SEC's One-Two Punch Aims at Severance Agreements

Labor & Employment Law Update

By Beverly Alfon on August 19, 2016

In the past week, the Securities and Exchange Commission (SEC) twice flexed its muscle in the arena of employee rights – taking specific aim at severance agreements that require departing employees to waive their rights to collect whistleblower awards.

Background

Severance Agreements: For many companies, it is standard practice to present departing employees with voluntary severance agreements that set out the terms of the termination of the employment relationship. Often, these include a monetary payment from the employer in exchange for a waiver and release of various potential claims that may stem from the course of the individual's employment.

SEC Whistleblower Award Program: Whistleblowers may be eligible for an award when they voluntarily provide the SEC with unique and useful information that leads to a successful enforcement action. Whistleblower awards can range from 10 percent to 30 percent of the money collected when the monetary sanctions exceed $1 million. The purpose for the program is "to encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees." See, SEC Release No. 34-64545, at p.197 (Aug. 12, 2011). The whistleblower program has awarded more than $85 million to 32 whistleblowers since the program's inception in 2011.

SEC Rule 21F-17 provides in part that: "No 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."

Punch #1: *Blue Linx Holdings, Inc.* (August 10, 2016)

The severance agreements at issue here contained the standard prohibition on the sharing of any confidential information acquired during the course of employment with the company, unless required to do so by law or court order. The agreement also required employees either to provide written notice to the company or obtain written consent from the company's legal department prior to providing confidential information pursuant to legal process. In addition, some

of the agreements specifically required the employees to waive their right to receive whistleblower awards.

In line with prior orders, the SEC found that the confidentiality provisions violated Rule 21F-17, by impeding participation in the whistleblower program by "forc[ing] … employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits." Most notably, however, the SEC also found that the waiver provision undermined the purpose of encouraging communications to the SEC, and also violated Rule 21F-17.

Punch #2: *Health Net, Inc.* (August 16, 2016)

The Health Net severance agreements explicitly stated that they did not prohibit the departing employee from participating in any government investigation – but in the same paragraph, specifically prohibited the employee from applying for or accepting a whistleblower award. The SEC found that the waiver language "directly targeted the SEC's whistleblower program" by removing the ability of the departing employee from seeking financial incentives from the SEC and as a result, undermined the purpose of the Exchange Act and whistleblower program.

Outcome

Both companies settled the SEC's charges by agreeing to pay a monetary penalty (BlueLinx – $265,000; Health Net – $340,000). The SEC also required them to contact all former employees who were a party to the settlement agreements in order to provide a copy of the SEC order and confirm no restriction on their ability to seek and obtain a whistleblower award.

Bottom Line

Severance agreements are on the SEC's radar. While the SEC only monitors the activities of publicly traded companies, privately held companies should also consider reviewing their severance agreements. The attention given to these recent SEC orders has highlighted waiver and release language that employers commonly include in their severance agreements. In this pro-employee/pro-labor climate, it would not be a difficult leap for other government agencies (e.g., IRS, DOL, EEOC and NLRB) to adopt the same logic and construe such language as an attempt to interfere with the rights that they seek to enforce.