

SEC Enforcement Hammer Protects Whistleblowers

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In the last week, the U.S. Securities and Exchange Commission announced two settled enforcement actions that may be deeply unsettling to companies — and their counsel — that have used broad confidentiality provisions to prevent the unauthorized disclosure of proprietary information by former employees.

In both actions, the SEC determined that severance agreements between the charged companies and their former employees potentially impeded those employees from providing information regarding securities violations to the SEC and therefore violated whistleblower rules adopted pursuant to the Dodd Frank Wall Street Reform and Consumer Protection Act. The similarity and timing of the two settlements suggest that these cases may be part of a larger SEC sweep that could result in more enforcement actions.

SEC Charges BlueLinx for Violating Rule 21F-17

The first action, filed on Aug. 10, involved BlueLinx Holdings Inc., an Atlanta-based building products distributor. The SEC claimed that certain severance agreements used by BlueLinx contained provisions that interfered with former employees' ability to report possible securities violations to the SEC. According to the SEC's allegations, the severance agreements prohibited employees from disclosing confidential information concerning BlueLinx unless the employees were compelled to do so by law or legal process (and only then after providing written notice to, or receiving written permission from, BlueLinx).

Later versions of these severance agreements also allegedly contained provisions requiring the employee to waive his or her right to monetary recovery in connection with any whistleblower complaints made to the SEC or other government agencies.

The SEC asserted that these agreements impeded potential whistleblowers from communicating with the SEC about possible securities law violations, and therefore violated the SEC's Dodd Frank whistleblower rules. In particular, the SEC alleged that BlueLinx "raised impediments to participation ... in the SEC's whistleblower program," "forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits," and "removed the critically important financial incentives that are intended to encourage persons to communicate directly with the commission staff about possible securities law violations."



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BlueLinx agreed to settle the SEC charges, without admitting or denying the SEC's allegations, and to pay a civil penalty of \$265,000. BlueLinx further agreed to undertake reasonable efforts to notify its former employees within 60 days of the settlement that the former employees were not prohibited from contacting the SEC or collecting a whistleblower award, or required to provide notice to the company in connection with any contact with the SEC.

In addition, the settlement requires BlueLinx to modify all of its severance agreements to conform to language provided by the SEC. In modifying its severance agreements, BlueLinx must add the following provision:

Protected Rights. Employee understands that nothing contained in this agreement limits employee's ability to file a charge or complaint with the U.S. Equal Employment Opportunity Commission, the National Labor Relations Board, the Occupational Safety and Health Administration, the Securities and Exchange Commission or any other federal, state or local governmental agency or commission (government agencies). Employee further understands that this agreement does not limit employee's ability to communicate with any government agencies or otherwise participate in any investigation or proceeding that may be conducted by any government agency, including providing documents or other information, without notice to the company. This agreement does not limit employee's right to receive an award for information provided to any government agencies.

Within Days, SEC Charges Health Net for Similar Violations

The SEC filed a second action on Aug. 16 against Health Net Inc., a California-based health insurance provider that deregistered in securities in April 2016 after being acquired by Cendene Corporation. The SEC objected to severance agreements used by Health Net that allowed employees to provide information to the SEC and other law enforcement agencies, but precluded those employees from obtaining any monetary recovery from the SEC as a result of any whistleblower tips.

The SEC noted, however, that it lacked any evidence that any former employees who signed the severance agreement failed to communicate with the SEC because of the severance agreements, or that Health Net ever enforced or threatened to enforce the severance agreements to prevent such communications. Nonetheless, in justifying the action, the SEC focused on the importance of the financial incentives to the success of its whistleblower program.

The Health Net settlement contained similar terms as those agreed to by BlueLinx. Without admitting or denying the SEC's allegations, Health Net agreed to pay a \$340,000 penalty and to undertake reasonable efforts to notify its former employees within 60 days of the settlement that they are not prohibited from collecting a whistleblower award from the SEC.

SEC's Underscores Commitment to Encouraging Whistleblowers

Whistleblowers have become an increasingly important resource for the SEC — the SEC's Office of the Whistleblower estimated that it received more than 4,000 whistleblower tips and paid more than \$37 million in whistleblower payments in its last fiscal year. While a large number of these tips likely are unmeritorious, many turn into enforcement investigations. Not surprisingly, the SEC has been (and will continue to be) very aggressive in protecting this pipeline of information.

The SEC's public statements concerning the Health Net and BlueLinx cases confirm its aggressive encouragement of whistleblowers. In BlueLinx, the acting chief of the SEC's Office of the Whistleblower, Jane Norberg, stated: "Companies simply cannot undercut a key tenet of our whistleblower program by requiring employees to forego potential whistleblower awards in order to receive their severance payments." The deputy director of the SEC's enforcement division, Stephanie Avakian, doubled-down on this enforcement strategy, promising to continue "to stand up for whistleblowers and clear away impediments that may chill them from coming forward with information about potential securities law violations."

Similarly, in Health Net, the SEC emphasized its intention to remove any restrictions to whistleblower activity. Its press release stated: "Financial incentives in the form of whistleblower awards, as Congress recognized, are integral to promoting whistleblowing to the commission ... Health Net used its severance agreements with departing employees to strip away those financial incentives, directly targeting the commission's whistleblower program."

Although the SEC appears determined to pursue such cases, the SEC's allegations in the BlueLinx and Health Net cases raise doubts about whether the alleged conduct actually violated Rule 21F-17. Rule 21F-17 prohibits a person only from "tak[ing] an action to impede" an individual from whistleblowing. The rule specifically includes "enforcing, or threatening to enforce, a confidentiality agreement" as examples of an "action to impede" whistleblowing. Here, by contrast, the SEC did not allege that BlueLinx committed any substantive securities violations or that its severance agreements actually impeded any former employee from reporting securities violations to the SEC.

In Health Net, the SEC actually conceded that it had no evidence of any actual Rule 21F-17 violations. Instead, SEC appears simply to have objected to the mere existence of agreements that have the potential to impede whistleblower activity. Unfortunately, these types of agreements likely have been used for legitimate purposes by other well-intentioned companies without realizing that the SEC would later contend that they violate Rule 21F-17.

Steps for Avoiding a Similar Enforcement Action

The Health Net and BlueLinx cases confirm not only the SEC's aggressive approach to encouraging whistleblowers, even in the absence of an actual Rule 21F-17 violation, but also the inherent risks companies face when navigating through the current SEC "broken windows" enforcement climate. These enforcement actions provide valuable guidance for companies seeking to protect themselves from the SEC's aggressive enforcement strategy.

Companies should review their policies regarding the maintenance of confidential information and the terms of employment and severance agreements. Companies should also assess their current and historical employment and severance agreements to better determine whether they are at risk for an enforcement action similar to the BlueLinx and Health Net settlements (as well as include this review to their due diligence when acquiring other companies).

By modifying all such agreements to account for the SEC's model language in BlueLinx, and by eliminating any other provisions that could restrict an employee's ability to communicate with a government agency or collect whistleblower rewards, companies could avoid the SEC's whistleblower hammer.

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