SEC Cracks Down On Anti-Whistleblower Severance Agreements

NEW ENFORCEMENT INITIATIVE MAY REQUIRE REVISITING CURRENT – AND FORMER – AGREEMENTS

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The federal Securities and Exchange Commission (SEC) has issued six-figure fines to two different employers in the past several weeks, claiming that each crafted restrictive severance agreements that violated agency rules aimed at preventing companies from discouraging whistleblowing by current and former employees. By levying over $600,000 in fines in the span of two weeks, the SEC is sending a strong message to corporate America that severance agreements cannot unduly limit workers from reporting possible whistleblower tips. This surge in enforcement may require you to revise your current template settlement agreements to remove offending language, and might also encourage you to revisit past agreements and make retroactive amends.

New Rules Embolden And Reward Whistleblowers

Following Congressional efforts to reform Wall Street and protect investors and markets, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) established rules in 2011 to incentivize and reward whistleblowers. A key portion of those rules, Section 21F, enables whistleblowers to collect up to 30% of any recovery if their information leads to a successful enforcement action garnering over $1 million.

From the SEC's perspective, the whistleblower program has been successful. In the five years since its inception, it has led the agency to issue $85 million in rewards to 35 different whistleblowers. However, from an employer's perspective, the rule is often seen as problematic, leading bounty-hunter employees to make spurious whistleblower claims against the company.

SEC Rule 21F-17 makes it unlawful for employers to take "any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation." Last year the SEC signaled that it would be scrutinizing employment agreements under Rule 21F-17 when it issued a cease-and-desist order against a company for a confidentiality provision that it deemed overly broad and chilling to potential whistleblowers.

Now, for the first time, the SEC has taken aim at severance agreements, finding that employer restrictions on the ability of employees to accept financial awards for providing information to the agency violates Rule 21F-17.

Corporate America Responds

In reaction to Rule 21F-17, insurer Health Net Inc. revised its standard severance agreements. The previous versions included language requiring employees to waive assorted claims as a condition of receiving the severance and preventing former employees from sharing certain information about the company with third parties. The company revised them to say that former employees were prohibited from applying for or accepting a SEC whistleblower award. The revised settlement agreements also said that former employees would have to waive recovery to any monetary award resulting from any government investigation in which they took part.

Several years later, the company revised its agreements once more, stating that nothing in the agreement should prevent an employee from communicating with government regulators, and removing the language prohibiting former workers from reporting issues to the SEC. However, the agreements continued to include language preventing these workers from recovering reward money from the SEC.

SEC Drops The Hammer

The SEC was not pleased with this restriction, claiming that it removed "critically important financial incentives that are intended to encourage persons to communicate directly" with the agency. It initiated enforcement proceedings against the company, and after a period of negotiation, it announced on August 16 that Health Net had agreed to pay a $340,000 penalty. This announcement was preceded by a similar penalty levied less than a week prior against another employer for the same kind of settlement agreement, this one for $265,000.

Besides the financial penalty, the agency confirmed that Health Net removed offending language from its standard settlement agreement as of late last year. More importantly, the company agreed to contact former workers who would have seen offending settlement language to tell them that they are entitled to collect and recover SEC bounties if they successfully use the whistleblower program.

What Employers Should Know

Employers that want to avoid the same fate should ensure that their standard settlement agreements do not contain any language that could be read as interfering with an employees' ability to communicate with a government agency or collect a monetary reward for whistleblowing activities.

If you are regulated by the SEC, you should also consider express language that acknowledges that nothing in your agreement prohibits departing or former employees from reporting and providing information regarding alleged wrongdoing or securities law violations to the SEC. You may even want to go so far as to amend your Code of Conduct or similar policy to encourage employees to report and provide information regarding alleged wrongdoing or securities law violations at the company to the SEC.

If your current or past versions of your agreement include language that may be seen as running afoul of the SEC's current enforcement posture, you may want to consider notifying any prior afoul of the SEC's current enforcement posture, you may want to consider notifying any prior employees who entered into severance agreements that your company will not enforce any provisions in those agreements which might restrict them from reporting possible securities law violations, or from partaking in whistleblower rewards that might come from the reporting.

However, any of these steps are fraught with peril and could bring about unintended negative consequences. There are also steps that could be taken in conjunction with your legal counsel to minimize exposure at these stages, especially when it comes to ensuring that subsequent remedial revisions to your agreements could be excluded as evidence from judicial proceedings. You should tread carefully and work closely with your legal counsel to ensure you are in compliance with the current state of the law and if you want to review past practices for compliance purposes.

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