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The Recent SEC Attack on Confidentiality Agreements: What Employers Need To Know and Do Now

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Introduction

- Employers typically impose confidentiality restrictions to protect trade secrets and confidential information, including when conducting internal investigations and in employee separation agreements.

- Employers also have a broader interest in preventing disparagement by both current and former employees.

Introduction (con't)

Internal Investigations

•Subjects include allegations of internal workplace harassment, ethical code violations, and systemic fraud/abuse in violation of various laws (*e.g.*, Dodd-Frank, False Claims Act).

•May be conducted by HR representatives, compliance officers, and/or in-house or outside counsel.

•Best practices dictate that witnesses not discuss/divulge information about the investigation or facts learned in interviews:

- To maintain investigation integrity: prevent internal "gossip" about the facts of the investigation; avoid risk that future witnesses change stories; minimize risk of retaliation against the person(s) who complained.
- To keep the facts of the investigation out of the press and contained before the company can determine whether a violation has in fact occurred, and, if so, how the company will respond.

The Escalating Trend

- Several executive branch agencies have recently adopted an aggressive stance that requires changes in the extent to which companies can require confidentiality in all the above examples.
- Focus today:
  - Securities and Exchange Commission (SEC)
  - National Labor Relations Board (NLRB)
- ***KEY MESSAGE:*** Employers may need to revise their workplace policies and employee agreements in light of current enforcement efforts by federal agencies.

Today's Agenda

- SEC
  - Basics of the whistleblower program & enforcement actions
  - New focus on employers' mere maintenance of confidentiality agreements and non-disclosure clauses in separation agreements
  - Discussion of April 1, 2015 enforcement action & what employers can learn from it
  - What employers may expect from the SEC going forward
- NLRB
  - Recent cases against ***non*-union** employers
  - March 2015 General Counsel's Memorandum
- Similar activity by other agencies of note (OIG & EEOC)
- Conclusions and Takeaways

SEC

Basics of the SEC Whistleblower Program

- Established through Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (enacted July 21, 2010).
- Dodd-Frank amended the Securities Exchange Act of 1934 to add new Section 21F, 15 U.S.C. § 78u-6, entitled "Securities Whistleblower Incentives and Protection."
- SEC adopted Regulation 21F, § 240.21F-1, *et seq.,* to implement Section 21F – became effective August 12, 2011.
- An SEC Office of the Whistleblower was created to administer the Program.

3 Main Components of the Program

- Requires the SEC to make financial payments to eligible whistleblowers who meet certain criteria.
- Prohibits retaliation by employers against individuals who provide the SEC with information about possible securities violations.
- Provides anonymity and other protections for whistleblowers who report possible securities violations.

SEC Whistleblower Program is Gaining Momentum

- Fiscal Year (FY) 2014 was historic for the Program
  - **The number and magnitude of the financial awards have increased**
    - As of the end of FY 2014, the SEC had authorized a total of 14 whistleblower awards since the Program's inception.
    - 9 of those awards were made in FY 2014 – totaling $35 million.
    - 1 award totaled $30 million and was made to a foreign whistleblower.
  - **The SEC brought its first anti-retaliation case**
    - *In the Matter of Paradigm Capital Management, Inc. and Candace King Weir*, Securities Exchange Act Release No. 72393 (June 16, 2014).
    - SEC Enforcement Director, Andrew Ceresney: "Paradigm retaliated against an employee who reported potentially illegal activity to the SEC.[.] . . .. Those who might consider punishing whistleblowers should realize that such retaliation, in any form, is unacceptable."

SEC Has Recently Attacked Confidentiality / Non-Disclosure Clauses in Employers' Agreements

- In March 2014: The SEC Office of the Whistleblower "promised" that the SEC would police **confidentiality and severance agreements** that contain *language that could discourage whistleblowers* – and thus violate Rule 21F-17.

- On April 1, 2015: SEC brings its first enforcement action under Rule 21F-17.
    - Securities Exchange Act Release No. 74619 (April 1, 2015)

What the Whistleblower Rule Governing Confidentiality Agreements Says: Exchange Act Rule 21F-17

- 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. 17 C.F.R. § 240.21F-17(a).

Text of the Confidentiality Statement that violated Rule 21F-17 in the April 1, 2015 SEC Enforcement Action

- 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.

April 1, 2015 Enforcement Case Summary

- SEC made **no finding** that employer had either (1) in fact prevented any employee from speaking with the SEC, or (2) ever taken action to enforce the form confidentiality agreements.

- SEC acted based on employer's use of language – in its Code of Business Conduct Investigation Procedures Manual (that governed its internal investigation process) and in "form" confidentiality statements signed by witnesses. SEC found the language had a "**potential for chilling**" whistleblowers, contrary to Rule 21F-17(a)'s purpose to "encourage individuals to report."

- Outcomes were that employer:

    1. voluntarily revised confidentiality language to make clear that employees were free to report possible securities violations without employer approval or fear of retaliation;
    2. sent out notices to current and former employees who had signed the originally-worded form; and
    3. agreed to a cease and desist order and a $130,000 penalty.

