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SEC Policing Severance Agreements

Two companies settle over provisions that allegedly violate Dodd-Frank rule

BY DOUG CHARTIER
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If there were any doubt that the U.S. Securities and Exchange Commission was serious about its whistleblower protection program, it was just erased by two major settlements the commission recently secured within a week of each other.

The SEC announced that companies Health Net and BlueLinx each settled with the commission over charges that they each required their outgoing employees, in order for them to receive severance pay, to waive the ability to file for whistleblower awards.

The recent enforcement indicates that the SEC's whistleblower program under the Dodd-Frank Act is alive and well, and legal experts say that in-house lawyers ought to be reviewing their companies' contracts for potential whistleblower-chilling language as a result.

On Aug. 16, the SEC reported that California-based Health Net agreed to pay $340,000 for using severance agreements that had departing workers sign away their right to receive financial incentives from federal agencies for whistleblowing. In a press release, the commission emphasized the importance of guaranteeing access to whistleblower awards, with SEC Enforcement Division Associate Director Antonia Chion saying that Health Net "used its severance agreements with departing employees to strip away those financial incentives, directly targeting the Commission's whistleblower program."

Notably, Health Net used the anti-whistleblower provision in question August 2011 but later removed all overly restrictive language from its severance agreements in 2015, according to the SEC. The company did not admit to or deny the findings in the commission's cease-and-desist letter.

Just six days prior to the Health Net announcement, the SEC reported its $265,000 settlement with Atlanta-based building products distributor Bluelinx over nearly identical charges. The company added a monetary recovery provision to its severance agreements in 2013, requiring exiting employees to forgo their severance pay if they pursued whistleblower awards, according to the commission. Like Health Net, BlueLinx has neither accepted nor denied the commission's findings.

In addition to paying the $265,000 penalty, BlueLinx agreed to revise its severance agreements to clearly state that employees have the right to pursue whistleblower awards without forfeiting their post-employment benefits. The SEC is also tasking the company with reaching out to former employees who might have signed the allegedly violating agreements and informing them of the same.

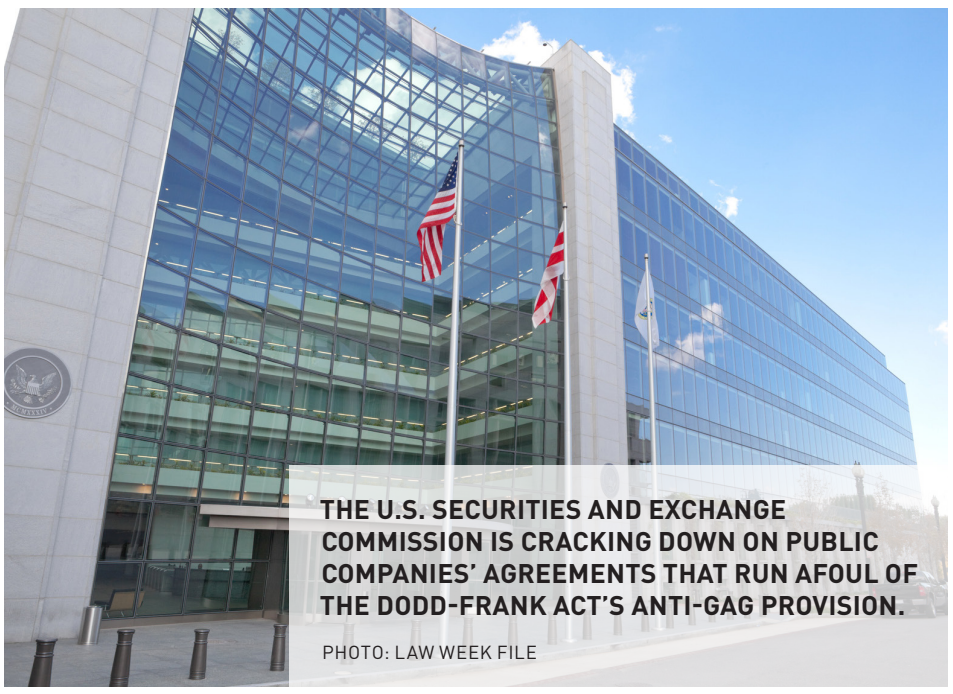
"We're continuing to stand up for whistleblowers and clear away impediments that may chill them from coming forward with information about potential securities law violations," said Stephanie Avakian, deputy director of the SEC's Enforcement Division in an SEC press release.

The regulation at issue is Rule 21F-17, which prohibits "any action (taken) 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."

The commission adopted Rule 21F-17 in August 2011 based on Dodd-Frank-granted authority.

But it wasn't until more than three and a half years later when the commission announced its first Rule 21F-17 enforcement action. The SEC investigated Houston-based KBR Inc. for improperly restrictive confidentiality agreements and announced a settlement with the company April 2015. KBR settled over the SEC's cease-and-desist order for $130,000 and voluntarily amended those agreements for Rule 21F-17 compliance.

The recent federal action over Rule 21F-17 is "another sign that the (Obama) administration wants to preserve the government's right to enforce public policy," said Bill Wright, Sherman & Howard member and manager of the firm's employment law practice group. Wright added that companies should be reviewing their releases for boilerplate language that could be seen as blocking employees from communicating with federal agencies or receiving financial rewards for those communications.



THE U.S. SECURITIES AND EXCHANGE COMMISSION IS CRACKING DOWN ON PUBLIC COMPANIES' AGREEMENTS THAT RUN AFOUL OF THE DODD-FRANK ACT'S ANTI-GAG PROVISION.

PHOTO: LAW WEEK FILE

Though the SEC's whistleblower department has been quiet in the past over Rule 21F-17 violations, it seems to be making a priority of them now, said securities attorney Rikard Lundberg, a partner at Brownstein Hyatt Farber Schreck in Denver.

"THE SEC IS FOCUSED ON THIS. THEY WANT US TO TAKE SERIOUSLY THE WHISTLEBLOWER PROGRAM AND THIS PROHIBITION BUILT INTO THE RULES."

Rikard Lundberg, securities attorney

"The SEC is focused on this," Lundberg said. "They want us to take seriously the whistleblower program and this prohibition built into the rules."

It's unclear from the SEC's orders whether there was a smoking gun of a whistleblower complaint that originated the severance agreement investigations. Brownstein partner Tom Krysa said it can be hard to tell how such probes come about, but in general, if a whistleblower approaches the SEC, it's standard procedure for the agency to see if that individual signed any agreements and if those agreements by themselves might be in violation of whistleblower rules.

Wright said that companies should also be mindful of whistleblower rule enforcement by other agencies, not just the SEC. The Occupational Health and Safety Administration's whistleblower protection program is especially active and wants to maintain access to information workers might have on regulatory violations.

Lundberg agreed that there is "definitely a trend in the last five years or so" of greater focus among various agencies on whistleblower protections, even on the state level.

He said that many public companies might be revisiting their severance agreements that contain confidentiality clauses that bar whistleblower recovery, at least those going back to August 2011 when the rule went into effect. Companies can amend those clauses if they might be running afoul of Rule 21F-17, but it might also be worth sending notification letters to the individuals who signed them letting them know they do in fact have access to whistleblower incentives, Lundberg said.

Between 2011 — when SEC's whistleblower rules under Dodd-Frank first went into effect — and 2015, the commission paid out more than $54 million to 22 individuals. The SEC awarded a total of $37 million to eight whistleblowers in fiscal year 2015 alone. •

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