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DOES THE GOVERNMENT THINK YOUR CONFIDENTIALITY AGREEMENTS CHILL WHISTLEBLOWING?

By [Janie F. Schulman](#)

INTRODUCTION

Employers routinely incorporate confidentiality provisions into a variety of agreements, including employment, proprietary information, separation and settlement agreements. In an era when many companies' most valuable asset is intangible knowledge, broad confidentiality provisions have become as standard in the workplace as the morning coffee break. Now, however, where employers see a tool to protect their intellectual

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property, the Securities and Exchange Commission (SEC) and other regulators see a nefarious device designed to chill whistleblowing. On April 1, 2015, the SEC announced a \$130,000 settlement with Kellogg Brown & Root, known as KBR, which resulted from the SEC's first enforcement action for allegedly using improperly restrictive language in confidentiality agreements with the potential to stifle the whistleblowing process.¹

Background

The Sarbanes-Oxley and Dodd-Frank Wall Street Reform and Consumer Protection Acts

The collapse of corporations like Enron and WorldCom prompted Congress to pass the Sarbanes-Oxley Act ("Sarbanes-Oxley," or SOX)² on July 30, 2002. As part of its design to restore investor confidence, SOX created provisions protecting whistleblowers, specifically, employees who raise concerns about fraud and accounting issues or other potential violations of enumerated laws and rules. Then, on July 21, 2010, in response to the mortgage and banking financial crises that contributed to the Great Recession of 2007–2009, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").³ As part of its sweeping overhaul of the financial regulatory scheme, Dodd-Frank amended the whistleblower provisions of SOX in several significant respects, both substantively and procedurally.

Section 922(b) of Dodd-Frank allows the SEC to pay monetary awards—popularly called bounties—to individuals who provide original information to the SEC that results in monetary sanctions exceeding \$1 million.⁴ So far, the SEC has awarded more than \$45 million in "bounties" to 14 whistleblowers.⁵

The Regulators Target Confidentiality Agreements

Although whistleblowers appear to be finding their way to the SEC and elsewhere to disclose allegedly illegal conduct, the regulators have undertaken an aggressive campaign against companies for their alleged use of confidentiality provisions to deter employees and other potential whistleblowers from coming forward. As part of its rulemaking implementing certain provisions of Dodd-Frank, the SEC promulgated Rule 21 F-17, which makes it a violation for any individual to

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. . . .⁶

The Financial Industry Regulatory Authority (FINRA) and the SEC have taken the position that firms may not include provisions in settlement agreements that impede a person's right to disclose information to FINRA, the SEC, or any federal or state regulatory agency regarding a securities law violation. In October 2014, FINRA issued Regulatory Notice 14-40, which reminded firms (for the fourth time)

that it is a violation of FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade) to include confidentiality provisions in settlement agreements or any other documents, including confidentiality stipulations made during a FINRA arbitration proceeding, that prohibit or restrict a customer or any other person from communicating with the Securities and Exchange Commission (SEC), FINRA, or any federal or state regulatory authority regarding a possible securities law violation.⁷

FINRA advises that, not only must settlement agreements allow individuals to respond to inquiries from government agencies, but they must also allow individuals to *initiate* direct communication with those agencies "without restriction or condition."⁸ For those who are unsure how to comply, FINRA offers a sample provision to include in settlement agreements, which states:

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.⁹

In March 2014, Sean McKessy, Chief of the SEC's Office of the Whistleblower, stated that his office was keeping an eye out for creatively drafted contracts

designed to provide incentives to keep potential whistleblowers from disclosing information.¹⁰ In remarks before the Georgetown University Law Center Corporate Counsel Institute, McKessy warned:

Be aware that this is something we are very concerned about. . . . And we are actively looking for examples of confidentiality agreements, separate[] agreements, employee agreements that . . . in substance say ‘as a prerequisite to get this benefit you agree you’re not going to come to the commission or you’re not going to report anything to a regulator.’¹¹

McKessy sent an especially strong message to in-house counsel, stating:

And if we find that kind of language, not only are we going to go to the companies, we are going to go after the lawyers who drafted it. . . . We have powers to eliminate the ability of lawyers to practice before the commission. That’s not an authority we invoke lightly, but we are actively looking for examples of that.¹²

