

LEGAL UPDATES

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SEC Targets Confidentiality Agreements

For the past few months, officials of the Securities and Exchange Commission (SEC) have expressed concern that provisions in confidentiality agreements may discourage corporate employees from reporting securities law violations under the Dodd-Frank Act.

SEC Enforcement Actions

On April 1, 2015, the SEC issued a cease-and-desist order against KBR Inc. that addressed the permissible limits of employee confidentiality obligations under the Dodd-Frank Act's whistleblower provisions (Section 21F).

KBR required employees to sign a confidentiality agreement at the outset of interviews in internal whistleblower investigations. The agreement prohibited employees from discussing any particulars regarding the interview or the subject matter without prior authorization of KBR's legal department. The SEC found that this practice of requiring prior authorization violated Rule 21F-17, which prohibits any action that impedes direct communication with the SEC regarding security violations.

The SEC also recently conducted a "sweep" of the confidentiality agreements of public companies, broker-dealers and private funds to identify potential candidates for enforcement action. It is unclear whether the SEC will extend its enforcement power to the ordinary confidentiality agreements that are required for many employees, including agreements designed to protect intellectual property. However, the order against KBR confirms that the SEC intends to aggressively enforce Rule 21F-17.

What This Means to You

The whistleblower provisions (Section 21F) apply to all companies, even those not registered publicly under the Securities Act of 1934. Therefore, all

companies should review their employment, confidentiality and intellectual property protection agreements and related policies to ensure that their procedures conform to the SEC's position.

In addition, companies should review their current whistleblowing procedures. It is still critical to encourage employees to first report internally, but this should be done in a way that does not impede reporting to the SEC. All executives should be educated about the new risks created by the SEC's order against KBR, as well as the proper procedures for handling internal complaints.

Ephraim Hintz, a summer associate at the firm, assisted in the preparation of this alert.