THE GOVERNMENT CONTRACTOR®

THOMSON REUTERS

Information and Analysis on Legal Aspects of Procurement

Vol. 58, No. 9 **March 2, 2016**

Focus

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FEATURE COMMENT: Walking The Line: Balancing Legitimate Interests And Compliance With New FAR Requirements For Confidentiality Agreements

On March 22, the comment period is set to close on a new rule proposed by the Federal Acquisition Regulatory Council. 81 Fed. Reg. 3763 (Jan. 22, 2016). If implemented as written, the proposed rule will prohibit Government agencies from awarding contract dollars to companies that require employees or subcontractors to sign "internal confidentiality agreements or statements prohibiting or otherwise restricting" employees or subcontractors from lawfully reporting waste, fraud or abuse. The proposed rule does not define the phrase "internal confidentiality agreement or statement," which could be interpreted to cover a range of documents that a contractor may ask an employee or a subcontractor to sign, including employment agreements, nondisclosure agreements, intellectual property protection agreements, severance agreements with confidentiality and non-disparagement clauses, and confidentiality agreements signed as part of an internal investigation conducted by the contractor.

This Feature Comment explores the tension contractors face in light of the proposed rule, which comes at a time of increased scrutiny from Government agencies on the use of internal confidentiality agreements. On the one hand, contractors have legitimate interests in using confidentiality agreements to protect proprietary and other confidential information. At the same time, contractors must be careful not to cross the line when it comes to placing restrictions on current and former employees or subcontractors. If the Government believes that a confidentiality provision in an employment or severance agreement is "gagging" current and former employees or subcontractors from reporting waste, fraud or abuse, the contractor could find itself facing an enforcement action or inquiries from a congressional committee or inspector general.

Lessons Learned from KBR—The proposed rule targets a subset of confidentiality agreements—i.e., those agreements that could reasonably be seen as muzzling employees or subcontractors from reporting wrongdoing. By narrowly focusing on "certain internal confidentiality agreements," the FAR Council implicitly acknowledges that confidentiality agreements can serve legitimate purposes.

For example, nondisclosure agreements and confidentiality agreements serve an important function when protecting a company's trade secrets or proprietary information about matters such as pricing and marketing strategies. In the context of separation agreements, companies want to keep private the terms of a severance package. Similarly, companies need to maintain confidentiality during internal investigations to protect the attorney-client privilege and preserve the integrity of the investigation by facilitating a thorough and unbiased inquiry. Indeed, the American Bar Association's model *Upjohn* warning given to corporate interviewees makes clear that an employee must keep the discussion with counsel confidential—i.e., the interviewee can discuss the underlying facts of what occurred, but cannot disclose the substance of the interview with any third party.

On this point, the False Claims Act suit in *U.S. ex rel. Barko v. Halliburton Co.*, 37 F. Supp. 3d 1 (D.D.C. 2014); 56 GC ¶ 108, provides an interesting case study because the investigative procedures of contractor Kellogg Brown and Root were attacked on several fronts. In that case, KBR conducted an internal investigation pursuant to a compliance program that was overseen by its legal department. The witness interviews, however, were performed by non-attorney investigators because the nature of the investigation required KBR to conduct them in an active conflict zone.

In the subsequent qui tam litigation, the relator sought KBR's internal investigation files. The district court granted the motion, ruling that the investigation materials were not privileged because the documents were created for a business purpose—i.e., regulatory compliance—and therefore the primary purpose of the materials was not to secure legal advice.

In ruling that the investigative report was not privileged, the district court noted that the investigators did not inform interviewees that their interviews were for the purpose of assisting counsel in providing legal advice. Ultimately, the D.C. Circuit issued a writ of mandamus vacating the district court's ruling on the grounds that the attorney-client privilege applied because providing legal advice was one of the significant purposes of the internal investigation even if the investigation was required by regulation. *In re Kellogg Brown & Root, Inc.*, 756 F.3d 754 (D.C. Cir. 2014), cert. denied sub nom. *U.S. ex rel. Barko v. Kellogg Brown & Root, Inc.*, 135 S. Ct. 1163 (2015); 56 GC ¶ 224.

The case returned to the D.C. Circuit after the district court compelled production of a portion of KBR's documents upon determining that KBR implicitly waived the attorney-client privilege and work product protection by allowing its in-house counsel to review documents from the investigation in preparation for a deposition, and by referring to that deposition testimony in a footnote in its motion for summary judgment. The D.C. Circuit issued a writ of mandamus for the second time, vacating the district court's ruling once again. *In re Kellog Brown & Root, Inc., 796 F.3d 137 (D.C. Cir. 2015); 57 GC ¶ 259*. But this was hardly the end of the *Barko* legal saga. During a deposition, KBR revealed that its non-attorney investigators had asked witnesses to sign confidentiality agreements that informed the witnesses that the investigation was sensitive and they were not to discuss the subject matter of the investigation with anyone without specific authorization from the company's legal department. Employees were instructed that they could face disciplinary action up to and including termination of employment if they violated the terms of the agreement.

