F-17, companies and their counsel would be wise to closely examine current and historic employee agreements to determine if any language therein could be interpreted as impeding potential whistleblowers.

Companies can likely protect themselves by explicitly excluding SEC reporting from any restrictions in their agreements, while also removing any specific reference to the whistleblower program. Including the model provision from the SEC's order against BlueLinx may be the simplest option to protect company interests from similar enforcement actions.

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