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The SEC as the Whistleblower Program's Advocate: Severance Agreements and FCPA Investigations

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The recent close of the SEC's fiscal year added notable guidance to a significant period of FCPA enforcement, including several cases that reveal a new feature of the SEC's efforts to protect whistleblowers. These actions imposed penalties on companies for severance agreements that restricted the ability of employees to seek financial rewards for reporting potential violations of the securities laws to the SEC. They provide further evidence not only of the SEC's dim view of companies' efforts to undermine its growing Whistleblower Program, but also of the agency's desire and ability to use Rule 21F-17 to combat them. The cases are particularly important precedents for companies with worldwide operations that present FCPA risks, as these companies must carefully reconcile their employment agreements in multiple jurisdictions with their employees' ability to become, and benefit from being, SEC whistleblowers.

This article briefly recaps the basic features of the SEC's Whistleblower Program and the financial incentives that it provides. It next describes three effects of the Whistleblower Program relevant to companies conducting FCPA investigations, both in response to government inquiries or on companies' own initiatives. Last, it addresses a new role that the SEC has increasingly adopted – that of the "whistleblower's advocate." Describing two recent SEC actions addressing restrictive severance agreements, it summarizes the SEC's latest efforts to defend the Whistleblower Program and the resulting effects on companies seeking to address the risks of FCPA violations.

Another Record Whistleblower Year

The SEC's Whistleblower Program enters its sixth year poised to continue its streak of increasing reporting activity, public attention and financial awards. Created as part of the Dodd-Frank Act of 2010, the centerpiece of the Whistleblower Program is its provision of substantial financial incentives for individuals to report potential securities law violations to the SEC. The law authorizes – indeed, requires – the SEC to provide awards between 10 percent and 30 percent of the monetary sanctions from SEC enforcement cases or certain related actions that are based on information provided by whistleblowers.[1]

Since the Whistleblower Program's inception in August 2011, the SEC has awarded a total of more than $111 million to 34 whistleblowers. The pace of significant awards has steadily increased, and the SEC is reportedly considering a whistleblower award in one of its larger recent enforcement actions.[2] Two recent awards – of $22 million in August and $17 million in June – are the second- and third-largest in the program's history. And the amount of the awards in the recently closed fiscal year was greater than the combined total of the four prior years.

Reports of potential FCPA violations provide particularly fertile ground for future whistleblower awards. The number of FCPA-related whistleblower tips increased nearly 62 percent between fiscal years 2012 and 2015, the second-largest percentage increase among the categories tracked by the SEC.[3] The extent to which these FCPA-related tips originated with employees or resulted in award-eligible enforcement actions is not clear from SEC sources; however, some of the highest SEC financial sanctions are obtained in FCPA cases, providing greater incentives to report FCPA-related information. The 16 FCPA-related actions with eligible financial sanctions announced by the SEC in fiscal year 2016 yielded nearly $1.4 billion in total financial sanctions. If these actions had resulted from whistleblower reports, the SEC could have potentially awarded up to $417 million to individual whistleblowers.

Further, given the diffuse geography in which FCPA issues may arise, potential whistleblowers may take action from virtually anywhere in the world. The Whistleblower Program has received tips from 95 countries to date,[4] and the SEC has made clear its willingness to provide awards to foreign nationals and residents for reporting foreign conduct.[5] With these diverse and substantial financial opportunities, it is increasingly likely that future FCPA actions will be based on whistleblower reports.

A Program with "Transformative Impact"

Beyond the attention-grabbing awards to individuals, SEC officials have repeatedly cited the "transformative impact" of the Whistleblower Program on the agency's own enforcement agenda. Three effects of particular relevance to companies facing FCPA investigations are apparent from the Whistleblower Program's early years. The sheer volume of tips – nearly 4,000 in fiscal year 2015 – has increased the likelihood that the length and focus of FCPA investigations will be influenced by whistleblower reports. The former Chief of the SEC's Office of the Whistleblower recently stated that hundreds of ongoing enforcement investigations have benefited from whistleblower tips;[6] SEC Enforcement Director Andrew Ceresney has likewise remarked on the prevalence of enforcement actions that began with a whistleblower report.[7] SEC officials have credited whistleblower tips – especially those from employees, who provide almost half of all reports – with focusing and shortening complex investigations. But incomplete reports, and those that involve companies' privileged materials or attorney work product that must be closely evaluated and segregated, hold the potential to delay already lengthy FCPA investigations.

In addition, frequent whistleblower reports have introduced a new factor for companies considering whether to self-report evidence of wrongdoing. Whistleblower reporting has increased the likelihood that the SEC will learn of potential misconduct before a company does, or at least before the company has an opportunity to self-report and remediate. This factor is particularly important in FCPA investigations, where the SEC and the DOJ have provided significant incentives for voluntary self-reporting.

