
ENF

NEW ORCEMENT ACTION HIGHLIGHTS RISKS of Corporate Compliance Program

There is an enforcement trend, headed by the SEC, to bring actions against government contractors who include limiting language in confidentiality agreements that could potentially silence whistleblowers from bringing good-faith allegations of fraud to the government, and it is important for contractors to be aware of this trend and to avoid the potential pitfalls.

By LORRAINE M. CAMPOS, LESLIE A. MONAHAN, and NKECHI KANU

Attempting to "silence" a potential whistleblower is a perilous path. Various U.S. federal entities have established and implemented programs to incentivize and protect individuals who "blow the whistle" on misconduct occurring in the public sector. However, recent actions by the Securities and Exchange Commission (SEC) have highlighted how truly dangerous this path can be for companies—even when there is no evidence of wrongdoing—and unfortunately, a federal contractor was at the center of the storm.

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SEC WHISTLEBLOWER PROTECTIONS

In response to the financial crisis of 2008, Congress passed the Wall Street Reform and Consumer Protection Act (also known as the "Dodd-Frank Act")[1] in July 2010. The Dodd-Frank Act amended the Securities Exchange Act of 1934[2] by adding Section 21F—"Whistleblower Incentives and Protection." Section 21F directs the SEC to establish an awards program to encourage the submission of high-quality information to aid with discovering and prosecuting violations of federal securities laws.

With the adoption of Rule 21F-1, the SEC established its whistleblower program. As part of the program, tipsters can receive between 10 percent and 30 percent of the sum of penalties collected if their information leads to an SEC enforcement action with sanctions of more than $1 million. Further, Rule 21F protects from retaliation persons who report possible wrongdoing, based on a reasonable belief that a possible securities violation has occurred, is in progress, or is about to occur. Rule 21F-17(a) states:

> 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.

Until recently, the SEC had not prosecuted any entity for violating the protections under Rule 21F-17(a). However, in April 2015, the SEC took action against KBR, Inc., a federal contractor, over concerns that innocuous language in the company's confidentiality agreements violated this provision—even though no employee was actually prevented from reporting potential law violations to the SEC. By doing so, the SEC signaled its intent to aggressively review employment agreements and interpret potentially limiting language as violating Rule 21F.

A New Approach to Rule 21F Enforcement

On April 1, 2015, the SEC settled its first enforcement action against KBR—an engineering, construction, and services company that is also a federal government contractor—for violating whistleblower protections by including restrictive language in confidentiality agreements used in internal investigations.[3] As part of its compliance program, which is typical for many federal government contractors, KBR's practice was to conduct internal investigations of complaints or allegations. As part of those internal investigations, KBR investigators would typically interview KBR employees to better understand the alleged illegal or unethical conduct. Such interviews typically began by requesting that employees sign a form confidentiality statement. Although the use of the form confidentiality statement was not explicitly required by KBR policy, it was consistently signed by interviewees and was included as an enclosure to the KBR "Code of Business Conduct Investigation Procedures" manual.

The form confidentiality statement contained the following provision:

> I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the law department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.

Although the SEC did not find any specific instances in which a KBR employee was in fact prevented from communicating directly with the SEC about potential securities law violations, or where KBR took action to enforce the form confidentiality agreement or otherwise prevent such communications, the SEC found that imposing pre-notification requirements before contacting the SEC could potentially discourage employees from reporting securities violations and undermined the purposes of Section 21F and SEC Rule 21F-17(a). In order to settle the allegations, KBR agreed to pay a penalty and amended its confidentiality statement to state expressly that its employees will not have to seek approval from the company before contacting government officials and would not have to fear the consequences of termination or retribution for doing so. The amended confidentiality statement states:

> 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 [KBR] 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.

As part of the settlement, KBR agreed to not violate Rule 21F-17 in the future. Additionally, KBR agreed to make reasonable efforts to contact employees who signed the confidentiality statements in the past to inform them of the revision and to clearly state that KBR does not require employees to seek permission from KBR's legal team before communicating with any governmental agency or entity.

