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SEC Scrutinizes Severance Agreements for Compliance With Dodd-Frank

Recent SEC Fines

On Aug. 16, 2016, the U.S. Securities and Exchange Commission (SEC) announced that it had issued its second fine in as many weeks concerning a company's use of severance agreements that contain confidentiality and/or covenant-not-to-sue or release provisions that allegedly violate SEC whistleblower Rules.

These recent SEC charges arise from SEC Rules, passed in August 2011 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which enable whistleblowers to collect 10 percent to 30 percent of the total award when giving information that leads to an action recovering at least \$1 million. Rule 21F-17 provides that "[n]o person may take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement."

According to the most recent SEC order, Health Net Inc. agreed to a monetary penalty without admitting or denying the SEC's allegations that it illegally used severance agreements requiring outgoing employees to waive their ability to obtain monetary awards from the SEC's whistleblower program. According to the cease-and-desist order from the SEC, from August 2011 to October 2015, Health Net had language in its severance agreements that stopped employees from "filing an application for, or accepting, a whistle-blower award" from the SEC. In addition to the fine, the settlement agreement also required Health Net to notify former employees who signed the severance agreements to let them know they are not prohibited from accepting SEC whistle-blower rewards.

This recent SEC action comes on the heels of another settlement order announced just last week which also fined another company for an alleged violation of Rule 21F-17. In that case, the company's original severance agreements contained confidentiality clauses that did not include carve-outs allowing employees to talk with regulators or the government. After the Dodd-Frank whistleblower rules were enacted in 2011, the company added a clause indicating that the restrictions on sharing confidential information would not apply to employees filing charges with the SEC and other government agencies. The clause, however, also required the company's employees to waive their right to any monetary remedy they could receive from filing a complaint or a charge with an administrative agency.

The agreements also mandated that if any disclosure of confidential information was required by law, the employee would provide the company's legal department with prompt written notice of such requirement in time to permit the company to seek an appropriate protective order or other similar protection prior to any such disclosure.

The SEC alleged both provisions were unlawful. According to the SEC, "by requiring its departing employees to forego any monetary recovery in connection with providing information to the Commission, [the company] removed the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations."

The SEC also took issue with the language in the agreements requiring the former employees to notify the company's legal department before going to a regulator stating the provision "forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits."

Extension of KBR, Inc.

The SEC's recent announcements signal an expansion of the SEC's scrutiny of broad confidentiality and covenant-not-to-sue or release provisions, which the SEC views as a deterrent to whistleblowing under Dodd-Frank. In April 2015, the SEC issued a cease-and-desist order against KBR, Inc. for including language in a confidentiality agreement (used in connection with conducting internal investigations) which did not make an exception for an employee's right to communicate directly with the SEC about a possible securities law violation.

Specifically, the SEC found language that prohibited employees from "discussing any particulars regarding this interview and subject matter discussed during the interview, without the specific advanced authorization of the company's general counsel" to violate the Dodd-Frank whistleblowing rules. Notably, the SEC made no finding that any KBR employees were ever actually prevented from communicating with the SEC pursuant to the confidentiality agreement, or that KBR took any actions to enforce the terms of the agreement.

The SEC's recent actions extend this same analysis to severance agreements which seek to require employees to waive the right to any whistleblower award under Dodd-Frank or require company notification prior to whistleblowing activity.

Take-Aways

Companies regulated by the SEC (and even companies not regulated by the SEC) should consider reviewing their severance and confidentiality agreement templates to confirm they do not contain language that violates SEC Rule 21F-17(a). The EEOC and other governmental agencies have taken similar positions as the SEC's position with respect to overly broad confidentiality provisions. Because of this, companies should also consider verifying compliance with those agencies' positions on filing charges or complaints, cooperating with investigations, and

providing information to the agencies. The recent enforcement in this area, and the various exceptions to confidentiality clauses being carved out by government agencies, can create challenges for employers who seek to protect confidential information from being disclosed.

In connection with the recent settlement agreements, the SEC specifically blessed the use of the following language to be used in a severance agreement:

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.

This very pro-employee language is likely more than is required to ensure compliance with the SEC Rules (or any other agencies' rules). The final sentence in the language quoted above particularly appears to go beyond any applicable legal requirements and there may be much better ways to address the SEC's concerns without expressly advising employees they have the right to receive whistleblower awards. Companies should consult with counsel when drafting confidentiality agreements and severance agreements as there are a number of alternatives to the language blessed by the SEC that can be more protective of an employer's information and less accepting of employees receiving monetary relief from investigations by other agencies, including the EEOC.

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