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SEC Charges Company for Language in Confidentiality Agreements

SEC announces language in confidentiality agreement violates Dodd-Frank whistleblower protection.

On April 1, 2015, the U.S. Securities and Exchange Commission ("SEC") announced its first enforcement action against a company for including language in its confidentiality agreements that violates the whistleblower protections of Rule 21F of the Securities Exchange Act of 1934 ("Rule 21F"), established by the Dodd-Frank Act. According to the SEC, the company subject to the enforcement action, a U.S. issuer, required witnesses in some of the company's internal investigations to sign confidentiality agreements containing language that the SEC believes violates Rule 21F. Rule 21F-17 prohibits "any action to impede an individual from communicating directly with the Commission staff about a possible securities fraud violation, including enforcing, or threatening to enforce, a confidentiality agreement."

According to the April 1, 2015 order instituting a settled administrative proceeding (the "SEC Order"), the company used a form confidentiality clause in the course of its internal company investigations that stated the following:

> 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 SEC Order states that the SEC was unaware of any instance in which the company took action to enforce the form language or where any of the company's employees were actually prevented from discussing potential securities law violations with the SEC. The SEC nonetheless concluded that the company violated Rule 21F-17 because the language in the form confidentiality clause undermined the purpose of the Rule.

The SEC Order reflects that the company has agreed to (1) make reasonable efforts to provide U.S. employees who signed confidentiality statements from August 21, 2011 to the present with a copy of the SEC Order and a statement that the company does not require its employees to seek permission before communicating with the government, (2) pay a penalty, and (3) add the following to its form confidentiality clause:

> 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.

The enforcement action comes after much publicity regarding the interplay between companies' use of confidentiality clauses and Rule 21F. Last March 2014, Sean McKessy, Chief of the SEC's Office of the Whistleblower, reportedly warned that the

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SEC is "actively looking for examples of confidentiality agreements, separat[ion] agreements, [and] 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.'" Mr. McKessy also reportedly said that if the SEC found language in companies' agreements that the SEC determines runs afoul of the whistleblower rules, "not only are we going to go to the companies, we are going to go after the lawyers who drafted it," and referenced the SEC's power to eliminate a lawyer's ability to practice before the SEC. Congress has also weighed in on how companies' use of confidentiality agreements should be viewed in light of Rule 21F's whistleblower protection. In an October 27, 2014 letter to SEC Chairwoman Mary Jo White, eight Democratic members of House Committees on Financial Services and Oversight and Government Reform urged the SEC to send a "strong message" to the industry that silencing prospective whistleblowers would not be tolerated. The letter also suggested that employees "should also be clearly informed that these [confidentiality] agreements in no way restrict their right to voluntarily report securities law violations to the [SEC]."

According to a February 2015 article in the Wall Street Journal, the SEC has recently sent letters to a number of companies asking for production of nondisclosure agreements and employment contracts. Companies should re-review their confidentiality clauses used in the course of their business to ensure that such clauses are clear that employees are free to report misconduct to government regulators without fear of penalty.

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