

SEC Ratchets Up Pressure on Companies to Change Employee Confidentiality Agreements with New Enforcement Actions and Fines

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SEC's Promise to Go After Employers Attempting to Muzzle Whistleblowers



- 17 C.F.R. 240.21F-17(a): Companies may not 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....”
- Sean McKessy, Head of SEC's OWB, repeatedly stated his office was actively looking for agreements (e.g., separation, confidentiality, etc.) that could have the effect of impeding reporting to the SEC, such as requirements that individuals first disclose complaints to employer prior to filing with SEC.
- “...if we find that kind of language, not only are we going to go after the companies, we are going to go after the lawyers who drafted it...[w]e have powers to eliminate the ability of lawyers to practice before the Commission.”

SEC Starts Taking Action in Early 2015



- February 2015: SEC's Office of the Whistleblower opens a broad "sweep" investigation, "In the Matter of Certain Non-Disclosure Agreements," sending a broad document requests to a number of companies for all of their employment agreements, severance agreements and release of claim agreements, as well as all policies and handbooks relating to confidentiality, going back to August 2011 (effective date of DF regulations). Investigations ongoing but some remedial actions have taken place.
- SEC routinely reviewing company Form 8Ks for problematic provisions in executive severance and other agreements.



- SEC looking at agreements which have the following types of provisions although they have made clear that there does not have to be any evidence that the company tried to enforce such provisions for a violation to take place:
 - Confidentiality or nondisparagement provisions that do not carve out communications with law enforcement, government or industry regulator;
 - Breach due to failure to notify company of subpoena from government or any requirement to notify company before communicating with regulator;
 - Covenants that employee has not filed allegations or charges of misconduct, or if he/she has, he/she will withdraw them, and/or that he/she will not do so in the future;
 - Prohibitions on “bounty” or monetary recovery in connection with law enforcement or agency action; and
 - Covenant that employee will not voluntarily cooperate in gov’t investigation or proceeding.

SEC Makes Good on its Enforcement Threats: The KBR Enforcement Action



- April 2015: SEC brought enforcement action against KBR for violation of the regulation. SEC asserted that KBR's confidentiality agreement undermined the purposes of Dodd-Frank in that it discouraged individuals from reporting to the SEC. KBR paid a fine of \$130,000 and agreed to put the following language in its confidentiality statement:

“Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.”

- This raised the question: do you need to go this far?

SEC Continues to Push the Envelope: BlueLinx and Health Net Actions



- August 2016: SEC brought cease and desist proceedings under Rule 21F-17. Companies simultaneously settled for \$265K and \$340K respectively.
- BlueLinx bounty waiver language:
 - 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.** (Emphasis added.)
- First time that the SEC explicitly held bounty waiver unenforceable.

BlueLinx: Other “Impeding” Provisions



- “Employee has not and in the future will not use or disclose to any third party Confidential Information, unless compelled by law and after notice to BlueLinx.”
- “[The employee shall] hold in a fiduciary capacity for the benefit of the Company [] all Confidential Information....
- For a period of two years, following the [employee’s] Termination Date, Executive shall not, without the prior written consent of the Company or as may otherwise be required by law or legal process, communicate or divulge Confidential Information.”
- SEC Holds: Needed to expressly exempt the Commission. Language “forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits.”



- “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.”* (emphasis added)
- Do companies need to go this far?



- In 2011, added language to agreements requiring employees to waive “the right to file an application for award for original information submitted pursuant to Section 21F of the Securities Exchange Act of 1934.”
 - About 600 employees signed between 8/11 and 6/13.
- In June 2013, updated agreements and removed this language and instead stated:
 - “Nothing in this Release precludes Employee from participating in any investigation or proceeding before any federal or state agency or governmental body . . .
 - “However, while Employee may file a charge, provide information, or participate in any investigation or proceeding, by signing this Release, Employee, to the maximum extent permitted by law . . . waives any right to any individual monetary recovery . . . in any proceeding brought based on any communication by Employee to any federal, state or local government agency or department.”



- SEC unaware of anyone actually impeded from communicating with the SEC.
- SEC unaware of company taking action to enforce provision.
- SEC holds: Both the 2011 **and 2013** agreements violated Rule 21F-17 by “directly targeting the SEC’s whistleblower program by removing the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations.”
- Extremely expansive reading of the Rule:
 - No direct targeting of SEC program; and
 - No removal of financial incentives unless permitted by law.
- Courts unlikely to agree with SEC, but issue not before the courts.



- If companies want to avoid SEC scrutiny:
 - Need carve out language making clear communications with SEC and other regulators are not “chilled” in any way.
 - To extent any provisions could be read otherwise, need to include or refer to carve out.
 - This includes:
 - » Future monetary waivers;
 - » Non-disclosure of confidential information;
 - » Non-disparagement of company;
 - » Failure to notify company of regulator inquiry; and
 - » Representation by employee that no charges or complaints are pending or if they are, will withdraw them.