The Employer's Revised 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.

SEC Comments on the Action Provide Insight

SEC Enforcement Director, Andrew Ceresney:

- "By requiring its employees and former employees to sign confidentiality agreements **imposing pre-notification requirements** before contacting the SEC, [the employer] **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." (emphasis added.)

Chief of the SEC Office of the Whistleblower, Sean McKessy:

- "[The employer] changed its agreements to make clear that its current and former employees will **not have to fear termination or retribution or seek approval** from company lawyers before contacting us. Other employers should similarly **review and amend existing and historical agreements that in word or effect stop** their employees from reporting potential violations." (emphasis added.)

Expect Future SEC Action

- Widely reported recently that SEC has contacted many other public companies—
  - required that they turn over to the SEC "every nondisclosure agreement, confidentiality agreement, severance agreement and settlement agreement they entered into with employees since Dodd-Frank went into effect," AND "all documents related to corporate training on confidentiality," "all documents that refer or relate to whistleblowing," and "a list of terminated employees." (emphasis added.)
  - SEC reportedly will find unlawful any agreement or policy that requires employees to forgo monetary benefits from government probes, or to notify their employers in advance of their intent to provide information to the government.

FINRA Regulatory Notice 14-40 (Oct. 2014): consistent with SEC position

- "FINRA reminds firms 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 [SEC], FINRA, or any federal or state regulatory authority regarding possible securities law violation," including those that "impede or have the potential to impede, FINRA investigations and the prosecution of FINRA enforcement actions." (emphasis added)

FINRA Regulation (con't)

- "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."
- Example of an acceptable confidentiality provision:

  "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."

SEC – Concluding Thoughts

- Additional enforcement actions against other companies are likely.
- All employers will be deemed "on notice" of SEC's legal position.
- SEC will feel pressure to make good on public promises to continue vigorous enforcement of Rule 21F-17, including from petitions currently before the agency:
  - filed by the vocal former Assistant Director in Division of Enforcement, Jordan A. Thomas, on behalf of "the Government Accountability Project," and >50 whistleblower protection organizations and plaintiff law firms; argues that *immediate* SEC attention is needed to remedy:

> "[the] alarming . . . proliferation of increasingly creative private agreements designed to silence or otherwise limit employees' rights to act as SEC whistleblowers with all of the incentives and protections Congress provided by statute."

NLRB

NLRB: *Why even non-union employers need to know*

- Board has been particularly activist in recent years – including by trying to catch non-unionized employers in activity that violates the National Labor Relations Act (NLRA).
- Two recent high profile cases against non-union employers held employers liable for violating the NLRA because they merely **maintained** workplace policies that ***could*** "**chill**" employees' ability to engage in "**concerted activity**":
  - *Triple Play Sports Bar*, 361 N.L.R.B. No. 31 (NLRB Aug. 22, 2014) (non-union employer liable based on its non-disparagement policy).
  - *Flex Frav Logistics, LLC v. NLRB*, 746 F.3d 205 (5th Cir. 2014) (non-union employer liable based on its confidentiality policy).

Quick Primer on the NLRA

- NLRA Section 7 protects employees' right to engage in "*concerted activity*."
    - **concerted activity** = a near boundless concept that permits employees to engage in any conduct that even arguably relates to the "terms and conditions of employment" without any negative repercussions by the employer.

E.g.:

- Employees have a right to discuss wage rates – both with co-workers and with people outside the company.
- Employees have a right to criticize their employers' workplace rules / treatment of employees – oftentimes, *even if that criticism is disparaging to company managers*.

Quick Primer on the NLRA (con't)

- An employer's *mere maintenance* of a workplace rule or policy will violate the NLRA if:
    - employees "would *reasonably construe*" it as
    - prohibiting any Section 7, protected concerted activity.
- Paralleling the recent SEC approach SEC, the NLRB has recently been scrutinizing employer policies.
- NLRB has held that employers violated the NLRA if any of their policies could have a "**chilling effect**" on employees' ability to engage in concerted, protected activity.

Triple Play case:

- Board held that non-union employer violated NLRA by maintaining this social media / non-disparagement policy:

> "[W]hen internet blogging, chat room discussions, . . . or other forms of communication extend to employees . . . **engaging in inappropriate discussions about the company, management, and/or co-workers**, the employee may be violating the law and is subject to disciplinary action, up to and including termination of employment. . . . In the event state or federal law precludes this policy, then it is of no force or effect."

- Policy was deemed facially unlawful – despite its final sentence / savings clause – on the grounds that employees could reasonably interpret the policy as barring employee criticism of the employer's treatment of employees – criticism that employees were statutorily entitled to lodge, ***including on Facebook***.

Flex Frav Logistics case:

- Court agreed with NLRB that non-union employer violated NLRA by requiring employees to sign a confidentiality agreement.

