SEC Announces First Enforcement Action Involving Restrictive Language in Confidentiality Agreement under Dodd-Frank Whistleblower Program

On April 1, 2015, the Securities and Exchange Commission (SEC) announced its first enforcement action involving restrictive language in an employee confidentiality agreement that it contends has "the potential to stifle the whistleblowing process." The enforcement action arose in the context of internal investigations in connection with which a company required employee witnesses to execute a form confidentiality agreement prohibiting them from discussing the internal investigations with outside parties without prior approval of its legal department. The agreement further stated that unauthorized disclosure "may be grounds for disciplinary action up to and including termination of employment." Because the internal investigations included allegations of possible securities law violations, the SEC found that the terms of the form confidentiality agreement violated Rule 21F-17 promulgated under the Securities Exchange Act of 1934, as amended (Exchange Act).

The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted on July 21, 2010, added Section 21F to the Exchange Act to create what is often referred to as the "Dodd-Frank Whistleblower Program." The SEC enacted Exchange Act Rule 21F-17(a) providing that no person may take any action to impede a whistleblower from communicating directly with the SEC about a possible securities law violation, including by enforcing or threatening to enforce a confidentiality agreement.

The SEC order noted that the SEC was unaware of any instance in which the company in question prevented any employees from communication directly with the SEC about potential securities law violations or that it took action to enforce the confidentiality provision. Nevertheless, the SEC found that the language in question "impedes such communication." In its press release announcing the order, the SEC's staff further noted 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. We will vigorously enforce this provision."

The company agreed to cease and desist from committing or causing any violation or any future violation of Rule 21F-17 and to pay a $130,000 penalty to settle the charges. It also agreed to make reasonable efforts to, among other things, deliver a statement to employees who signed the confidentiality statement, stating that the company does not require them to seek permission from its legal department before communicating with any governmental agency or entity, including, but not limited to, the Department of Justice, the SEC, the Congress, and any agency Inspector General, regarding possible violations of federal law or regulation.

The SEC's focus on an employer's attempt to restrict the circumstances under which an employee can contact the SEC is consistent with other governmental enforcement agencies' positions in similar circumstances. For instance, the Equal Employment Opportunity Commission (EEOC) takes the same stance on any restrictions that would prevent an employee from reporting discrimination to that agency. This means that, in release agreements that often accompany severance payouts or settlement

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agreements between an employer and a departing employee, employers cannot require that employees forego their rights to file a charge of discrimination with the EEOC or to limit an employee's right to testify, assist, or participate in an investigation, hearing, or proceeding conducted by the EEOC under various federal statutes. In a similar vein, we have authored client alerts about actions by the National Labor Relations Board (NLRB) relating to sections of the National Labor Relations Act (NLRA) that apply to both unionized and non-unionized employers. In particular, Section 7 prohibits restricting the rights of employees to discuss wages, hours and other terms and conditions of employment, so any confidentiality language in an employment agreement should be reviewed with these restrictions in mind.

What does this mean to your business?

- Confidentiality clauses are often part and parcel of employee agreements, whether you are asking employees to sign them in connection with their continuing employment or termination of employment. You should make it clear that employees are free to make good faith reports of possible violations of statutes or regulations to governmental agencies, including the SEC. In that respect, it is noteworthy that Exchange Act Rule 21F-17 only concerns communication with the SEC staff but that the settlement discussed herein required the company in question to make it clear to its employees that the confidentiality agreement they had executed did not require them to seek permission before communicating "with any governmental agency or entity."
- With respect to already existing employee agreements, you should ensure that they do not prohibit communications of the nature discussed herein or amend them as necessary.
- Note that it is still an open question whether courts will strike the entire offending confidentiality provision, thereby eliminating the confidentiality obligation for all purposes, especially in the absence of severability and reform provisions.

This document is intended to provide you with general information regarding the SEC's enforcement involving restrictive language. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact an attorney listed in the link provided or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

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