STROOCK
SPECIAL BULLETIN

SEC Announces First Whistleblower Protection Case Based on Confidentiality Agreement

Employers Take Note: Do Your Employment-Related Documents Impede Employees’ Ability to Engage in Whistleblowing Process?

April 8, 2015

Background

The Securities and Exchange Commission (the “SEC”) announced on April 1, 2015, that it had settled the first enforcement action it brought against a company for using language in an agreement that could “stifle the whistleblowing process” created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).1 Among other things, Dodd-Frank includes anti-retaliation provisions, financial incentives and confidentiality provisions to encourage whistleblowers to report potential securities law violations. Multiple factors suggest that the SEC may bring additional enforcement actions pursuant to Rule 21F-17 of the Securities Exchange Act of 1934 (the “Exchange Act”).2

The settlement arose out of a cease-and-desist proceeding filed by the SEC with respect to a confidentiality statement maintained by KBR, Inc. (“KBR”) in connection with its internal investigation of complaints, including allegations of potential federal securities violations.3 Under the confidentiality statement, any witness that was interviewed by a KBR investigator in connection

2 Rule 21F-17 provides, in relevant part: “No 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 . . . with respect to such communications.”
with an investigation, including the employee that filed the initial complaint, could be asked to sign the confidentiality statement, which contained the following provision:

I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.

The confidentiality statement was also included in KBR’s Code of Business Conduct Investigation Procedures manual.

The KBR Settlement

Although there was no evidence that KBR (i) prevented any employee from communicating with the SEC about potential securities laws violations or (ii) attempted to enforce the form confidentiality statement containing the objectionable language, the SEC still filed a cease-and-desist proceeding with respect to this practice. Thus, the basis of the SEC’s proceeding was not that KBR prevented an employee from speaking to the SEC staff, but rather, that the confidentiality statement could discourage an employee from reporting an alleged violation of federal securities law directly to the SEC – in contravention of Dodd-Frank.

While neither admitting nor denying the SEC’s allegations, KBR agreed, among other things, to revise its confidentiality statement to include the following language:

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.

KBR also agreed to pay a $130,000 civil penalty, make reasonable efforts to contact KBR employees who signed the confidentiality statement and advise them of the provisions of the revised statement, and cease and desist from committing future violations of Rule 21F-17.

Harbinger of Things to Come?

There have been several indications that this proceeding may be a harbinger of things to come, including:

(i) The Wall Street Journal reported that the SEC has sought years of documents from companies, including non-disclosure and employment agreements and currently has a number of ongoing investigations into attempts to silence whistleblowers;

(ii) the SEC’s announced “Broken Windows” policy of pursuing even minor violations of the securities laws in an attempt to deter more significant violations;

(iii) the SEC Enforcement Director, Andrew Ceresney, stated in the press release announcing the KBR settlement that the SEC intends to vigorously enforce Rule 21F-17; and

(iv) several federal courts, including the United States Court of Appeals for the Fifth Circuit, have held that the Dodd-Frank anti-retaliation provisions apply only to employees that report potential federal securities law violations directly to the SEC. The SEC may find it more important to encourage direct SEC reporting if courts do not extend Dodd-Frank protection to internal reports of potential violations.

Furthermore, employers should be aware that, while the KBR settlement applied to a provision in a statement signed by witnesses in investigations, by no means is the SEC taking a narrow view of its mandate. To the contrary, the SEC has stated that “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.” Indeed, other federal, state, and local agencies with authority to enforce whistleblower or anti-retaliation provisions of laws protecting employees may, depending upon the statutory basis for their authority, attempt to take a similar approach as the SEC has done with respect to Rule 21F-17.

The Takeaway

A clear lesson from the KBR Settlement is that employers should review their employee handbooks, policies, and practices, as well as agreements pertaining to employees and former employees (such as confidentiality agreements and restrictive covenants, employment agreements, separation agreements and the like) to analyze whether any provisions may be construed as discouraging employees from reporting directly to any governmental entity with authority to accept complaints or allegations of violations of applicable law and consider whether modifications may be necessary or appropriate.

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5 Asadi v. G.E. Energy (USA), L.L.C., 720 F.3d 620 (5th Cir. 2013).
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