

# Employers Should Not Thwart Whistleblower Awards

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In two recent orders, the U.S. Securities and Exchange Commission (SEC) signaled that it is paying particular attention to attempts by companies to prevent former employees from whistleblowing through restrictive covenants contained in severance agreements.

Section 21F was added to the Dodd-Frank Wall Street Reform and Consumer Protection Act to "encourage whistleblowers to report potential violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees."<sup>1</sup> Since the SEC started allowing whistleblowers to receive financial incentives for reporting securities law violations, it has paid over \$100 million in whistleblower awards.<sup>2</sup> Most recently, on Aug. 30, 2016, the SEC paid a \$22.4 million whistleblower award—the second largest whistleblower award to date—to a financial executive for reporting accounting fraud by Monsanto Co.<sup>3</sup> This executive's action led to an \$80 million settlement between the SEC and Monsanto.<sup>4</sup>

Despite the SEC clearly favoring rewards for whistleblowers, some companies still attempt to prevent departing employees from reporting securities violations. Rule 21F-17 of the Dodd-Frank Act specifically prohibits companies from impeding whistleblowers by enforcing, or threatening to enforce, confidentiality agreements.<sup>5</sup> Yet, companies have attempted to find an end-run around Rule 21F-17 through cleverly drafted severance agreements that do not prevent an employee from contacting a government agency, but effectively remove the financial incentives for doing so.

## **Impediments to Program**

Prior to 2013, building-products wholesaler, BlueLinX Holdings Inc.'s standard-form severance agreements contained provisions that prevented former employees from voluntarily sharing confidential information with anyone, including government agencies.<sup>6</sup> Around June 2013, BlueLinX revised its severance agreement so that former employees could report securities violations, thus following Rule 21F-17. These new severance agreements, however, contained a general-release provision that prevented departing employees from receiving monetary awards in connection with any future complaint that employees filed with the SEC. Essentially, departing employees had to choose between a severance package or a possible SEC reward. More than 150 BlueLinX former employees signed the revised severance agreement with the provision stating:<sup>7</sup>

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.

On Aug. 10, the SEC concluded that the general-release provision acted as an impediment to employees' participating in the SEC's whistleblower program. BlueLinX essentially "removed the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations."<sup>8</sup>

As a result of violating Rule 21F-17, the SEC ordered BlueLinx to change the language in its severance agreements to make clear that employees can still receive awards for whistleblowing. BlueLinx also had to contact all of the former employees who had signed the severance agreements and inform them that they could provide information to government agencies and that disclosure would not run afoul of their executed severance agreement. Finally, the SEC ordered BlueLinx to pay a \$265,000 civil money penalty.<sup>9</sup>

Like BlueLinx, health-care provider Health Net, Inc. had also created a severance agreement that attempted to undermine Rule 21F-17. After Rule 21F-17 was enacted, Health Net revised its standard-form severance agreements to "conform" to the new rule.<sup>10</sup> In 2013, Health Net amended the waiver and release of claims provisions in its form severance agreements to remove express language precluding departing employees from applying for whistleblower awards. Instead, by signing the waiver, departing employees renounced "any right to any individual monetary recovery...."<sup>11</sup>

Despite a lack of evidence of former Health Net employees withholding information about potential securities law violations because of the executed waiver, the SEC determined that Health Net had violated Rule 21F-17 and imposed a \$340,000 civil money penalty for its attempt to negate the SEC's incentives for whistleblowers.<sup>12</sup>

### **A Warning to Companies**

The SEC's recent actions are a clear warning to companies drafting severance agreements to ensure that they do not act as a hindrance to employees reporting a company's violation of securities laws. Restricting a former employee's ability to receive a whistleblower reward is no less a violation of Rule 21F-17 than restricting a former employee's ability to report a securities violation.

As the associate director of the SEC Enforcement Division, Antonia Chion, stated, "[f]inancial incentives in the form of whistleblowing awards, as Congress recognized, are integral to promoting whistleblowing to the Commission."<sup>13</sup> With whistleblower tips<sup>14</sup> accounting for over \$500 million in SEC sanctions against companies, including \$346 million in repayments to investors, the SEC has viewed its whistleblower awards program to be a success.<sup>15</sup> Thus, if employers want to avoid the SEC's ire, they should not hinder departing employees from receiving these awards.

### **Footnotes**

1. *In re BlueLinx Holdings*, Exchange Act Release No. 78528, Order Instituting Cease-And-Desist Proceedings Pursuant to Section 21C of the Securities and Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order, Aug. 10, 2016, available at <http://bit.ly/2bwWtWt>. Hereinafter known as "BlueLinx Order."
2. U.S. Securities and Exchange Commission, Press Release, "SEC Whistleblower Program Surpasses \$100 Million in Awards" (Aug. 30, 2016), available at <https://www.sec.gov/news/pressrelease/2016-173.html>.
3. *Id.*
4. *Id.*
5. 17 C.F.R. §240.21F-17.
6. BlueLinx Order at ¶¶6-11.
7. *Id.* at ¶¶13-15.

8. Id. at ¶17.

9. Id. ¶¶20-21; Id. at § IV(B).

10. *In the Matter of Health Net*, Exchange Act Release No. 78590, Order Instituting Cease-And-Desist Proceedings Pursuant to Section 21C of the Securities and Exchange Act of 1934, Making Findings, and Imposing a Cease-And-Desist Order, Aug. 16, 2016, available at <http://bit.ly/2cmJqpl>.

11. Id.

12. Id. ¶13; Id. at §IV(B).

13. U.S. Securities and Exchange Commission, Press Release, "Company Punished for Severance Agreements that Removed Financial Incentives for Whistleblowing" (Aug. 16, 2016), available at <http://bit.ly/2bxqFAM>.

14. U.S. Securities and Exchange Commission, Press Release, "SEC Whistleblower Program Surpasses \$100 Million in Awards" (Aug. 30, 2016), available at <https://www.sec.gov/news/pressrelease/2016-173.html>

15. See id. (quoting Mary Jo White, Chair of the SEC, that the "SEC whistleblower program has proven to be a game changer for the agency in its short time of existence, providing a source of valuable information to the SEC to further its mission of protecting investors while providing whistleblowers with protections and financial rewards.").