The SEC Enforcement Division has announced that only companies that self-report violations will be eligible for deferred-prosecution or non-prosecution agreements in FCPA cases.[8] And the DOJ's Fraud Section recently announced an FCPA Pilot Program that provides companies with up to a 25 percent penalty discount if they report FCPA violations to the DOJ "prior to an imminent threat of disclosure or government investigation."[9] The increasingly likely prospect of a whistleblower beating a company to the SEC provides an important incentive to self-report potential wrongdoing sooner, to reap benefits that may disappear once a whistleblower has filed his or her report.

The third change to FCPA investigations brought on by the Whistleblower Program has been the SEC's new enforcement role, both in bringing independent cases and adding elements to existing investigations. The SEC is increasingly viewing itself, in Chair Mary Jo White's words, as the "whistleblower's advocate."[10] In rulemaking and amicus filings, the SEC has pushed for a provision in the Dodd-Frank Act providing a private right of action that allows whistleblowers to sue employers for retaliation to cover not only those who report to the SEC, but also those who report through the internal reporting channels prescribed by the Sarbanes-Oxley Act. (According to the SEC's most recent statistics, approximately 80 percent of SEC whistleblowers first reported their concerns to supervisors or compliance personnel, or otherwise understood that their companies were aware of the violations.[11]) Circuit courts are currently split on this issue.[12]

The SEC has also shown its willingness to punish employers directly if they retaliate against their whistleblowing employees. It has settled two enforcement actions to date alleging such retaliation.[13] Perhaps the most wide-ranging example of the SEC's advocacy on behalf of whistleblowers, however, has come in the form of SEC rulemaking that broadly prohibits impediments to whistleblower reporting.

The remainder of this article provides an overview of this rulemaking, related enforcement actions and the consequences for companies facing government or internal investigations of potential FCPA violations.

Rule 21F-17 and SEC Whistleblower Advocacy

The SEC has assumed its most forceful and novel role as a whistleblower advocate in its promulgation and interpretation of Rule 21F-17. This rule was designed to protect the ability of whistleblowers to report to the SEC by providing that "[n]o 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."[14]

When promulgated, the precise contours of this broad rule were not clear. The rule itself lacked guidance on whether "any action to impede" referred to steps beyond the specific confidentiality agreements mentioned in the rule, or how it would apply to the steps that companies typically take in hiring and terminating employees. Ensuing enforcement actions, including one involving the FCPA, have shown that the SEC has taken a broad view of its powers under 21F-17, and that companies need to consider whether the actions that they typically take in conducting internal investigations or responding to FCPA investigations run afoul of this rule.

The SEC's first foray into enforcing 21F-17 cautioned companies regarding the confidentiality instructions that they provide as part of their internal investigations. This effort had been previewed by SEC officials, who indicated that enforcement actions would be brought based on restrictive confidentiality provisions even if they did not explicitly preclude whistleblowing to the SEC and absent any evidence either that an employee believed he was restricted from speaking with the SEC or that the company attempted to invoke the agreement for that purpose.[15]

In its April 2015 settlement with the global technology and engineering firm KBR, the SEC set forth an unanticipated view of 21F-17's reach. The SEC order required KBR to pay a penalty of $130,000 for using a confidentiality agreement during the course of an internal investigation that, in the SEC's view, may have impeded its employees from discussing matters with the SEC.[16] In reaching this settlement, the SEC made clear that it had not identified any employees who were actually prevented from making reports to the SEC. Combined with the similarity between KBR's confidentiality agreement and the Upjohn instructions that are routinely provided to employees during internal investigations, this initial 21F-17 action presented a lesson that companies must be careful not to foreclose SEC whistleblowing when delivering confidentiality instructions, which take many forms every day at public companies for legitimate reasons.

See "*Implications of the SEC's First-Ever Whistleblower Protection Enforcement Action*" (Apr. 15, 2015).

The SEC followed this action with two settlements this year suggesting that a review of confidentiality agreements has become a routine feature of SEC enforcement actions. As part of a $415 million settlement with Merrill Lynch related to the misuse of customer funds, the SEC noted a violation of 21F-17 regarding the company's standard severance agreement.[17] The 21F-17 violation likely constituted a small portion of the total financial sanction. The order notes, however, that during the course of the investigation Merrill Lynch – along with all affiliates of its Bank of America parent company – implemented a wide-ranging whistleblower training program covering, among other things, employees' rights to report suspected violations to the SEC under 21F-17.

In addition, a recent FCPA settlement also included an alleged 21F-17 violation.[18] These actions indicate that companies facing FCPA inquiries must be prepared for broader reviews of their severance agreements and whistleblower-protecting practices.

