SEC Settles Enforcement Cases with Two Companies for Whistleblower Violations

In mid-August, the Securities and Exchange Commission ("SEC") issued cease-and-desist orders against BlueLinx Holdings Inc. ("BlueLinx") and Health Net, Inc. ("Health Net") for violating the Securities Exchange Act of 1934 (the "Exchange Act") whistleblower provisions through the use of severance agreements impeding former employees from coming forward with information about potential securities law violations. Both companies agreed to settle the charges without admitting or denying wrongdoing, and BlueLinx additionally agreed to amend its agreements with specific language relating to employees' rights to communicate with the government without waiving any right to monetary recovery from the government. These actions represent a continued effort by the SEC to zealously protect whistleblowers and underscore the importance the SEC places on financial awards in encouraging employees to come forward to the Commission with whistleblower information.

I. Background

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Exchange Act to add Section 21F, entitled, "Securities Whistleblower Incentives and Protection." Congress stated that the purpose of the new section was "to encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees."[1] Describing the financial incentives built into the whistleblower program, Congress stated that they are a "critical component . . . that any individual could look towards in determining whether to take the enormous risk of blowing the whistle in calling attention to fraud."[2]

At issue in these recent actions was Rule 21F-17(a), which was adopted pursuant to Section 21F and provides in relevant part: "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."

The SEC found that both companies had violated Rule 21F-17 through the use of severance agreements that, *inter alia*, impeded former employees' ability to communicate with the SEC about possible securities law violations without in turn jeopardizing their post-employment benefits and/or waiving their right to monetary recovery from the Commission.

II. The Cease-and-Desist Orders

The first of the enforcement actions, *In the Matter of BlueLinx Holdings Inc.*,[3] involved the use of various forms of severance agreements by BlueLinx since August 2011 that limited the disclosure of confidential

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[1] *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934*, Exchange Act Release No. 34-64545, at 197 (Aug. 12, 2011) (Adopting Release).

[2] The Restoring American Financial Stability Act of 2010, Committee on Banking, Housing, and Urban Affairs Report, at 111 (Apr. 30, 2010).

[3] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, *BlueLinx Holdings Inc.*, Exchange Act Release No. 78528 (Aug. 10, 2016).

information by an employee unless the employee was compelled by law to disclose the information.[4] Even in the event of mandatory disclosure by legal process, the confidentiality provisions in these agreements still required employees to provide written notice to BlueLinx and to obtain written consent from the company's legal department before disclosing the confidential information. The SEC found in its Order that these provisions did not provide any exemption for the SEC from the disclosure restriction.

The Order further states that in June 2013 BlueLinx revised its severance agreements—after the adoption of Rule 21F-17—and "added or amended a number of provisions that a departing employee was required to accept as a condition for receiving monetary severance payments and other consideration from BlueLinx."[5] The additional language at issue stated in relevant part that the "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."[6]

The SEC found that BlueLinx's disclosure provisions and those relating to monetary recovery "raised impediments to participation by its employees in the SEC's whistleblower program" and "undermine[d] the purpose of Section 21F".[7] By including such provisions in its severance agreements, "BlueLinx 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."[8]

In settling the matter, BlueLinx agreed to pay a civil penalty of $265,000 and to provide former employees that signed the problematic agreements with a copy of the SEC's order and a statement that BlueLinx does not prohibit them from providing information to the SEC or from accepting a whistleblower award pursuant to 21F. In addition, BlueLinx agreed to amend all of its severance agreements with the following language:

> "Protected Rights. Employee understands that nothing contained in this Agreement limits Employee's ability to file a charge or complaint 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 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."[9]

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[4] As defined in the company's "Termination Agreements," "Confidential Information" is "data and information relating to the business of BlueLinx which is or has been disclosed to the Employee or of which the Employee became aware as a consequence of or through his relationship to BlueLinx". *BlueLinx* Order at ¶ 8.

[5] *Id.* at ¶ 12.

[6] *Id.* at ¶ 14.

[7] *Id.* at ¶¶ 16, 18.

[8] *Id.* at ¶¶ 16–17.

[9] *Id.* at ¶ 20.

The other recent action, *In the Matter of Health Net, Inc.,* involved similar language regarding the waiver of financial incentives by an employee providing whistleblower information to the government.[10] According to the Order, Health Net's severance agreements prior to August 2011 through October 2015 prohibited employees who signed the agreements from filing an application for or accepting a whistleblower award from the Commission related to any government investigation. The SEC brought the enforcement action despite being "unaware of any instances in which (i) a former employee of [Health Net] who executed the . . . agreements did not communicate directly with Commission staff about potential securities law violations or (ii) [that Health Net] took action to enforce those provisions or otherwise prevent such communications".[11] Nonetheless, the SEC found that Health Net had directly targeted the SEC's whistleblower program by removing the financial incentives intended to encourage whistleblowing and as a result violated Rule 21F-17.

Health Net agreed to pay a civil penalty of $340,000 and to provide former employees that signed the agreements at issue with a copy of the SEC's order and a statement that the company does not prohibit them from seeking or obtaining a whistleblower award from the SEC under 21F.

III. Significance of the Orders

These two recent enforcement actions illustrate the SEC's ongoing commitment to pursuing companies that seek to undermine the protections of their whistleblower program through the use of severance or other confidentiality agreements that potentially chill potential whistleblowers from providing information about securities law violations to the government. Describing the BlueLinx settlement, Jane Norberg, Acting Chief of the SEC's Office of the Whistleblower 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." Notably, similar to the SEC's first enforcement action for a Rule 21F-17 violation against KBR, Inc. last year,[12] the two recent settlements demonstrate that the SEC will pursue companies for 21F violations even in the absence of any finding that an employee actually refrained from contacting the SEC as a result of language in the agreements they signed. The immediate practical effects of the orders suggest that companies should consult with counsel and review their severance agreements.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Kerry A. Burns at 212.701.3415 or kburns@cahill.com.

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[10] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, *Health Net, Inc.*, Exchange Act Release No. 78590 (Aug. 16, 2016).

[11] *Id.* at ¶ 13.

[12] *See SEC Fines KBR, Inc. and Signals New Enforcement Scrutiny of Employer Confidentiality Agreements Under Dodd-Frank Whistleblower Protections*, Cahill Gordon & Reindel LLP Memorandum, April 16, 2015.

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