Client Alert

pillsbury

Whistleblower Prevention & Defense Team
Corporate & Securities
Litigation
Securities Litigation & Enforcement
Employment
Executive Compensation & Benefits

January 19, 2017

SEC Continues Crackdown on Employer Whistleblower Restrictions

Current and prior severance agreements and other employment-related contracts should be reviewed.

By Kathryn A. Nyce, Sarah A. Good, Susan P. Serota, Kenneth W. Taber and Paula M. Weber

Takeaways:

- *SEC is targeting contract terms that appear to restrict contact with the SEC or require employee whistleblowers to waive monetary recoveries.*
- *Express disclosure of these rights in severance agreements is now required by the SEC.*
- *The fact that the contract did not thwart any whistleblowers is not an adequate defense.*

The U.S. Securities & Exchange Commission (SEC) continues to attack any employer practices which may have the effect of suppressing whistleblowers' access to the SEC. The recent spate of settled enforcement actions against companies with agreements or policies that could potentially impede employee communication with the SEC demonstrates the SEC's intention to scrutinize all levels of business practices—and eradicate anything that could even potentially stifle whistleblowers' rights.

Thus, employers should carefully review their current agreements and, in certain circumstances described below, notify signatories to prior, more restrictive agreements, that those restrictions are now lifted.

Overview

The SEC has grounded each such enforcement action in a violation of Rule 21F-17, a rule developed by the SEC to implement the "Securities Whistleblower Incentives and Protection" section of the Dodd-Frank Wall Street Reform and Consumer Protection Act. 15 U.S.C. § 78u-6 (Dodd-Frank). Under Rule 21F-17, no person may take any action to impede a whistleblower from communicating with the SEC about a possible violation of securities law, including enforcing or threatening to enforce a confidentiality agreement. 17 C.F.R. § 240.21F-17.

In April 2015, the SEC announced its first settled enforcement action against a public company which had required witnesses in internal investigations to sign confidentiality statements agreeing that they would not discuss the subject matter of the interview. *In the Matter of KBR, Inc.*, SEC File No. 3-16466 (April 1, 2015). Despite the fact that there was no explicit prohibition regarding communicating with the SEC or any government entity, in response to the enforcement action, the company voluntarily amended its confidentiality statement to affirmatively state that employees were free to report possible violations of federal law to any government agency including the Department of Justice, the SEC and Congress.

Subsequently, the SEC has announced a number of settled enforcement actions against employers for agreements and policies that the SEC asserts restrain whistleblower rights. In each of these actions, the SEC has focused on two issues: (1) contract provisions that limit communication with the SEC; and (2) contract provisions that require employees to waive monetary recovery in connection with reporting information to the government.

Documents Limiting Communications with the SEC

The SEC has made clear that any contract provisions which explicitly prohibit voluntary communication with the SEC violate Rule 21F-17. Recently, the SEC took issue with a company that had a non-disparagement clause in its severance agreement that expressly prohibited former employees from communicating with the SEC and other government agencies. *In the Matter of NeuStar, Inc.*, SEC File No. 3-17736 (Dec. 19, 2016). One day after the *NeuStar* settlement, the SEC more broadly invalidated another company's severance provisions that prohibited former employees from voluntarily contacting government agencies with any complaint, participating in a government investigation, being paid as a result of a government investigation, providing confidential information to the government, or disparaging the company to any government agency. *In the Matter of SandRidge Energy, Inc.*, SEC File No. 3-17739 (Dec. 20, 2016).

While the *NeuStar* and *SandRidge* settlements dealt with contract provisions that expressly prohibited government communication, the SEC has also taken issue with more nuanced provisions. In the first enforcement action following *KBR*, the SEC extended its reach to severance agreements which prohibited employees from sharing confidential information *with anyone* unless compelled to do so by law and unless the company was given notice of the disclosure. *In the Matter of BlueLinx Holdings Inc.*, SEC File No. 3-17371 (Aug. 10, 2016). *BlueLinx* is striking in that the company was held accountable, not for language that was improper on its face, but because it did not also contain language that expressly excluded voluntary communications with government agencies from the prohibited conduct.

Documents Waiving Awards from the SEC

The SEC has also taken issue with provisions that purport to waive recovery of monetary awards for SEC whistleblowers because it removes the financial incentives that are intended to encourage communication with the SEC. In *BlueLinx*, the SEC focused on a provision which stated broadly that an employee could file charges with certain named government agencies including the SEC but that, in doing so, the employee waived the right to any monetary recovery for such complaint. In requiring that the company revise its agreement to state that former employees were not limited in their right to receive an award from *any* government agency, the SEC appears to read its authority to extend beyond protecting potential whistleblower communications with its own staff.

