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SEC Finds Certain Separation Agreement Provisions Unlawful Under Dodd-Frank Whistleblower Rule

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Twice in the past two weeks, the Securities and Exchange Commission ("SEC" or "Commission") issued a cease-and-desist order settling proceedings against companies for using confidentiality and waiver of claims provisions in employee separation or severance agreements that violate an SEC rule promulgated after passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). The rule in question is designed to encourage and allow whistleblowers to freely disclose information to the SEC without impediments and ensure that they are (and remain) entitled to collect monetary incentive awards if the Commission determines that they are eligible for such awards. In both cases, the companies were required, as part of the settlement of claims without admission of liability, to take affirmative remedial actions and pay fines of hundreds of thousands of dollars as the result of fairly typical language in their separation agreements. In addition, the SEC has signaled that not only will it take action in response to separation agreements that may limit an employee's ability to communicate with the SEC, but also it will oppose attempts by employers to limit an employee's right to receive whistleblower incentive awards.

The SEC's Ongoing "Sweep" to Enforce Rule 21F-17

Dodd-Frank amended the Securities and Exchange Act to include the whistleblower incentives and protections set forth in Section 21F. Rule 21F-17 prohibits employers from taking any action to "impede" an employee from communicating with the SEC about a possible securities law violation, including enforcing or threatening to enforce a confidentiality agreement. In 2014, the SEC announced that it would be strategically analyzing and looking to bring enforcement actions with respect to severance agreements, confidentiality agreements, and employment agreements that violate Rule 21F-17.

In connection with this well-publicized, targeted enforcement sweep, the SEC has become increasingly aggressive about confidentiality and waiver provisions in various types of employment-related agreements. As we reported in April 2015 (see the *Financial Services Employment Law* blog post titled "SEC Finds That Employer's Confidentiality Agreement Unlawfully Silences Whistleblowers in Violation of the

Securities Exchange Act"), the SEC selected a very specific and particular type of agreement for its first publicized action: not a severance, employment, or general confidentiality agreement or policy, but rather, an agreement that an employer's compliance investigators required witnesses interviewed in connection with certain internal investigations to sign. In that agreement, the witnesses acknowledged that they could face discipline or be fired if they discussed the substance of the interview with outside parties without prior approval from the company's legal department. The SEC found such confidentiality language unlawful and the company was required to pay $130,000 and revise its confidentiality agreements to include specific language proffered by the SEC.

SEC Says Employers Cannot Require Employees to Waive the Right to Communicate with, or Receive Financial Awards from, the Commission

In the following cases, the SEC penalized employers for certain provisions in their separation agreements.

A. BlueLinx Holdings, Inc.

On August 10, 2016, the SEC issued an order against BlueLinx Holdings, Inc. ("BlueLinx"), for maintaining provisions in various iterations of its severance agreements that violated Rule 21F-17. Several versions of its separation agreements contained a provision that permitted employees to disclose confidential information "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."

In addition, the BlueLinx separation agreements contained a fairly common proviso to its waiver of claims:

> 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.

The SEC concluded that these two provisions violated Rule 21F-17. The SEC found that "[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, BlueLinx forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits."

With respect to the language regarding the waiver of monetary recovery, even though the provision (i) was limited to a filed "complaint or charge" and not all disclosures, tips, or information provided to an agency, and (ii) did not expressly refer to the SEC's whistleblower incentive award program, the SEC concluded that "by requiring its departing employees to forgo any monetary recovery in connection with providing information to the Commission, BlueLinx removed the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations."

The cease-and-desist order against BlueLinx included a $265,000 penalty and an obligation to contact former employees to inform them that the separation agreements that they signed do not prevent them from providing information to the SEC or accepting a whistleblower bounty award. In addition, BlueLinx had to agree to include the following revised language in its separation agreements going forward:

> 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.

