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SEC Assault on Employee Confidentiality Agreements

The Securities and Exchange Commission recently announced an enforcement action against KBR, Inc., alleging that a form of confidentiality agreement used in internal investigations violated an SEC whistleblower rule. To settle the matter, KBR revised its form of agreement and agreed to pay a fine of \$130,000.

Rule 21F-17 prohibits a person from taking

“any action to impede an individual from communicating directly with the [SEC] about a possible securities law violation, including enforcing or threatening to enforce a confidentiality agreement”

The rule also authorizes the SEC to communicate directly with company personnel without consent of company counsel.

KBR required employees being interviewed as part of internal investigations to sign an agreement prohibiting them from disclosing the subject matter or particulars of the interview with outside parties without the prior approval of in-house counsel and specified disciplinary action (including firing) that could ensue from violating the agreement. In the SEC’s view, this agreement violated its prohibition on impeding whistleblowing, even though the SEC acknowledged that it was unaware of any instance in which KBR attempted to

prevent an employee from communicating with the SEC. KBR revised the agreement to expressly permit an employee to report securities law violations to the SEC, Department of Justice and other government agencies.

Although the enforcement action related to a confidentiality agreement used specifically in connection with internal investigations, statements by SEC officials suggest that any confidentiality agreement may be similarly vulnerable. According to a recent article in *The Wall Street Journal*, the SEC reportedly sent letters to a number of companies asking for copies of nondisclosure agreements, employment agreements and other documents in use since the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In a speech last year, Sean McKessy, chief of the SEC’s Office of the Whistleblower, warned in-house counsel against preparing employee agreements that violate the rule.

There are reasons to disagree with the SEC that it had authority to adopt the rule under Dodd-Frank’s “anti-retaliation” provisions. In addition, the text of Rule 21F-17 appears not to prohibit KBR’s original form of agreement, but only enforcement of the agreement to

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inhibit whistleblowing. Given the SEC's aggressive interpretation of the statute and its own rule, however, nothing – beyond self-restraint – prevents the SEC from extending the rule to confidentiality provisions ordinarily included in employment contracts and employee intellectual property agreements. Public companies should consider reviewing – and revising where necessary – provisions in all employee agreements to account for Dodd-Frank whistleblower laws.

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