The SEC has followed through on McKessy’s promises: In February 2015, *The Wall Street Journal* reported that the SEC sent letters to a number of firms asking for years of nondisclosure agreements, employment contracts, confidentiality agreements, severance agreements, and settlement agreements they entered into with employees since the enactment of Dodd-Frank.¹³

The SEC Settles with KBR

On April 1, 2015, the SEC announced its settlement with KBR, which was the largest U.S. contractor operating in Iraq and Afghanistan between 2002 and 2011, winning nearly \$40 billion worth of federal work.¹⁴ The Houston-based company has

UK: Employment Legislation Update – Spring 2015

This month we highlight the key changes to UK employment legislation shortly coming into force:

1. **Family leave rights:** As we reported in January’s [ELC](#)¹ the new system of shared parental leave and pay will be available to parents of babies due (or children placed for adoption) on or after 5 April 2015. In addition, from 5 April:
 - a. Adoption leave will be aligned more closely with maternity leave. The requirement for employees’ to have 26 weeks’ service before becoming entitled to take adoption leave will be removed, and a new right to take paid time off for adopters to attend adoption appointments will be introduced. Statutory adoption pay will change to reflect statutory maternity pay so that the first six weeks of leave are payable at 90% of the employee’s normal weekly earnings. Also, the adoption leave and pay scheme will be extended to those adopting a child from outside the UK.
 - b. Unpaid parental leave will be extended to allow all parents with children under 18 to take leave (rather than, as is currently the case, only those with children under 5 (or 18 if the child is disabled)).

been the subject of numerous lawsuits and fraud allegations relating to some of those contracts. During a deposition in one of those lawsuits, KBR's vice president of legal affairs disclosed that KBR used confidentiality agreements that "prohibited employees who reported fraud from discussing the 'subject matter' of their allegations with anyone, including government auditors and investigators, without 'specific authorization' from the company. Employees were warned that if they violated the terms of the agreements, they could face 'disciplinary action up to and including termination of employment.'"¹⁵ KBR, which admitted no guilt in the settlement, contends that it used the agreements only during confidential internal investigations to preserve attorney-client privilege,¹⁶ but the SEC sees it differently. According to Andrew J. Ceresney, Director of the SEC's Division of Enforcement:

By requiring its employees and former employees to sign confidentiality agreements imposing pre-notification requirements before contacting the SEC, KBR potentially discouraged employees from reporting securities violations to us . . . SEC rules prohibit employers from taking measures through confidentiality, employment, severance, or other type of agreements that may silence potential whistleblowers before they can reach out to the SEC. We will vigorously enforce this provision.¹⁷

In addition to agreeing to pay \$130,000, KBR agreed to change its confidentiality policies, and McKessy used the opportunity to warn that "[o]ther employers should similarly review and amend existing and historical agreements that in word or effect stop their employees from reporting potential violations to the SEC."¹⁸

2. Statutory payments and awards: The rates and limits of certain statutory payments and employment tribunal awards shall increase this month as follows:

STATUTORY PAYMENT / AWARD	NEW RATE / LIMIT
• Statutory maternity, paternity and adoption pay	£139.58
• Statutory sick pay	£88.45
• One week's pay (where capped)	£475
• Statutory redundancy payment	£14,250
• Unfair dismissal compensatory award*	£78,335

*Compensatory awards for unfair dismissal claims are unlimited in certain circumstances.

3. Holiday pay claims cap: A two-year cap on backdated holiday pay claims will be applied to claims brought in the employment tribunal on or after 1 July 2015. This cap was introduced to limit the impact of recent decisions of the courts and tribunals which state that employers must, when calculating holiday pay, take into account all contractual sums that are inherently linked to the employee's performance. This means that certain commission, bonuses, overtime pay and other shift allowances may need to be included in the calculation and that limiting holiday pay to basic salary only will not always be sufficient (see further our May 2014 [ELC²](#) and November 2014 [ELC³](#)).

For further advice or information on any of these points, or for assistance with updating employee handbooks or policies, please contact [Caroline Stakim](mailto:cstakim@mofo.com) at cstakim@mofo.com or +44 (0)20 7920 4055.

