Harvard Law School Forum on
Corporate Governance and Financial Regulation

SUPPORTED BY:
pwc

The SEC and Whistleblowers: A Spotlight on Severance Agreements

Posted by John F. Savarese and Wayne M. Carlin, Wachtell, Lipton, Rosen & Katz,
on Tuesday, August 23, 2016

Editor's note: John F. Savarese and Wayne M. Carlin are partners in the Litigation Department of Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton memorandum by Mr. Savarese, Mr. Carlin, Jeannemarie O'Brien, and David B. Anders.

In the space of one week, the SEC brought two enforcement actions that reiterate its focus on protecting the rights of whistleblowers. In each case, companies attempted to remove the financial incentives for departing employees to submit whistleblower reports to the SEC. The result instead was a pair of administrative orders (on a neither admit nor deny basis) finding that each company violated SEC Rule 21F-17, which prohibits any person from taking any action to impede a whistleblower from communicating with the SEC about possible securities law violations. *In the Matter of BlueLinx Holdings Inc.* (August 10, 2016); *In the Matter of Health Net, Inc.* (August 16, 2016). For earlier developments in this area, see our post, "The SEC Opens a New Front in Whistleblower Protection" (April 2, 2015).

Both recent cases involved severance agreements entered into with individuals in connection with the termination of their employment relationship, as a condition to the receipt of severance payments and benefits. As is common, such agreements included language that memorialized the departing employee's obligation to maintain the confidentiality of company information. Notwithstanding the confidentiality provisions, BlueLinx included language in its agreements that acknowledged, among other things, the employee's right to "file a charge" with the SEC. The BlueLinx agreements went on, however, to provide that "Employee understands and agrees that Employee is waiving the right to any monetary recovery in connection with any such complaint or charge…." Similarly, Health Net's severance agreements included a provision in which the departing employee expressly waived the right to file an application for a whistleblower award pursuant to Section 21F of the Securities Exchange of 1934. Health Net removed the specific reference to the Exchange Act from later agreements, but still retained language providing that the employee waived any right to monetary recovery in any proceeding based on any communication by the employee to any government agency. It should not come as a surprise that the SEC would find Rule 21F-17 violations on such a record: explicit efforts to eliminate the financial incentive to blow the whistle and seek an award under the SEC's bounty program surely appear to involve an attempt, in the SEC's words, to remove the "critically important financial incentives" on which the agency's whistleblower program is built.

While the principal focus of these cases is the relatively unusual interference with financial incentives discussed above, the *BlueLinx* agreements also included a more commonplace provision requiring employees to notify the company's legal department in the event that they

believed they were required by law or legal process to disclose any confidential information. *BlueLinx* thus raises the question whether the SEC would assert that a notice requirement without an express carve-out for whistleblowing violates Rule 21F-17, even if it is entered into at a time when no investigation is in progress or contemplated and even if there are no provisions in the agreement directly aimed at deterring whistleblower activity. One might reasonably argue that—without more—a general confidentiality provision entered into at a time when there was no contemplation of an SEC investigation could not be an action taken with an intention "to impede" whistleblowing activity. In future cases, however, there is a substantial risk that the SEC will focus on the *effect* of such provisions, even if they were intended to serve a legitimate business purpose unrelated to discouraging whistleblowing.

SEC Chair Mary Jo White has previously acknowledged that the SEC does not seek to interfere with the ability of companies to protect trade secrets or other confidential information through "properly drawn" agreements. "The SEC as the Whistleblower's Advocate" (April 30, 2015), discussed on the Forum here. Later in the same speech, however, White expressed the view that a properly drawn agreement should ensure that employees "understand that it is always permissible to report possible securities laws violations to the Commission." Juxtaposing these comments with the *BlueLinx* order suggests that the SEC is likely to take the position that an agreement that is otherwise "properly drawn" nonetheless may run afoul of Rule 21F-17 if it includes standard confidentiality language but lacks an express carve-out disclaiming any intent to prevent the employee from engaging in whistleblowing activities.

These enforcement actions confirm that the SEC continues to focus on protecting whistleblower rights. Companies should review all forms of agreements with employees, including standard form separation agreements and releases, to ensure that the terms do not prohibit an employee from exercising any legally protected whistleblower rights, and should consider including an express exclusion with that effect. This seems prudent, notwithstanding that the SEC would arguably be stretching the reach of Rule 21F-17 if it sought to proscribe conventional confidentiality language implemented in the absence of a reason to believe that an employee is a potential whistleblower.