U.S. Securities Law Briefing
Check Your Forms – SEC Fines Company for Confidentiality Agreement Language Potentially Restricting Whistleblowing

Following a recent U.S. Securities and Exchange Commission (the “SEC” or the “Commission”) enforcement action fining a company for restrictive language in a confidentiality agreement, companies should closely review language in their standard confidentiality agreements. The SEC brought the enforcement action against KBR Inc., a technology and engineering company, under the SEC’s whistleblower protection rules, for including a warning that employees could face discipline or be fired for disclosing matters discussed during an internal investigation to outside parties without the prior approval of KBR’s legal department. KBR agreed to remove the language and pay a $130,000 penalty, though there were no allegations that KBR ever took action to enforce the confidentiality agreement or prevent whistleblower communications with the SEC.

As part of the whistleblower program established by Section 21F of the U.S. Securities Exchange Act of 1934\(^1\), the SEC adopted Rule 21F-17, which states: “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.”

According to the SEC’s order, KBR, a SEC-registered and reporting company, used a form confidentiality statement in connection with interviews in internal investigations, which included allegations of possible U.S. federal securities law violations. The SEC determined that whistleblowers could have been stifled by a provision in the agreement that employees were “prohibited from discussing any particulars” of the interview and its subject matter “without prior authorization of the Law Department” and that disclosure without approval could result in “disciplinary action up to and including termination of employment.”

Pursuant to its settlement with the SEC, KBR agreed to revise the language of its confidentiality agreements to make clear that employees are not prohibited from reporting possible violations of federal law or regulation, that

\(^1\) Section 21 was added by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The whistleblower program awards whistleblowers who provide the SEC with original information about a federal securities law violation a minimum of 10% and up to 30% of any monetary sanctions obtained by the SEC exceeding $1 million. For further information on the whistleblower program, please see our earlier client briefing.
such disclosures are protected under federal law, and that no prior company authorization is required before doing so.

KBR agreed to pay a fine of $130,000, though it neither admitted nor denied the SEC’s charges under the settlement. The SEC conceded that it was unaware of any instances in which a KBR employee was in fact prevented from communicating directly with the SEC about potential securities law violations or that KBR ever took action to enforce the form confidentiality agreement. Nevertheless, the SEC asserted that the language found in the form confidentiality statement impedes whistleblower communications by prohibiting employees from discussing the substance of an interview without clearance from KBR’s law department, under penalty of disciplinary action including termination of employment. In its press release, the SEC explained that “any company’s blanket prohibition against witnesses discussing the substance of the interview has a potential chilling effect on whistleblowers’ willingness to report illegal conduct to the SEC.”

KBR also agreed to make reasonable efforts to contact KBR employees in the United States who signed the confidentiality statement from August 21, 2011 to the present, providing them with a copy of the SEC’s order and a statement that KBR does not require the employee to seek permission from the General Counsel of KBR before communicating with any governmental agency or entity regarding possible violations of federal law or regulation.

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Companies should consider the SEC’s recommendation that they “review and amend existing and historical agreements that in word or effect stop their employees from reporting potential violations to the SEC,” or they risk an SEC enforcement action.

Accordingly, to the extent a company uses confidentiality agreements in connection with its internal investigations, or in any other instances, any language that could discourage whistleblowing should be revised, or language should be included that expressly informs employees of the legal rights and protections afforded to whistleblowers. In this action, the SEC recognized as a remedial measure the inclusion of the following provision in KBR’s confidentiality agreement:

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.

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2 Rule 21F-17 became effective on August 12, 2011.
Companies should also refrain from taking any action that could be seen to discourage whistleblower complaints, such as threatening to enforce confidentiality agreements and/or requiring internal authorization before contacting the SEC.

Non-U.S. companies may also want to consider reviewing their confidentiality language, as the case law is not yet settled regarding the whistleblower program’s reach outside the United States. The Second Circuit Court of Appeals recently held, in Liu Meng-Lin v. Siemens AG, that the anti-retaliation protections of the Dodd-Frank whistleblower program do not apply outside the United States, because there was no clear congressional intent that the provision should apply extraterritorially, as required pursuant to the U.S. Supreme Court’s Morrison v. Australia National Bank decision. The court questioned – but did not decide – whether the SEC’s regulations with respect to the whistleblower bounty program (as opposed to the antiretaliation provisions), which contemplate extraterritorial awards, should be accorded deference. However, the case did not discuss Rule 21F-17, the regulation at issue in the KBR case.

We will continue to monitor developments in this area and welcome any queries you might have.