Any Agreements with Employees Might Implicate Whistleblower Rules

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Employee Benefits, Employment, Securities Litigation, and White Collar

The U.S. Securities and Exchange Commission (SEC) continues to aggressively pursue companies using severance and other employment agreements that could be perceived to discourage employees from reporting possible securities law violations. Three enforcement actions this past summer demonstrate the need for companies to proactively review and give consideration to any provision in an employee agreement that could be interpreted as impeding whistleblowing activity—regardless of whether the agreement has actually stifled potential whistleblowers or was intended to do so.

Also this past summer, the U.S. Department of Labor's (DOL) Occupational Safety and Health Administration (OSHA) revised its policy guidelines for approving settlement agreements with employees who have filed OSHA whistleblower complaints. Many of the same provisions the SEC's enforcement actions describe as problematic are also problematic under the revised DOL guidelines.

The Commission's Focus on Employee Agreements

The SEC's whistleblower program has resulted in more than $111 million in awards to 34 whistleblowers,[1] highlighting the Commission's commitment to reward individuals who file reports concerning securities law violations. Under SEC Rule 21F-17, "[n]o 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." SEC issued its first cease-and-desist order concerning the limits of employee confidentiality obligations under Section 21F-17 last year in *In re KBR, Inc.*, as discussed in our April 1, 2015 client alert. Although SEC had no evidence of KBR taking any action to enforce the confidentiality provision or to impede communications with the SEC in any other way, the Commission levied a fine in addition to issuing the cease-and-desist order.

KBR involved a confidentiality agreement signed by employees participating in internal investigations. Recently, SEC has extended its enforcement actions pursuant to Rule 21F-17 to severance, separation, and confidentiality agreements that are much more widely and routinely used by employers. In the three actions this past summer, the SEC alleged that the companies violated Rule 21F-17 by using language in severance agreements that *could* operate to impede

[1] SEC Issues $4 Million Whistleblower Award, SEC Press Release (Sep. 20, 2016), *available at* https://www.sec.gov/news/pressrelease/2016-188.html.

or deter employees from providing information to the Commission, but did not allege that the agreements actually *had* impeded such communications. *In re Merrill Lynch, Pierce, Fenner & Smith Incorporated et al.*, Release No. 34-78141 (Jun. 23, 2016); *In re BlueLinx Holdings Inc.*, Release No. 34-78528 (Aug. 10, 2016); *In re Health Net, Inc.*, Release No. 34-78590 (Aug. 16, 2016). The companies eventually agreed to pay a monetary penalty, amend their severance agreements if the offending provisions were still in use, and notify former employees that they are not prohibited from providing information to the Commission or from accepting whistleblower awards.

The Commission's recent enforcement actions reveal that the agency has adopted a broad interpretation of Rule 21F-17 and will continue to take issue with any employee agreements that may appear to undermine the Commission's whistleblower program. The enforcement actions resulting from this scrutiny may cause companies to incur substantial defense costs and could also result in reputational harm and significant penalties.

Problematic Language

The SEC has made clear that it considers unacceptable any language in a company's severance or separation agreement with departing employees that either (1) restricts the employees' ability to disclose confidential information about the company to government authorities voluntarily and anonymously, or (2) forces employees to forgo their severance pay and other benefits, including whistleblower awards, if they become whistleblowers.

In Re Merrill Lynch

In re Merrill Lynch involved language in a form severance agreement for certain departing employees that prohibited them from disclosing the company's confidential information to any outside person or entity, except pursuant to formal legal process or unless the former employee first obtained written approval from Merrill Lynch. In addition, the form severance agreement limited the types of information that employees could convey to the SEC to those relating to the agreement itself or to its underlying facts. Although the SEC noted that it was unaware of any instances in which a Merrill Lynch employee was prevented from communicating with the SEC about a potential violation, the Commission nevertheless found that the language "operated to impede such communications" with the SEC, violating Rule 21F-17.

Merrill Lynch, which was also charged with multiple violations of consumer protection laws, agreed to admit wrongdoing and pay $415 million to settle all of the charges. In addition, Merrill Lynch agreed to revise its employee agreements, policies and procedures, as well as to supplement its training programs on Rule 21F-17. The fact that Merrill Lynch resolved the 21F-17 issue as part of a broader settlement suggests that the SEC may be inclined to scrutinize compliance with 21F-17 alongside investigations into other potential securities laws violations, and companies in such situations would be wise to consider this possibility.

In re BlueLinx Holdings Inc.

In re BlueLinx Holdings Inc. involved the use of severance agreements with confidentiality provisions that required departing employees to inform the company prior to disclosing certain information to a third party. The SEC faulted BlueLinx for not "expressly exempting the Commission" from this requirement. Moreover, BlueLinx's severance agreements required employees to waive their rights to monetary recovery if they filed a complaint with the SEC or

other federal agencies. BlueLinx's severance agreements (which were signed by approximately 160 BlueLinx employees) provided in relevant part:

> 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.

According to the SEC, BlueLinx's restrictive language forced departing employees to waive possible whistleblower awards or risk losing their severance payments and other benefits. BlueLinx settled the charges on a "neither admit nor deny" basis, agreed to pay a $265,000 penalty, and promised to make reasonable efforts to inform former employees who had signed the severance agreements that the company does not prohibit disclosures to the SEC or prohibit the acceptance of whistleblower awards. In addition, the SEC required BlueLinx to add a provision to its severance agreements stating, among other things, that the agreement did not "limit Employee's right to receive an award for information provided to any Government Agencies" (defined as the Equal Employment Opportunity Commission (EEOC), the National Labor Relations Board, the Occupational Safety and Health Administration, the SEC or any other federal, state or local governmental agency or commission).

