

# Memorandum

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## The SEC Brings Its First Enforcement Action Involving Confidentiality Provisions That Have the Potential to Silence Employees From Reporting Suspected Misconduct to the SEC

April 3, 2015

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On April 1, 2015, the Securities and Exchange Commission (“SEC”) announced a settled administrative cease-and-desist proceeding against technology and engineering firm KBR, Inc. (“KBR”) for what the SEC described as the company’s “improperly restrictive” confidentiality agreements that allegedly violated the whistleblower protection rules adopted as part of the Dodd-Frank whistleblower bounty program. Specifically, the SEC alleged that KBR violated Rule 21F-17 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).<sup>1</sup> This announcement comes in the wake of media reports concerning SEC investigations into confidentiality agreements that have the potential to inhibit whistleblower activity.<sup>2</sup>

Section 21F of the Exchange Act was added by the Dodd-Frank Act as part of the whistleblower provisions in order to “encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees.”<sup>3</sup> To effectuate this purpose, the SEC adopted Rule 21F-17, which provides that “[n]o 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 conducts internal investigations into allegations of potential securities law violations as part of its compliance program. Both before and after the promulgation of Rule 21F-17,

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<sup>1</sup> See U.S. Securities and Exchange Commission, “[SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements](#)” (April 1, 2015).

<sup>2</sup> The Wall Street Journal, “[SEC Probes Companies’ Treatment of Whistleblowers](#)” (Feb. 25, 2015).

<sup>3</sup> “Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934,” Release No. 34-64545; File No. S7-33-10 at 197 (Aug. 12, 2011).

KBR allegedly required employees who were interviewed during internal investigations to sign confidentiality statements that prohibited these employees from discussing the investigations without prior authorization from KBR's legal department. These confidentiality statements indicated that failure to comply with their terms could lead to disciplinary action, including termination of employment.

While the SEC noted that it is not aware of any instances in which KBR actually silenced whistleblowers through its confidentiality agreements, it stated that the blanket prohibition in these agreements nonetheless "has a potential chilling effect on whistleblowers' willingness to report illegal conduct to the SEC"<sup>4</sup> and "undermines the purpose of" Section 21F and Rule 21F-17.<sup>5</sup> As part of its settlement with the SEC, KBR agreed to amend its confidentiality agreements to include the following 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."<sup>6</sup>

In addition, without admitting any of the charges, KBR agreed to pay a civil monetary penalty of \$130,000 to the SEC and to cease and desist from committing or causing any future violations of Rule 21F-17.

### Implications of the Action

The SEC's enforcement action against KBR is a reminder that to ensure compliance with Section 21F and Rule 21F-17, companies should "review and amend existing and historical agreements that *in word or effect* stop their employees from reporting potential violations to the SEC."<sup>7</sup> The action underscores that even outside of confidentiality provisions in separation agreements, any measures that have the potential to interfere with the ability of employees to report securities law violations to the SEC will be closely scrutinized and potentially deemed a violation of the SEC's whistleblower rules. In KBR's case, Andrew J. Ceresney, Director of the SEC's Division of Enforcement, observed that "[b]y requiring its employees and former employees to sign confidentiality agreements imposing pre-notification requirements before contacting the SEC, KBR potentially discouraged employees from reporting securities violations."<sup>8</sup>

In light of the SEC's enforcement action against KBR, it may be an opportune time for companies and their counsel to review their employment agreements and other employee confidentiality provisions and policies

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<sup>4</sup> U.S. Securities and Exchange Commission, *supra* note 1.

<sup>5</sup> *In the Matter of KBR, Inc.*, Release No. 74619; File No. 3-16466 at 3 (April 1, 2015).

<sup>6</sup> *Id.*

<sup>7</sup> U.S. Securities and Exchange Commission, *supra* note 1 (emphasis added).

<sup>8</sup> *Id.*

and amend them, if necessary, to ensure that they do not have even the unintended effect of interfering with the ability of employees to report suspected violations to the SEC.

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If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or [yafit.cohn@stblaw.com](mailto:yafit.cohn@stblaw.com), or any other member of the Firm's Public Company Advisory Practice or Litigation Practice.

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