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Labor and Employment Alert: SEC Gives Employers 265,000 Reasons to Revise Their Separation Agreements

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The Dodd-Frank Wall Street Reform Act and Consumer Protection Act incentivizes and protects whistleblowers to encourage reporting of possible securities laws violations. The Security and Exchange Commission's (SEC) Rule 21F-17 prohibits a person from "taking 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...with respect to such communications." The congressional purpose underlying these provisions is "to encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees." Financial incentives are a "critical component" of the whistleblower program.

The SEC has taken an increasingly hardline position on employers' confidentiality agreements. The chief of the SEC's Office of the Whistleblower has said that his office is "actively looking for examples of confidentiality agreements, separation agreements, [and] employee agreements" that impede an employee's ability to report activities to regulators like the SEC. The SEC found such an agreement in a recent enforcement action involving Atlanta-based building products distributor BlueLinX.

BlueLinX had entered into severance agreements with its employees. One form of the agreement included a confidentiality clause prohibiting employees from disclosing confidential information and trade secrets. The clause allowed disclosure when required by law or legal process if the employee "provide[s] 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 agreement also included a clause expressly permitting the employee to disclose information to the SEC (emphasis added):

Employee further acknowledges and agrees that nothing in this Agreement prevents Employee from filing a charge 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 administrative agency if applicable law requires that Employee be permitted to do so; **however, 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.***

At first glance, this would appear to obviate the SEC's concern that the confidentiality clause could impede potential whistleblowers. But the SEC found these provisions were "impediments to participation by its employees in the SEC's whistleblower program."

First, the SEC found that requiring employees to notify the company's legal department before disclosing information to third parties without expressly exempting the SEC forced them to choose between outing themselves as whistleblowers or potentially losing their severance pay. Second, by requiring employees to forgo any monetary recovery in connection with providing information to the SEC, the company removed the "critically important financial incentives that are intended to encourage persons to communicate directly" with the SEC about possible securities law violations.

As a result, the SEC ordered the company to inform the employees who signed the agreement that they are not prohibited from (1) providing information to, or communicating with, the SEC without notifying the company, or (2) accepting an SEC whistleblower award. The SEC further required the company to include in its severance agreements and any agreement concerning the disclosure of confidential information (which could include employment agreements) 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 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.

And then the SEC fined the company \$265,000 for good measure.

Under the SEC's current enforcement position, it is not necessary to show that an employee was actually chilled from communicating with the SEC or that a company actually tried to enforce a confidentiality provision in order to prevent the employee from doing so. The SEC's enforcement action highlights the importance of reviewing and revising severance and other agreements that contain confidentiality provisions.

Contact your Vorys lawyer if you have questions about confidentiality provisions in your employment and separation agreements.