- Court and NLRB reasoned that employees would reasonably construe the agreement as prohibiting employees from discussing the topic of wage rates with people outside the company.

Flex Frav case (con't)

Text of confidentiality agreement held to be unlawful:

Confidential Information includes, but is not limited to, information that is related to: our customers, suppliers, distributors; management and marketing processes, plans and ideas, processes and plans, our financial information, including costs, prices; current and future business plans, our computer and software systems and processes; personnel information and documents, and our logos, and art work.

No employee is permitted to share this Confidential Information outside the organization, . . . without prior management approval. Disclosure of Confidential Information could lead to termination, as well as other possible legal action.

NLRB General Counsel's Memorandum March 2015

Examples of *per se un*lawful policies:

- "Do not discuss 'customer or employee information' outside of work, including 'phone numbers [and] addresses.'"
  - *Reasoning:* "employee information" is too broad.
- "Discuss work matters only with other [Employer] employees who have a specific business reason to know or have access to such information.... Do not discuss work matters in public places."
  - *Reasoning*: facially unlawful, even though it does not explicitly reference terms and conditions of employment or employee information, because it does not clarify, in express language or contextually, that the policy does not restrict Section 7 communications.

Per Se ***Un***lawful Policies (con't)

- "Confidential Information is [a]ll information in which its [sic] loss, undue use or unauthorized disclosure could adversely affect the [Employer's] interests, image and reputation or compromise personal and private information of its members."
    - *Reasoning:* Employees not only have a Section 7 right to protest their wages and working conditions, but also have a right to share information in support of those complaints.
    - "This rule would reasonably lead employees to believe that they cannot disclose that kind of information because it might adversely affect the employer's interest, image, or reputation."

Examples of Facially Lawful Policies

- No unauthorized disclosure of "business 'secrets'."
- "Misuse or unauthorized disclosure of confidential information not otherwise available to persons or firms outside [Employer] is cause for disciplinary action, including termination."
- "Do not disclose confidential financial data, or other non-public proprietary company information. Do not share confidential information regarding business partners, vendors or customers."

NLRB Wrap Up

- When reviewing policies and agreements for SEC compliance purposes, should take NLRB standards into account at same time.
- Different employers with different complements of workers will likely balance the legal risks and business goals in different ways.

Parallel Activity by Other Agencies

1. Office of Inspector General (OIG)

- Series of news reports in 2014 led to an inquiry by the Special Investigator General for Afghanistan Reconstruction (SIGAR) under the False Claims Act (FCA)
    - FCA has whistle-blower protections similar to those in Dodd-Frank
- SIGAR focused on a contractor's separation agreements with former employees who had participated in a prior government audit at the contractor.
- Agreement language with which SIGAR took issue:
    - "[you] may not make" "any derogatory, disparaging, negative, critical, or defamatory statements to . . . [a number of parties, including] funding agencies [and] officials of any government."

2. Equal Employment Opportunity Commission (EEOC)

- EEOC has targeted severance agreements since 2012, filing two major suits in 2014.
- Suits alleged that employers' severance agreements were "overbroad, misleading, and unenforceable," because they arguably *interfered with* employees' rights:
    - to file administrative charges of discrimination, or
    - to communicate with EEOC investigators.

EEOC (con't)

Separation Agreement Clauses the EEOC Attacked

- **cooperation clause**: required employees who received subpoenas, deposition notices, or interview requests as part of a criminal, civil, or administrative investigation or suit ***to promptly notify the employer's General Counsel*** by phone and in writing;
- **non-disparagement clause**:
  - prevented employees from making any statements that impugned employer's business or reputation, or the reputation of any of its officers, directors, or employees;
  - prohibited employees from sharing with a third party, or using themselves, any confidential information without the written authorization of the employer; and
- **litigation disclaimer**: required employees to confirm they had no pending action against company, in any court or agency, and also would not initiate such an action.

EEOC (con't)

- EEOC argued that all the above clauses were improper, ***even though*** the agreement did include carve out language that nothing in agreement was intended to interfere with employees' rights:
  - to participate in a proceeding with a court or agency enforcing discrimination laws, or
  - to prohibit an employee from cooperating with any agency in its investigation.

- Courts eventually dismissed the EEOC suits based in part on the EEOC's failure to conciliate the claims before litigation, but the underlying, substantive issues remain unresolved.

TAKEAWAYS

What Employers Should Be Doing Now

Thank you for attending!

We will send you the recorded session.

We welcome your feedback.

Questions?

Please call or email any of today's presenters.

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Resources

- *www.sec.gov/whistleblower*
- http://www.sec.gov/about/offices/owb/annual-report-2014.pdf
- "SEC Probes Companies' Treatment of Whistleblowers," Wall St. Journal (Feb. 25, 2015)
- http://www.sec.gov/rules/petitions/2014/petn4-677.pdf
- http://www.nlrb.gov/reports-guidance/general-counsel-memos
- https://oig.state.gov/system/files/esp-15-03.pdf