In re Health Net, Inc.

On August 16, less than a week after issuing the *BlueLinx* order, the SEC issued a comparable order in *In re Health Net, Inc.* The SEC alleged that Health Net's severance agreements impermissibly eliminated the financial incentive for reporting information. Certain of Health Net's severance agreements provided in relevant part:

> [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.

Health Net settled the charges on a "neither admit nor deny" basis, agreed to pay a $340,000 penalty, and promised to make reasonable efforts to inform former employees who had signed the severance agreements that the company does not prohibit whistleblowers from seeking and obtaining an award from the SEC. Again, although the Commission was not aware of any instance in which the severance agreement caused a former employee who executed the agreement to not communicate with the SEC about a potential violation, or any instance in which Health Net actually enforced the offending provision in the agreement, the fact that the severance agreement could be read to deter whistleblowers was enough, in the SEC's view, to constitute a violation of Rule 21F-17.

DOL's OSHA Guidelines

Although the DOL's guidelines apply only to DOL's review of agreements settling active complaints that have been filed with OSHA, the guidelines reflect that DOL shares the SEC's concerns about provisions that can be considered to prohibit, restrict, or otherwise discourage complainants from participating in protected activity. The DOL guidelines highlight four types of provisions it considers problematic: any provision that (1) restricts a complainant's ability to provide information to the government, whether through complaints, cooperation, or testimony; (2) requires a complainant to notify his or her employer before providing information to a government agency; (3) obligates a complainant to affirm that he or she has not previously reported wrongdoing to the government, or to disclaim that he or she has knowledge of any wrongdoing; or (4) requires a complainant to waive his or her right to receive a monetary award or reward from a "government administered whistleblower-award program," including the SEC's whistleblower program. The memo asserts that DOL will not approve settlements that contain the offending provisions, but will instead ask that the offending provisions be removed and/or that contrary "savings" language be added.[2]

Impact of the Orders and Guidance

A troubling aspect of the SEC's actions is its broad view of its power to insist upon changes to agreements and provisions that have routinely been used by companies since before the adoption of Rule 21F-17. The SEC's orders may also run counter to guidance issued by other agencies. For example, the EEOC has counseled employers to maintain confidentiality with respect to workplace investigations—which may have been part of the motive behind the confidentiality agreements that KBR asked employees to sign in connection with internal investigations. In addition, the EEOC has given guidance in its policy document concerning employee severance agreements and elsewhere, that it is acceptable to ask employees in severance agreements to waive monetary awards in actions brought on their behalf by the EEOC—guidance that directly conflicts with the SEC's suggestion, through the required language in *BlueLinx*, that such waivers are unenforceable. Similarly, significant case law has developed around the enforceability of employee waivers of False Claims Act claims and any resulting relator's share, and the SEC arguably does not have the necessary jurisdiction over the FCA regime to alter that landscape.

DOL's guidance memo is more circumspect than the orders issued by the SEC and directly impacts only a small number of claims pending with OSHA, but still it purports to mandate the types of provisions that are acceptable concerning all possible "government-administered whistleblower award programs"—and serves as a caution to employers that government agencies are united behind the protection of whistleblowers.

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[2] The language that DOL may ask parties to add in a "prominent[] position" is: "Nothing in this Agreement is intended to or shall prevent, impede or interfere with complainant's non-waivable right, without prior notice to Respondent, to provide information to the government, participate in investigations, file a complaint, testify in proceedings regarding Respondent's past or future conduct, or engage in any future activities protected under the whistleblower statutes administered by OSHA, or to receive and fully retain a monetary award from a government-administered whistleblower award program for providing information directly to a government agency."

As explained above, companies should carefully review their confidentiality provisions, severance agreements, and other employee agreements and policies to identify whether they contain language similar to the language that the Commission determined to be in violation of Rule 21F-17 in *In re Merrill Lynch*, *In re BlueLinx Holdings Inc.*, and *In re Health Net, Inc.,* or similar to the provisions identified by DOL in its guidance memo. The extent to which companies might wish to revise any such provisions will depend on a number of factors, including whether any such company is at risk of SEC or DOL investigation (or is willing to tolerate such risk), what sorts of whistleblower protections are already in place, and the volume of employment disputes that arise in the whistleblower context versus others (such as False Claims Act or discrimination). Companies are advised to assess these various risks and to consider whether they wish to craft or continue to use agreements that include (1) broad confidentiality or non-disparagement obligations, (2) disclaimers concerning prior reports to the government or knowledge of wrongdoing, and/or (3) broad waivers of certain types of awards and recoveries, without the type of carveouts the SEC and DOL have recently required.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

Tammy Albarran	+1 415 591 7066	talbarran@cov.com
Lindsay Burke	+1 202 662 5859	lburke@cov.com
Steven Fagell	+1 202 662 5293	sfagell@cov.com
Barbara Hoffman	+1 212 841 1143	bhoffman@cov.com
Nancy Kestenbaum	+1 212 841 1125	nkestenbaum@cov.com
David Kornblau	+1 212 841 1084	dkornblau@cov.com
David Martin	+1 202 662 5128	dmartin@cov.com
Richard Shea	+1 202 662 5599	rshea@cov.com

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