

Securities Regulation and Compliance Alert

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SEC Enforces Whistleblower Protection Rule Against Restrictive Confidentiality Agreement

On April 1, 2015, the U.S. Securities and Exchange Commission (SEC) announced its first enforcement action against a company for a restrictive provision in confidentiality agreements that could deter employees from using the whistleblower process. The SEC charged KBR Inc. with violating whistleblower protection Rule 21F-17, which was enacted under the Dodd-Frank Act and prohibits companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC.

This action follows numerous warnings from SEC officials that the agency would bring charges against companies for employment agreements that violate Dodd-Frank whistleblower rules and recent media reports of SEC officials requesting that companies provide such agreements and relevant policies so that the SEC may determine whether companies are preventing or discouraging employees from communicating with the agency. These efforts highlight the need for companies to ensure that their policies and agreements related to employment, confidentiality, or severance do not contain provisions that may run afoul of the whistleblower rules.

The Enforcement Action

KBR is a leading global technology and engineering firm. During internal investigations of possible illegal conduct, employees were interviewed. These employees were required to sign confidentiality statements, which warned that, if they discuss the matters with outside parties without prior approval of KBR's legal department, they could face "disciplinary action up to and including termination of employment."

Although the SEC admitted that it was unaware of any instances where KBR actually prevented an employee from communicating directly with SEC staff about potential securities law violations, the SEC found the restrictive language to violate Rule 21F-17(a), which prohibits companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC. However, the SEC claimed that any company's blanket prohibition against witnesses discussing the substance of the interview has a potential chilling effect on whistleblowers' willingness to report illegal conduct to the SEC.

Without admitting or denying the SEC charges, the company agreed to a cease and desist order and a fine. Furthermore, KBR agreed to add a provision to its confidentiality agreement clarifying that employees can report possible violations of federal law or regulation to any governmental entity, including the SEC, without prior authorization from or subsequent notification to the company. Employees also can make other disclosures that are protected under the whistleblower provisions of federal law or regulation.

Implications

In the SEC's press release regarding this matter, Sean McKessy, the Chief of the SEC's Office of the Whistleblower, cautioned that companies should "review and amend existing and historical agreements that in word or effect stop their employees from reporting potential violations to the SEC." Confidentiality provisions may violate Rule 21F-7 if they require employees to seek authorization or to provide notification prior to reporting federal violations to the appropriate authority. Companies should be mindful of the SEC's guidance and its expected ongoing enforcement efforts in this area when evaluating company policies or agreements related to employment, confidentiality or severance. For example, in resolving threatened or pending litigation with individuals who could fall within the scope of SEC whistleblower protections, companies should consider including a provision in severance or settlement agreements that acknowledges that any restrictions on confidentiality do not prohibit truthful disclosures to regulatory agencies.

This enforcement action also underscores the need for companies to take care in how they deliver the oral confidentiality instructions typically given to employees interviewed in an internal investigation (i.e., the standard "Upjohn warning"). Companies should ensure that these instructions are consistent with the company's legitimate desire to maintain its attorney-client privilege with respect to the interview but do not imply that disclosure of non-privileged information to the SEC and other government enforcement agencies will subject an employee to adverse employment action.

The SEC's press release and cease-and-desist order, which includes the text of the related provisions of KBR's confidentiality agreement, can be found [here](#).