In response, counsel for the relator filed a complaint with the Securities and Exchange Commission arguing that the confidentiality agreement had a chilling effect on employees who wanted to report potential wrongdoing to the corporation. The SEC opened an investigation, and on April 1, 2015, it announced its first-ever enforcement action against a company for having confidentiality agreements with restrictive provisions in violation of Rule 21F-17.

This rule, enacted under the Dodd-Frank Act, prohibits public companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC. In other words, after fighting an expensive discovery battle to preserve the privilege over the investigate report, KBR also had to face SEC allegations that it was overzealous in protecting the confidentiality of its investigations through the use of written confidentiality agreements.

Moreover, industry had strong reason to believe that this was not a one-off enforcement action. In February 2015, the Wall Street Journal reported that the SEC had sent requests to a number of companies seeking "every nondisclosure agreement, confidentiality agreement, severance agreement and settlement agreement [the companies] entered into with employees since Dodd-Frank went into effect, as well as documents related to corporate training on confidentiality." The SEC further requested "all documents that refer or relate to whistleblowing."

The scope of the probe may be indicative of the SEC's broad interpretation of the rule. In public remarks after the announcement of the enforcement action, SEC Chair Mary Jo White stated that Rule 21-F17 does not prohibit companies from giving the standard *Upjohn* warning during internal investigations, but she noted that "a company needs to speak clearly in and about confidentiality provisions, so that employees, most of whom are not lawyers, understand that it is always permissible to report possible securities laws violations to the Commission." In other words, when delivering the *Upjohn* warning, counsel will want to consider reciting the line from the ABA model warning, "[y]ou may discuss the facts of what happened [to any third party,] but you may not discuss *this* discussion."

Although there was no evidence that KBR ever enforced the confidentiality agreement (e.g., by terminating someone's employment for violation thereof) or that any employee who signed the confidentiality agreement was in fact impeded from reporting to the SEC, KBR decided to settle the enforcement action by paying a $130,000 fine and voluntarily amending its internal investigation confidentiality agreements to state expressly that employees are not prohibited from reporting, without prior company consent, violations of federal law to relevant federal agencies. Relatively speaking, the SEC's fine might seem like a small slap on the wrist for a company that held a Government Logistics Civil Augmentation Program contract valued at close to $50 billion, but, as described in the next section, the situation faced by contractor International Relief and Development (IRD) shows that the use of restrictive confidentiality agreements can contribute to far greater problems.

USAID's Suspension of IRD—For much of 2014 and 2015, IRD faced a Government contractor's worst nightmare. In May 2014, the Washington Post ran an investigative series profiling alleged misconduct at IRD, then one of the largest recipients of U.S. Agency for International Development funds. As part of its reporting, the Post obtained a copy of the confidentiality agreement that employees receiving severance pay were asked to sign upon leaving IRD. That agreement barred exiting employees from making "derogatory, disparaging, negative, critical or defamatory statements" about the company to "anyone, including … funding agencies or … officials of any government."

A number of IRD's alleged shortcomings were raised in the Post report, but the contractor's use of confidentiality agreements appeared to be the backbreaker for John Sopko, special inspector general for Afghanistan reconstruction (SIGAR). In a letter to IRD, Sopko gave the contractor two weeks to turn over copies of all separation agreements signed by its workers since 2004, and he asked IRD to disclose whether the nonprofit group ever enforced provisions of agreements. After reviewing 81 agreements signed by IRD employees since 2004, Sopko found that 48 of the agreements contained unacceptable gag provisions. In a letter to USAID, Sopko stated that the confidentiality agreements infringed IRD's current and former employees' federal whistleblower rights in violation of the False Claims Act, 31 USCA § 3730(h), the FAR, 48 CFR subpt. 3.9, and other federal whistleblower protection laws, e.g., 10 USCA § 2409, 41 USCA § 4712.

Events for IRD took a turn for the worse in December 2014 when a former IRD employee was indicted in Texas for allegedly soliciting and accepting bribes in exchange for his influence in awarding U.S. Government-funded contracts in Afghanistan. Considering the earlier news reports, USAID suspended IRD in January 2015, stating that its review of the contractor "revealed serious misconduct in IRD's performance, management, internal controls and present responsibility." A likely factor contributing to the suspension was the SIGAR's finding that IRD's confidentiality agreements limited the rights of potential whistleblowers to report instances of waste, fraud and abuse. After challenging USAID in court, IRD's suspension was lifted, and in August 2015 the suspension was found to be void from its commencement. However, the seven-month suspension had taken its toll on IRD, which lost tens of millions of dollars in revenue and laid off 340 employees.

Having discovered the use of an overly restrictive confidentiality agreement at IRD, the State Department inspector general opened an inquiry to determine whether the problem was endemic in the industry. The IG requested the confidentiality and non-disparagement agreements of the 30 companies with the largest dollar amounts of Department of State contract awards in 2012. In its report, the IG found that although none of the companies had policies that were "overly restrictive," 13 of the contractors had policies that contained provisions that could have a "chilling effect on employees who wish to report fraud, waste, or abuse to a Federal official." The IG report identified, as an example, provisions requiring employees to notify company officials if they were contacted by a Government auditor, or if they received a subpoena or other administrative demand.

