JENNER&BLOCK

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Securities Litigation and Enforcement

Companies Should Review Confidentiality, Severance and Other Agreements in View of New SEC Whistleblower Case

It was no joke when the Securities and Exchange Commission (SEC) on April Fools' Day announced its first enforcement action against a company for using improperly restrictive language in confidentiality agreements. SEC RELEASE 2015-54. The SEC was concerned that language requiring an employee to maintain the confidentiality of certain information could have the potential to stifle the whistleblowing process. This action, with the promise of similar cases to come, should encourage all companies to review their existing confidentiality, severance and other employee agreements to ensure full compliance with the SEC's whistleblower rules as expansively applied by the SEC. The SEC has suggested curative language to explicitly provide that a whistleblower may go directly to the SEC or other agency without notification to or fear of retaliation from the company.

The Dodd-Frank Act provides that a whistleblower who provides original information can recover 10 to 30 percent of the aggregate award of the sanctions collected in that SEC action and in any "related action" brought by certain governmental authorities when that information leads to collection of more than a million dollars in sanctions. The SEC is aggressively seeking such tips and one recent $30 million award should provide considerable encouragement to potential whistleblowers.

On April 1, 2015, the SEC charged Houston-based global technology and engineering firm KBR Inc., a former Halliburton Co. unit, with violating whistleblower protection Rule 21F-17 enacted under the Dodd-Frank Act. KBR required witnesses in certain internal investigation interviews to sign confidentiality statements with language warning that they could face discipline, including possible termination, if they discussed the matters with outside parties without the prior approval of KBR's legal department.

Without admitting any violation, KBR agreed to pay a $130,000 civil penalty to settle the SEC's charges that the company violated Rule 21F-17, which prohibits companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC. Additionally, the company voluntarily amended its confidentiality statement by adding language explicitly stating that employees are free to report possible violations to the SEC and other federal agencies without KBR approval or fear of retaliation.

Separately, KBR litigation VP Mark E. Lowes, explained that "It never dawned on us that a confidential investigation for the purposes of protecting attorney-client privilege would be viewed as potentially dimming whistleblower complaints." Moreover, the SEC's cease and desist order recognized that there are no apparent instances in which KBR actually prevented employees from communicating with the SEC about securities law violations. But the SEC held that the potential chilling effect of the language on whistleblowers' willingness to report illegal conduct to the SEC was all that was necessary for the company's conduct to violate SEC Rule 21F-17.

Andrew J. Ceresney, Director of the SEC's Division of Enforcement, vowed that the SEC "will vigorously enforce this provision." And Sean McKessy, Chief of the SEC's Office of the Whistleblower, warned that "Other 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." SEC RELEASE 2015-54.

This new case follows the recent filing of the first anti-retaliation case in June 2014. Paradigm Capital Management, Inc., Rel. Nos. 34-72393, No. 3-15930 (June 16, 2014). The SEC there charged that, upon learning that the whistleblower reported potential securities law violations to the SEC, Paradigm engaged in a series of retaliatory actions that ultimately resulted in the whistleblower's resignation. The SEC concluded that Paradigm violated Section 21F(h) of the Exchange Act, which prohibits an employer from discharging, demoting, suspending, threatening, harassing, directly or indirectly, or in any other manner discriminating against a whistleblower for providing information to the SEC.

Together these settled cases should alert all companies of the danger of loose language in agreements or dealings with whistleblowers which might be interpreted in hindsight as interfering, retaliating or chilling the flow of information from potential whistleblowers to the SEC.

Potential Battle

The SEC's order was not contested by the company, which agreed to its terms. Indeed, no court has yet ruled on the scope or authority of the SEC's whistleblower retaliation regulations. Certainly companies have legitimate interests in assuring that their trade secrets and attorney client privileged materials are not compromised. Accordingly, depending on the facts of particular cases, some restrictions may be justified.

Additionally, there may be a potential legal defense to the SEC's expanded enforcement efforts. The Dodd-Frank Act explicitly provides for whistleblower awards, but it does not actually say anything about the SEC enforcing the anti-retaliation provisions. The anti-retaliation provisions establish only a whistleblower's right to sue a company alleged to have retaliated for whistleblowing activities. Nonetheless, the SEC issued rules providing itself authority to enforce the anti-retaliation provisions, apparently on the basis that the whistleblower portion of Dodd-Frank Act modified the 1934 Securities Exchange Act and that under that Act the SEC has general enforcement authority.

The SEC position is in stark contrast to that of the Commodity Futures Trading Commission (CFTC), which was granted nearly identical whistleblower authority under the Dodd-Frank Act. The CFTC takes the position that it does not have the "statutory authority" independently to pursue whistleblower retaliation charges and thus has no rule that prohibits impeding whistleblowers from reporting.

Thus, a company that becomes the subject of an SEC anti-retaliation action might argue that the SEC lacks authority or does not have standing to bring such an action. This raises issues of how much deference should be provided the SEC's interpretation of the statute, especially in light of the CFTC's different approach. But most companies are better advised to avoid such disputes altogether by complying with the new rules and guidance provided in the cases discussed in this alert.

Curative Language

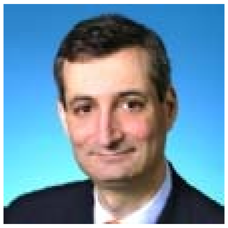
As part of its settlement with the SEC, KBR amended its confidentiality statement to include the following statement:

> 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.

Companies should consider adopting this or similar language as part of any confidentiality, severance or other employment agreement which concerns disclosure of information outside of the company. While this language may be broader than is required, it is the only specific language that has thus far found favor with the SEC and it may well become the accepted model for compliance and internal controls in this area.

But this probably is not a one-size solution for all situations and types of agreements. Given the early stage and lack of precedent available under these new SEC rules, a company and its counsel should carefully review each type of agreement it has with employees and weigh the company's legitimate interests as well as the public and individual interests in assuring that law violations may generally be reported without unnecessarily compromising the company's lawful secrets.

Securities Litigation and Enforcement Practice Co-Chairs



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