

## SEC Takes a Hard Line on Confidentiality and Severance Agreements

The latest enforcement actions by the Securities and Exchange Commission (SEC) will require organizations to proceed even more cautiously when including confidentiality and waiver terms in agreements, such as severance agreements. Last year, the SEC challenged a standard confidentiality provision because it lacked an express carve-out informing employees that they retained the right to report violations of law. This past month, the SEC went further, punishing companies that included SEC's carve-out because the companies asked departing employees to waive rights that included any rights to a whistleblower reward. The SEC also doubled-down on its scrutiny of confidentiality agreements, by attacking a confidentiality agreement that permitted disclosure to the SEC, but required advance notice to enable the company to take appropriate measures to protect proprietary information and trade secrets. These orders are critical for any evaluation of severance agreements to ensure they do not run afoul of the SEC's interpretation of its rules.

### Background

The SEC's whistleblower program exists as part of the Dodd-Frank Act, enacted in 2010 in the wake of the financial crisis. The congressional purpose underlying the new program was to add incentives and protections for whistleblowers reporting suspected misconduct to the SEC. The program provides meaningful financial incentives to whistleblowers. To encourage and protect potential whistleblowers, the SEC adopted Rule 21F-17, which prohibits companies from taking "any action to impede an individual from communicating directly with the [SEC] about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications." In April 2015, the SEC took the position that standard confidentiality agreements, including those issued in an internal investigation, could run afoul of this rule, unless they expressly carved out the right to report violations of law.

This month, the SEC applied Rule 21F-17 to waivers within severance agreements in two recent enforcement actions. On August 10, 2016, the SEC issued a consent order ([linked here](#)) against BlueLinx Holding, Inc., a publicly traded building products distributor, and on August 16, 2016, the SEC issued a similar order ([linked here](#)) against Health Net, Inc., a publicly traded health insurance provider. In both cases, the companies' severance agreements included provisions that purported to waive the employees' rights to receive any whistleblower rewards upon the filing of a tip or complaint with the SEC. The Commission announced that these purported waivers violated Rule 21F-17 because the "severance agreements with departing employees . . . strip[ped] away th[e whistleblower program's] financial incentives." The SEC fined the companies and required corrective measures, including notice to departed employees of their whistleblower rights.

In addition, the SEC used one of these recent consent orders to refine its objections to confidentiality language. Both companies had included carve-outs that permitted departing employees to report violations of law. Yet BlueLinx's agreements had required employees to contact its legal department in advance of disclosing any trade secrets or other confidential information to third parties. No separate provision specifically exempted the SEC from that advance-notice requirement. The SEC determined that "requiring departing employees to notify the company's Legal Department prior to disclosing any financial or business information to any third parties without expressly exempting the Commission from the scope of this restriction, BlueLinx forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits." The SEC concluded that the advance-notice requirement within the confidentiality agreement thus "raised impediments to participation by its employees in the SEC's whistleblower program" and also violated Rule 21F-17.



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## Implications

Through these recent actions, the SEC has signaled that it will proceed against employers whose actions may, even unwittingly, make would-be whistleblowers less likely to report suspected violations of law to the SEC. To avoid an SEC challenge, employers should not ask employees to waive any rewards from whistleblowing to the Commission, and any confidentiality agreement must not only include a carve-out permitting communications with the government but, moreover, those carve-outs must not require advance notice to the company. These interpretations may have widespread impact on confidentiality and severance agreements.

## Conclusion

Organizations subject to SEC regulation should consider Rule 21F-17, and the SEC's latest steps to enforce that rule, when reviewing their standard confidentiality or severance agreements or when preparing new agreements. HSE attorneys can assist you in reviewing and crafting appropriate provisions to protect your interests while complying with the law. If you would like our assistance, or if you have any questions about this LEGALcurrents®, please contact any member of our [Labor and Employment](#), [Securities](#), or [Government and Internal Investigations](#) practice groups at (585) 232-6500. ■



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