Congress Responds—The headlines about KBR and IRD sparked interest on Capitol Hill and triggered an inquiry from Ranking Member of the House Committee on Oversight and Government Reform Elijah Cummings, and Ranking Member of the House Subcommittee on National Security John Tierney. In December 2014, Congress took action by adding language to the 2015 Appropriations Act prohibiting funds from going to any contractor that required its employees or contractors to sign restrictive internal confidentiality agreements. Section 743 of Title VII of the act provided:

> None of the funds appropriated or otherwise made available by this or any other Act may be available for a contract, grant, or cooperative agreement with an entity that requires employees or contractors of such entity seeking to report fraud, waste, or abuse to sign internal confidentiality agreements or statements prohibiting or otherwise restricting such employees or contactors from lawfully reporting such waste, fraud, or abuse to a designated investigative or

> law enforcement representative of a Federal department or agency authorized to receive such information.

To start the rulemaking process to implement the requirements set forth in the Appropriations Act, the FAR Council opened FAR Case 2015-012, Contractor Employee Confidentiality and Non-disclosure Agreements, in January 2015. Pending issuance of the rule, agencies were authorized to issue a class deviation. Thus far, the Environmental Protection Agency, the General Services Administration, the Department of Veterans Affairs, the Department of the Treasury and the Department of Defense have issued deviations to allow them to incorporate the new requirement immediately, and the substance of the new FAR rule is already appearing in some solicitations issued by these agencies.

Substance of Proposed Rule—Soon enough, contracting officers at all federal agencies will be required to include the new provision in solicitations. On January 22, the FAR Council published its proposed rule in the *Federal Register*. To be eligible for a contract award under the proposed rule, an offeror must represent by submission of its offer that it does not require employees or subcontractors to sign internal confidentiality agreements that could restrict them from lawfully reporting waste, fraud or abuse.

The proposed rule would apply to all federal contracts, except personal services contracts with individual workers, regardless of amount, including ones below the simplified acquisition threshold. Contracts for the purchase of commercial items, both special order and off the shelf, would also be subject to the proposed rule. It also requires COs to modify existing contracts to include the new FAR clause before obtaining fiscal year 2015 or subsequent FY funds that are subject to the same prohibition on confidentiality agreements. The proposed rule is written to cover successor provisions in congressional appropriations acts and continuing resolutions, such that if future appropriations acts do not contain a similar provision, the FAR will be modified accordingly. Furthermore, under the proposed rule, contractors must notify their employees that any pre-existing, non-conforming confidentiality agreements are no longer in effect.

In addition to the repercussions experienced by KBR and IRD described above, contractors with overly restrictive confidentiality agreements could face several risks in light of the new requirements. For example, if a contract awardee is in violation of the proposed rule, it could lose the award in a bid protest if a protester discovers the awardee's noncompliance and asserts that funds cannot be used on the contract. If the restrictive confidentially agreement comes to light during contract performance, it could be grounds for contract termination.

Moreover, by submitting an offer, the contractor is making a representation and expressly certifying that its confidentiality agreements do not restrict whistleblower reporting. If found to be false, such a representation could expose the contractor to False Claims Act liability. Furthermore, a company might pay out a handsome severance package in order to secure language in the separation agreement detailing what former employees may and may not say about the circumstances of their departure, but there is a risk that an overly restrictive confidentiality or non-disparagement clause in a separation agreement could be found unenforceable by a court.

Steps to Mitigate Risk—As described above, the substance of the proposed rule is already appearing in solicitations from the agencies that issued class deviations. But even contractors not competing for work from these agencies would be wise to take a hard look—well before the final FAR rule issues—at the internal confidentiality agreements that they ask employees, separated employees and independent contractors to sign.

Absent from the proposed rule is any specific guidance about what sort of confidentiality provisions are problematic, or, for that matter, acceptable "safe harbors." That said, there are some signposts that contractors can use to determine whether their agreements contain problematic language. For example, the State IG report described above includes examples of problematic language as well as best practices. The report states that contractors can enhance their reporting mechanisms by informing employees of their right to contact the Government directly if they have concerns about fraud, waste or abuse. Moreover, the SEC settlement with KBR suggests that companies can help protect themselves by including a disclaimer that acknowledges that any restrictions on confidentiality do not prohibit truthful disclosures to regulatory agencies. If during the review of confidentiality agreements, contractors discover that their agreements may be noncompliant, contractors will want to notify each employee that such agreements are no longer effective. Lastly, contractors may also want to consult with counsel to ensure that their internal confidentiality agreements comply with the proposed rule because, in the end, contractors could be signing up for a lot of legal headaches if their employees or subcontractors are signing overly restrictive confidentiality agreements.

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