B. Health Net, Inc.

On August 16, 2016, the SEC issued a cease-and-desist order against Health Net, Inc., in a similar case, but one that involved even more explicit language that the company had eliminated on its own. In August 2011, after Rule 21F-17 became effective, Health Net modified its severance agreements to waive explicitly a departing 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." In June 2013, Health Net revised the severance agreement to delete the language expressly prohibiting employees from

applying for SEC whistleblower awards 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."

The severance agreement also included a provision similar to the one at issue in BlueLinx:

> [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.

The SEC conceded that there was no evidence that Health Net ever tried to enforce the provision quoted above or prevent communication with the Commission, nor was there evidence that anyone had ever refrained from contacting the Commission because of this paragraph. In addition, Health Net had removed the paragraph quoted above on its own in October 2015. Nevertheless, the SEC concluded that the quoted provision "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" and, as such, violated Rule 21F-17 "by impeding individuals from communicating directly with the Commission staff about possible securities law violations."

The cease-and-desist order against Health Net included a $340,000 penalty and an obligation to contact former employees to inform them that the separation agreements that they signed between August 2011 and October 2015 do not prevent them from seeking or obtaining a whistleblower incentive award from the SEC. There was no new language required because the company had already removed the offending provision, but despite doing so, the company was still proactively required to contact former employees to remediate the past use of the provision at issue.

It bears noting that the position taken in the cease-and-desist orders issued by the SEC in these two matters has not been ratified by the courts. Moreover, the SEC's position is limited to its interpretation of its own Rule 21F-17 and has no impact outside the SEC (for example, in the federal civil False Claims Act arena).

Is the SEC's Remedial Language Overly Broad?

There is a significant respect in which the BlueLinx remedial language appears to be overly broad. In the language quoted above, the SEC includes several other federal

agencies—the Equal Employment Opportunity Commission ("EEOC"), the National Labor Relations Board, the Occupational Safety and Health Administration ("OSHA"), and "any other federal, state or local governmental agency or commission"—in the definition of "Government Agencies," such that the new language could be read so as to invalidate waivers of the right to receive monetary awards from those agencies in addition to the SEC. This sentence likely goes beyond the scope of the SEC's authority by requiring language that may limit the scope of waivers relevant to other federal, state, or local agencies that have their own rules with respect to waivers. The EEOC, for example, has expressly stated that athough a settlement agreement cannot waive the right to file a charge with the EEOC, "you can waive the right to recover from your employer either in your own lawsuit, *or in any suit brought on your behalf by the Commission*."[1]

Thus, it appears that the SEC's remedial language, at least in the *BlueLinx* matter, may be overly broad and conflict with guidance from the EEOC on acceptable waivers of monetary awards from the agency. Similarly, various state and local laws will likely allow employees to waive the right to monetary recovery, which would also conflict with the SEC's remedial language. Employers should take this apparent conflict into consideration when analyzing potential revisions to their separation agreements, rather than simply cutting and pasting the SEC's remedial language from the *BlueLinx* case into their own agreements. It may be sufficient just to carve out the whistleblower programs created by the Dodd-Frank amendments to the Securities Exchange Act and Commodity Exchange Act, and perhaps other specific bounty award programs, or to simply remain silent on the issue of eligibility to receive monetary awards.

What Employers Should Do Now

It is clear that SEC is fully committed to investigating and prosecuting violations of Rule 21F-17 and that it holds a liberal view of what "impedes" an employee from communicating with it. Employers subject to the SEC's jurisdiction (including, but not limited to, any publicly traded company) should therefore:

- review current separation and severance agreement templates to determine whether they are in compliance with Rule 21F-17;

- if necessary, work with legal counsel to determine appropriate revisions to bring those agreement templates into compliance;

- discuss with legal counsel whether to take affirmative steps to remedy past uses of confidentiality or waiver provisions that would be unlawful under the SEC's *BlueLinx* and *Health Net* orders; and

[1] EEOC, "Understanding Waivers of Discrimination Claims in Employee Severance Agreements" (Apr. 4, 2009) (emphasis added).

- review other types of confidentiality and waiver agreements with employees, in whatever form they are used, to ensure that those agreements do not similarly violate Rule 21F-17.

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