1 <http://www.mofo.com/~media/Files/Newsletter/2015/02/150202EmploymentLawCommentary.pdf>

2 <http://www.mofo.com/~media/Files/Newsletter/2014/12/141203EmploymentLawCommentary.pdf>

3 <http://www.mofo.com/~media/Files/Newsletter/140530EmploymentLawCommentary.pdf>

Recommendations to Employers

Do these developments mean that employers must abandon all confidentiality provisions with their employees? Definitely not. Thus far, the SEC's primary focus appears to be companies that the SEC believes are throwing up intentional roadblocks to disclosing illegal conduct, not companies that rightfully want to maintain the secrecy of competitively sensitive business information. As with many issues where competing interests tug at a business, a balanced approach seems the most prudent.

Government agencies' insistence that employers may not stop employees from disclosing illegal conduct is not new. The Equal Employment Opportunity Commission has long taken the position that employees may never waive their right to file charges. As a result, it has become common for general releases in settlement agreements to be accompanied by language such as:

Notwithstanding the foregoing release, you understand that nothing in this paragraph prevents you from filing a charge with or participating in an investigation by a governmental administrative agency; provided, however, that you hereby waive

any right to receive any monetary award resulting from such a charge or investigation and provided further that you agree not to encourage any person, including any current or former Company employee, to file any kind of claim whatsoever against the Company.

In the same vein, companies regulated by the SEC and FINRA should consider including FINRA's sample language or similar language in agreements containing any kind of confidentiality provision. Companies should also determine whether any broad language in agreements can be narrowed or modified. Changes to agreements should be made with an eye toward protecting the attorney-client privilege and the employer's valuable secrets while reassuring employees and the government that the employees may exercise their statutory whistleblowing rights.

[Ms. Schulman](#) is co-chair of Morrison & Foerster's [Employment and Labor Group](#) and is co-author of the upcoming third edition of *Whistleblowing: The Law of Retaliatory Discharge* (Bloomberg BNA 2015). She can be reached at jschulman@mof.com or (213) 892-5393.

To view prior issues of the ELC, click [here](#).

1 SEC: *Companies Cannot Stifle Whistleblowers in Confidentiality Agreements* (Apr. 1, 2015), available at <http://www.sec.gov/news/pressrelease/2015-54.html#VRwmBKQtFp9> ("SEC Press Release").

2 See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 800 (codified in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., and 28 U.S.C.).

3 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o).

4 Pub. L. No. 111-203, § 922(b) (July 21, 2010), 15 U.S.C. § 78u-6(b).

5 U.S. SECURITIES & EXCHANGE COMMISSION, 2014 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 10 (2014), available at <http://www.sec.gov/about/offices/owb/annual-report-2014.pdf>.

6 17 C.F.R. § 240.21F-17(a).

7 FINRA Regulatory Notice 14-40 (Oct. 2014), available at <http://www.financialservicesemploymentlaw.com/files/2014/10/FINRA-Regulatory-Notice-14-40.pdf>.

8 *Id.* FINRA also admonishes in the Regulatory Notice that protective orders in arbitration provisions must similarly preserve litigants' right to disclose.

9 *Id.*

10 Brian Mahoney, *SEC Warns In-House Atty's Against Whistleblower Contracts*, LAW360 (Mar. 14, 2014), available at <https://www.law360.com/articles/518815/sec-warns-in-house-attys-against-whistleblower-contracts>.

11 *Id.*

12 *Id.*

13 Rachel Louise Ensign, *SEC Probes Companies' Treatment of Whistleblowers*, WALL ST. J. (Feb. 25, 2015), available at <http://www.wsj.com/articles/sec-probes-companies-treatment-of-whistleblowers-1424916002>.

14 Scott Higham, *SEC says confidentiality agreements may have 'muzzled' whistleblowers at top government contractor*, WASH. POST (Apr. 1, 2015), available at <http://www.washingtonpost.com/blogs/federal-eye/wp/2015/04/01/sec-says-major-federal-contractor-tried-to-intimidate-and-muzzle-whistleblowers/>.

15 *Id.*

16 *Id.*

17 SEC Press Release

18 *Id.*

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