Severance Agreements and the SEC as Defender of the Whistleblower Program

The SEC's two most recent standalone 21F-17 actions demonstrate the seriousness with which the SEC has taken its role as an advocate for whistleblowers, and the severity with which the SEC will confront what it perceives to be efforts to undermine the Whistleblower Program. In August 2016, the SEC announced two settled actions against companies that were alleged to have attempted through severance agreements to prevent their employees from seeking awards.

BlueLinx Holdings

First, in settling an action against Atlanta-based building products distributor BlueLinx Holdings Inc., the SEC imposed a $265,000 penalty because of the company's alleged efforts to ensure that its employees did not seek SEC whistleblower awards.[19] BlueLinx used several severance agreements, some of which prohibited employees from disclosing confidential information to third parties "unless compelled by law and after notice to BlueLinx." Around June 2013, BlueLinx added a provision – apparently in response to 21F-17 – specifying that employees are not prohibited from "filing a charge with" certain government agencies "if applicable law requires that [employees are] permitted to do so." The agreement, however, contained a provision requiring employees to "waiv[e] the right to any monetary recovery in connection with any such complaint or charge."

In setting forth the changes to its severance agreement that BlueLinx agreed to undertake, the SEC indicated the focus of its 21F-17 concerns. The new agreements' "Protected Rights" specifically allow an employee to file a "charge or complaint" with certain government agencies, including the SEC. They also preserve employees' "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" BlueLinx.

This provision affirms the SEC's defense of whistleblower confidentiality, a critical feature of the Whistleblower Program. To require notice, in the SEC's words, would "force[] . . . employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits." And in perhaps the most sweeping change, BlueLinx also agreed to affirm that its severance agreements do not limit the "right to receive an award for information provided to any Government Agencies."

Health Net

Less than a week later, the SEC followed with another 21F-17 settlement, against California-based health insurance provider Health Net, Inc.[20] According to the order, Health Net had included a provision in its severance agreements since 2011 that, while explicitly preserving the ability of employees to participate in government investigations, required employees to waive any right to "any individual monetary recovery" brought based upon the information that they provided. A revised version of this severance agreement, adopted in June 2013, removed the express prohibition on employees applying for an award, but required them, "to the maximum extent permitted by law," to waive any monetary recovery.

As in prior actions, the SEC noted that it was not aware of instances in which former employees did not report violations to the SEC because of these agreements, or even instances in which Health Net had sought to enforce them. Nonetheless, the SEC's order imposed a $340,000 penalty on Health Net for having "directly targeted the SEC's whistleblower program by removing the critically important financial incentives that are intended to encourage persons to communicate" with the SEC.

Taken together, the SEC's actions against BlueLinx and Health Net evince the SEC's rejection not only of agreements that impose obstacles between potential whistleblowers and the SEC, but also of agreements that may lessen the incentives for employees to become whistleblowers. The BlueLinx and Health Net severance agreements arguably did not preclude former employees from reporting violations to the SEC. But by requiring prior notice and removing the prospect of financial rewards, the companies "directly target[ed] the Commission's whistleblower program".[21] The provisions requiring employees to forsake whistleblower awards, in particular, seemed to the SEC to be designed for no other purpose than to discourage reporting to the SEC.

As with prior whistleblower-related efforts, the SEC actions based on these severance agreements were previewed by comments from SEC officials about companies' efforts to undermine the Whistleblower Program. Chair White noted in April 2015 the Enforcement Division's skepticism of agreements through which companies restricted the ability of employees to seek whistleblower awards.[22] The actions were likely preordained, too, by the Dodd-Frank Act's requirement on the SEC to pay whistleblowers who meet the relevant requirements. Companies' efforts to interfere with the SEC's obligations will be met with continued skepticism, and with these two most recent standalone actions the SEC has demonstrated its willingness to defend the Whistleblower Program.

Two Further Considerations for Severance Agreements

The SEC's recent actions provide additional guidance to companies regarding actions prohibited under 21F-17. Companies have already been on notice that they should carefully review confidentiality instructions in agreements to ensure that – no matter the purpose for which they were originally intended – they could not ever be interpreted as precluding employees from presenting whistleblower reports to the SEC. Companies are also well advised to consider fostering their internal reporting mechanisms to ensure that they can address employee concerns and, if necessary, remediate issues or self-report potential misconduct.

See "*Addressing Employees' Perception That Internally Reporting Compliance Violations Is Futile*" (Aug. 10, 2016).

The language that BlueLinx and Health Net agreed to adopt when settling with the SEC, moreover, presents two new considerations for companies in drafting severance agreements. These recent orders suggest that common carve-outs that reference the limits of existing law may not be sufficient to preserve employees' rights under 21F-17. Companies should carefully consider whether their efforts to abide by 21F-17 do not alter their relationships with employees and other government agencies unaffected by 21F-17.