- “Confidentiality provisions in settlement agreements should be written to expressly authorize, without restriction or condition, a customer or other person to initiate direct communications with, or respond to any inquiry from, FINRA or other regulatory authorities.”
 - Blessed language:
 - “Any non-disclosure provision in this agreement does not prohibit or restrict you (or your attorney) from initiating communications directly with, or responding to any inquiry from, or providing testimony before, the SEC, FINRA, any other self-regulatory organization or any other state or federal regulatory authority, regarding this settlement or its underlying facts or circumstances.”



- OSHA’s Whistleblower Protection Advisory Committee has recommended that employers “not require employees to disclose that they have reported or communicated with any government agency.”
- *EEOC v. CVS and EEOC v. College America*: challenges to standard separation agreement language, including notifying company of gov’t inquiry, nondisparagement, non-disclosure of confidential info, with stated goal of “preserving access to the legal system.”
- NLRB challenges nondisparagement and confidentiality provisions.

Defend Trade Secrets Act and Intersection with Whistleblower Protections



- Creates a new federal cause of action for trade secrets misappropriation with criminal and civil remedies.
- However, provides civil and criminal immunity for employees and contractors who:
 - (1) disclose trade secrets in confidence to the government or their lawyers solely for the purpose of reporting or investigating a suspected violation of law;
 - (2) disclose the trade secrets to their personal attorneys in connection with a lawsuit alleging retaliation for reporting a suspected violation of law; or
 - (3) disclose or use the trade secret in any complaint or other document filed in a lawsuit, as long as they file the trade secret information under seal.



- Employers “shall” provide notice of the immunity in any contract or agreement with an employee or contractor that governs the use of a trade secret or other confidential information.
 - Or employers may comply with this requirement by providing a cross-reference to a policy document provided to the employee or contractor that sets forth the employer’s policy for a suspected violation of law.
- Consequence of failure to comply with notice provision:
 - Employer will not be able to recover exemplary damages (of up to two times actual damages) and attorneys’ fees for willful or malicious violations.

What Whistleblower Claims May Be Waived By Agreement?



- **“All federal, state, and local whistleblower claims to the maximum extent permitted by law”**
- SOX claim based on pre-release conduct: Depends on whether employee asserted a potential SOX whistleblower claim prior to signing.
 - Dodd-Frank’s amendments to SOX provide that SOX’s “rights and remedies may not be waived by any agreement.”
 - Such language could be read to preclude any enforceable release of SOX claims.
- However, the Department of Labor’s regulations state that pending or threatened SOX claims can be settled (if at DOL, agency must approve), and the DOL’s Administrative Review Board confirmed in a 2012 decision that it holds the same view. No Circuit court has yet opined on the meaning of the amendment’s language.
- To the extent an employee has not raised a SOX issue prior to signing the release, however, it clearly cannot be effectively released.

What Whistleblower Claims May Be Waived By Agreement?



- Claim under section 1057 of Dodd-Frank regarding retaliation for reporting violations of consumer financial protection laws: This section contains identical non-waiver language to SOX and we expect the DOL to interpret it in the same way as SOX.
 - i.e., existing claims may be released, but to the extent no claim has been asserted prior to signing the waiver, it may not be released.
- Claim under Dodd-Frank section 748 regarding retaliation for reporting commodity law violations: This section contains identical non-waiver language to SOX and Section 1057. Not administered by DOL and no federal court has yet interpreted the provision.
 - At least clear that claims that have not yet been asserted cannot be waived.

What Whistleblower Claims May Be Waived By Agreement?



- Claim under section 922 of Dodd-Frank regarding retaliation for reporting securities law violations. Section 922 does not contain the non-waiver language contained in SOX, Section 1057, or Section 748.
 - The SEC takes the position that the claims may not be waived.
 - Based on statutory language, courts would likely hold a waiver of a section 922 claim to be enforceable.
 - But a waiver may not prevent the SEC from taking action on its own by prosecuting such a claim.
- Claim for SEC bounty under Dodd-Frank section 922: Not according to SEC as described above.
- Claim for CFTC bounty under Dodd-Frank section 748: Although the CFTC has not been active on this issue, risk they will follow SEC's interpretation.

What Whistleblower Claims May Be Waived By Agreement?



- Pending False Claims Act Qui Tam action: The release would not cover a pending qui tam claim, because such a release would require government and court approval.
- Future FCA Qui Tam action: May be releasable if the government is aware of the allegations prior to the signing of the release (but this may vary by jurisdiction).
- Other miscellaneous federal and state whistleblower statutes: There are many other state and federal whistleblower statutes of varying breadth. The quoted language should cover those to the maximum extent permitted by law.

***Still include carve-out language**



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