Six days after *BlueLinx*, another SEC settlement concerned a severance agreement containing provisions that (1) explicitly waived awards for information submitted to the SEC, and (2) informed employees that they were free to participate in any investigation with a government agency, but that they waived any right

to monetary recovery in such a proceeding. *In the Matter of Health Net, Inc.*, SEC File No. 3-17396 (Aug. 16, 2016). The company later removed these provisions from its severance agreement. Because the revised severance agreement no longer included problematic language, the SEC did not require an affirmative statement that informed employees of their right to receive financial incentives as it had done in *BlueLinx*. Similarly, in a recent settlement, the target company voluntarily removed language which waived the employee's right to a monetary recovery for reporting misconduct under the Dodd-Frank Act. *In the Matter of BlackRock, Inc.*, SEC File No. 3-17786 (Jan 17, 2017). While the company's revised documents inform all employees of their rights to report potential violations of law to the SEC or other government agencies, the revised documents do not mention government monetary awards. Like *Health Net*, the SEC did not require the company to include an affirmative provision regarding the right to monetary awards.

Based on *Health Net* and *BlackRock*, the SEC may not require an affirmative statement that an employee can recover monetary awards from the SEC as long as the agreement informs the employee of his or her right to communicate directly with any government regulator, and is silent as to the ability or inability to recover monetary awards from such government agencies.

Companies Subject to Enforcement Actions

The SEC has thus far focused its efforts on public companies. However, the SEC bounty program is not explicitly limited to information about public companies and there is some indication it could also apply to private companies. While the SEC has been particularly severe with companies that use prohibited language in their employment documents while under active investigation, the SEC has also made clear that offending agreements and policies violate Rule 21F-17 regardless of whether there is any evidence that an employee was actually impeded by the problematic language. Indeed, in a number of the settlements, the SEC observed that it was unaware of any instances where an employee had been prevented from communicating with the SEC because of the violative provisions. Therefore, even companies that do not believe their contracts have prevented free communication with the SEC are susceptible to SEC scrutiny.

Remedial Measures Required by the SEC in Enforcement Actions

In each of these settlements, the SEC has, not surprisingly, required the target companies to revise their agreements and policies (if the company had not done so already). Indeed, the SEC has stated explicitly that revision of all employment documents is its primary remedial step in its enforcement actions. *See* SEC Office of Compliance Inspections and Examinations Risk Alert (Oct. 24, 2016) (SEC Risk Alert). Though the SEC has focused most of its scrutiny on severance agreements, it has also highlighted the following documents that it will regularly analyze as part of its examinations: compliance manuals, codes of ethics, and employment agreements. *Id*.

But, in addition to revising documentation going forward, recent SEC settlements have also demanded remedial measures with respect to past agreements. In all but one of those settlements, the SEC has required the targeted companies to send all former employees who signed offending agreements after August 12, 2011, the effective date of Rule 21F-17, notices disavowing the offending provisions of their particular severance agreements. In fact, the only case in which the SEC did not order such notice to former employees was one where the company had already voluntarily provided the notice to all affected former employees prior to the issuance of the cease-and-desist order. *See SandRidge Order*.

In a recent Risk Alert, the Office of Compliance Inspections and Examinations indicated that it will continue to require companies to provide notice to current and former employees who have signed unduly restrictive agreements of their right to contact the SEC or to seek whistleblower awards. *See* SEC Risk Alert.

Recommended Actions:

1. Review and, where necessary, revise all severance agreements, as well as all other employment related contracts and policies, which could be read to limit communications with the SEC or bounty recoveries in any way. This includes explicit provisions prohibiting such communication with the SEC or more broadly all government agencies; provisions limiting the types of information that can be provided such as prohibitions on sharing confidential information; provisions requiring company approval prior to such communications; provisions waiving all monetary recovery from government agencies; and even provisions which make no reference to the government at all but which restrict communication generally without exempting the SEC.

2. Consider whether past severance and other agreements entered into by the company on or after August 12, 2011 should be amended or clarified by advising the signatories that the restrictions have been lifted. Such amendments or clarifications should only be done with the advice of counsel, and may not be appropriate in all circumstances.

If you have any questions about the content of this Alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Kathryn A. Nyce (bio)
San Diego
+1.619.544.3115
kathryn.nyce@pillsburylaw.com

Sarah A. Good (bio)
San Francisco
+1.415.983.1314
sarah.good@pillsburylaw.com

Susan P. Serota (bio)
New York
+1.212.858.1125
susan.serota@pillsburylaw.com

Kenneth W. Taber (bio)
New York
+1.212.858.1813
kenneth.taber@pillsburylaw.com

Paula M. Weber (bio)
San Francisco
+1.415.983.7488
paula.weber@pillsburylaw.com