In its resolutions with both BlueLinx and Health Net, the SEC appears to have expressed skepticism about agreements that merely preserve the availability of SEC reporting by restricting confidentiality agreements "to the extent of applicable law." These agreements, lacking explicit reference to the ability of employees to report violations to the SEC or other government agencies, may result in increased scrutiny of companies' agreements, policies and training programs. Higher-profile references to employees' ability to report potential violations to the SEC may be necessary. Absent explicit mentions of 21F-17, companies should consider including references to employees' rights to report obligations to government agencies.

By the same token, companies should take particular care in ensuring that they do not upset lawful agreements with their employees in the name of 21F-17 compliance. BlueLinx agreed to a provision in its severance agreements that appears to remove restrictions on employees' seeking monetary rewards from all government agencies, even though 21F-17 requires only that companies avoid interfering with SEC awards. In certain federal, state and international contexts, however, companies and their employees may agree to lawfully restrict the manner in which employees seek rewards from other agencies as part of severance agreements.

In ensuring that severance agreements do not run afoul of 21F-17, companies must determine whether to adjust additional aspects of their employment agreements designed to address their relationships with their employees and other federal, state or foreign agencies.

Conclusion

The increasing size and frequency of SEC whistleblower awards, along with the growing number of whistleblower tips from overseas and a continued SEC focus on FCPA enforcement, suggest an expanding role for whistleblowers in SEC investigations of FCPA violations. In conducting these investigations, the SEC has taken an increasingly expansive view of its ability to advocate on behalf of whistleblowers and defend the Whistleblower Program. Companies should carefully consider the steps that they take as part of their internal investigations, in encouraging internal reporting mechanisms and, after recent SEC actions, in negotiating severance agreements with their employees. These steps are necessary to ensure that companies safeguard their ability to respond appropriately to allegations of wrongdoing in ways that are consistent with the SEC's expectations for its Whistleblower Program.

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[1] See 15 U.S.C. § 78u-6(b)(1). To qualify for an award, a whistleblower must have voluntarily provided "original information" that led to the successful enforcement of an action with a monetary sanction greater than $1 million.
[2] See David J. Lynch, SEC Rewards Help Bring Forward the Whistleblowers, Fin. Times, Sept. 18, 2016 (SEC Rewards Help Bring Forward the Whistleblowers).
[3] 2015 SEC Ann. Rep. Dodd-Frank Whistleblower Program at 28.
[4] Id. at 24.
[5] See Whistleblower Award Proceeding File No. 2014-10, Exchange Act Release No. 73174 (Sept. 22, 2014).
[6] See SEC Rewards Help Bring Forward the Whistleblowers.
[7] Andrew Ceresney, The SEC's Whistleblower Program: The Successful Early Years, (Sept. 14, 2016).
[8] Andrew Ceresney, ACI's 32nd FCPA Conference Keynote Address (Nov. 17, 2015).
[9] See DOJ, The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan and Guidance (Apr. 5, 2016).
[10] Mary Jo White, The SEC as the Whistleblower's Advocate (Apr. 30, 2015) (Whistleblower's Advocate).
[11] 2015 SEC Ann. Rep. Dodd-Frank Whistleblower Program at 16–17.
[12] See Berman v. Neo@Ogilvy LLC et al., 801 F.3d 145 (2d Cir. 2015); Asadi v. G.E. Energy (USA), L.L.C., 720 F.3d 620 (5th Cir. 2013).
[13] See In re Paradigm Capital Management, Inc., Exchange Act Release No. 72393 (June 16, 2014); In re International Game Technology, Exchange Act Release No. 78991 (Sept. 29, 2016).
[14] 17 C.F.R. § 240.21F-17(a).
[15] See Stephanie Russell-Kraft, SEC Whistleblower Head to Punish Cos. That Silence Tipsters, Law360, Oct. 17, 2014.
[16] In re KBR, Inc., Exchange Act Release No. 74619 (Apr. 1, 2015).
[17] In re Merrill Lynch, Pierce, Fenner & Smith Incorporated et al., Exchange Act Release No. 78141 (June 23, 2016).
[18] In re Anheuser-Busch InBev SA/NV, Exchange Act Release No. 78957 (Sept. 28, 2016).
[19] In re BlueLinx Holdings Inc., Exchange Act Release No. 78528 (Aug. 10, 2016).
[20] In re Health Net, Inc., Exchange Act Release No. 78590 (Aug. 16, 2016).
[21] Press Release, Company Punished for Severance Agreements That Removed Financial Incentives for Whistleblowing (Aug. 16, 2016).
[22] See Whistleblower's Advocate.