SEC Issues Landmark Order Barring Gag Clauses

Jason Zuckerman

In public remarks, including at ABA Labor and Employment conferences and webinars, Sean McKessy, Chief of the SEC's Whistleblower Office, has warned that the SEC is identifying and investigating confidentiality agreements that attempt to impede employees from reporting securities violations to the SEC.[1] Recently the SEC made good on its promise and took administrative action against KBR, Inc. for requiring employees to sign confidentiality agreements that could impede employees from reporting violations. This is an important development for employment attorneys and warrants a thorough review of corporate confidentiality agreements and policies.

SEC Administrative Action

On April 1, 2015, the SEC took administrative action against KBR for requiring witnesses in certain internal investigations to sign confidentiality statements with language warning that they could face disciplinary action, including termination of employment, if they discussed the subject of the interview with outside parties without the KBR legal department's prior approval. *See* Exchange Act Release No. 74619 (April 1, 2015).The SEC concluded that such agreements violate Rule 21F-17, which prohibits companies from using gag clauses in agreements or policies to prevent whistleblowers from providing information to the SEC: "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." Rule 21F-17 is one of the regulations implementing the Dodd-Frank SEC whistleblower reward program.

Significantly, the SEC brought this action absent any evidence that the agreement prevented a KBR employee from communicating directly with SEC and without proof that KBR took any disciplinary action against an employee to enforce the form confidentiality agreement. Instead, the SEC found a violation because the threat of disciplinary action undermines the purpose of Rule 21F-17(a), which is to "encourage[e] individuals to report to the Commission." *Id.*

To settle the charges, KBR agreed to pay a $130,000 penalty and amend the confidentiality statement to clarify that employees are free to report possible violations to the SEC and other federal agencies without KBR's approval. In announcing this enforcement action, Andrew J. Ceresney, Director of the SEC's Division of Enforcement, pledged that the SEC "will vigorously enforce" Rule 21F-17 to ensure that whistleblowers are not silenced.[2]

Impact of the KBR Order

In light of the SEC's demonstrated commitment to combat gag clauses that undermine the SEC Whistleblower Reward Program, employers should revise their agreements and policies to ensure that they do not dissuade current or former employees from making lawful disclosures to the SEC. The SEC Order suggests that a disclaimer similar to the following modification that KBR made to its confidentiality statement will likely suffice:

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.

Note though that the SEC's action against KBR is not an attack on confidentiality agreements and policies serving legitimate business interests. As SEC Chair Mary Jo White pointed out in an April 30, 2015 speech, Rule 21F-17 is not "a sweeping prohibition on the use of confidentiality agreements . . . Companies may continue to protect their trade secrets or other confidential information through the use of properly drawn confidentiality and severance agreements."[3] The SEC Whistleblower Program is not a license to engage in unfair competition or use an employer's proprietary information to benefit a competitor. Instead, Rule 21F-17 is designed to ensure that whistleblowers can provide information to the SEC to enable the SEC to investigate and enforce violations of federal securities laws.

Although the SEC's administrative action against KBR stemmed from a specific prohibition against disclosure of information related to an internal investigation, the SEC might also target clauses in severance agreements that indirectly impede an individual from communicating with the SEC. For example, conditioning severance benefits on a certification that an employee has not made any disclosure to the SEC could be construed as interfering with an employee's right to make a confidential disclosure to the SEC.[4]

Gag Provisions Under Scrutiny at Other Agencies

The SEC is not alone in combatting gag provisions that restrict whistleblowing to law enforcement and regulatory agencies, or that interfere with National Labor Relations Act (NLRA) concerted activity. Other agencies, including the EEOC, NLRB and DOL, are scrutinizing gag provisions in confidentiality agreements and policies. And Congress recently renewed a ban on government contractors using gag provisions in confidentiality agreements that bar disclosures about violations of law, gross mismanagement, a gross waste of funds, or an abuse of authority.

The NLRB has held that agreements barring employees from discussing ongoing internal investigations violates Section 7 of the NLRA. *Banner Health System*, 358 N.L.R.B. No. 93 (July 30, 2012). The Board reasoned that the employer's generalized concern in ensuring the integrity of its internal investigations did not outweigh employees' Section 7 rights. *Id*. at 2. OSHA's Whistleblower Investigations Manual prohibits investigators from approving settlement agreements that include gag clauses. And last month, OSHA obtained a preliminary injunction barring an auto parts company from telling any current or former employee not to speak to or cooperate with representatives of DOL, and enjoining the company from obstructing any OSHA investigation. In addition, the EEOC has issued guidance barring provisions in settlement agreements that interfere with an employee's right to file a charge or cooperate with an investigation, and has sued employers under Section 707 of Title VII of the Civil Rights Act of 1964 for conditioning the receipt of severance benefits on the waiver of the right to file discrimination charges and communicate with the SEC.

[1]*See* 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program at 8-9 (2014).

[2]*See* Press Release from U.S. Securities Exchange Commission, "SEC: Companies Cannot Stifle Whistleblowers in Confidentiality Agreements" (April 1, 2015) (on file).

[3]*See* Speech from Mary Jo White, "The SEC as the Whistleblower's Advocate" (April 30, 2015) (on file).

[4]In 2015, the ABA Journal of Labor and Employment Law published an article discussed *de facto* gag provisions that significantly reduce or eliminate the congressional incentives promoting SEC whistleblowing. *See* R Moberly, J Thomas, and J Zuckerman,"De Facto Gag Clauses--The Legality of Employment Agreements That Undermine Dodd-Frank's Whistleblower Provisions," ABA J. Labor & Employment Law, Vol. 30, No. 1, 2014.

Jason Zuckerman *is Principal of Zuckerman Law, a Washington D.C. firm that represents whistleblowers nationwide. Zuckerman serves as Co-Chair of the Whistleblower subcommittee of the ABA Employee Rights and Responsibilities Committee.*