Trend in Interpreting Confidentiality Agreements

While KBR was the first company to settle with the SEC over innocuous language in its confidential agreements, it will not be last. In early 2014, the SEC announced its renewed commitment to prosecuting companies who attempt to stifle their employees' whistleblower rights. The SEC's chief of the Office of the Whistleblower, Sean McKessy, warned companies that the SEC would be actively looking for companies who attempted to find "creative ways" to deter employees from reporting violations to the SEC and for "examples of confidentiality agreements, separate agreements [and] employee agreements" that linked compensation and benefits to compliance with restrictive whistleblower policies.[4] Nearly a year later, the SEC followed up on this promise.

It was widely reported that in February 2015, the SEC sent letters to several companies asking for past nondisclosure agreements, employment contracts, and other documents in order to investigate whether companies were attempting to restrict whistleblowing. These actions indicate that it is only a matter of time before the confidentiality provisions of other public companies receive SEC scrutiny based on the potential to discourage whistleblowing, as opposed to actually being enforced and preventing the reporting of instances of wrongdoing.

The SEC is not the only governmental agency that is challenging the chilling effect of language in confidentiality agreements. Other federal agencies have recently scrutinized confidentiality provisions in employment-related documents and found that such language can intimidate potential whistleblowers and prevent them from alerting regulators and law enforcement about wrongdoing. For example, the Equal Employment Opportunity Commission brought action against CVS Pharmacy alleging that certain clauses contained in its

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separation agreements, including nondisclosure and general release clauses, interfered with employee rights under federal antidiscrimination laws.[5] Additionally, the special inspector general for Afghanistan reconstruction recently examined the confidentiality agreements of a nonprofit nongovernmental organization for potentially limiting the federally protected rights of employees to report waste, fraud, or abuse. Clearly, the government is taking an aggressive stance on the interpretation of what it considers to be potentially limiting language, and companies must prepare themselves to be examined under this new lens and face competing sources of pressure.

FAR-REACHING IMPLICATIONS

Based on the position the SEC took with KBR, it is possible the agency could take an even broader stance in the future. One point to consider is the impact this enforcement action could have on attorney-client privilege in internal investigations—in particular, the use of the "*Upjohn* warning." While there has not been a case to date that challenges the *Upjohn* warning against SEC Rule 21F, the potential for such a challenge is not that farfetched.

As a standard course of practice, interviews associated with internal investigations typically begin with an attorney providing warning to the interviewees regarding the parameters of the attorney-client privilege,[6] also known as an "*Upjohn* warning" or "corporate Miranda warning." This warning informs the employee that information that will be discussed during the interview is protected by the attorney-client privilege. In order for the communication to be subject to the privilege, it must be kept in confidence. Usually, this warning is provided verbally. However, sometimes employees are asked to agree to this by signing a written statement.

While the verbal *Upjohn* warning is a standard practice, the KBR settlement may call into question whether the employee hearing the warning has a standard understanding of it and its reach. Theoretically, it may be possible that an employee hearing the warning believes that in order to maintain the privilege, he or she cannot disclose the substance of the interview to any third party, including government agencies. If the SEC was to take this position, the implications on attorney-client privilege would be highly damaging. While the SEC has not decided to take that leap yet, companies and their outside counsel should take measures to ensure that all *Upjohn* warnings given protect the company's legitimate right to attorney-client privilege and avoid implying that the employee is restricted from disclosing nonprivileged information to regulators or law enforcement officials.

POTENTIAL PITFALLS

In order to prevent any appearance of impropriety for attempting to silence a potential whistleblower, employers should take proactive measures to ensure their employees do not feel like they are trying to be silenced. Companies must be cognizant of the potential pitfalls that could raise red flags and address these risks before any government agency reviews them under the current trend in enforcement.

Overbroad Language

Employers must be careful in drafting confidentiality provisions in various employment documents to ensure that the language used is not overbroad in its restrictions. The types of documents to be reviewed include, but are not limited to:

- Nondisclosure agreements,
- Severance agreements,
- Settlement agreements, and
- Employment manuals.

Language that can be construed as preventing an employee from lawfully reporting or communicating with a government agency about possible illegal conduct will most likely be seen as infringing on whistleblower rights. Furthermore, provisions that restrict an employee from communicating with the government after his or her employment terminates—such as nondisparagement provisions and covenants not to sue—may be considered restrictions on whistleblowing activity if they are drafted too broadly.

Lack of Employee Knowledge of Whistleblower Protections

Employees should know their rights and the protections available to them if, and when, they blow the whistle on their employer. However, many companies have failed to adequately inform their employees of the safe channels available for reporting potential fraud, abuse, and misuse within the organization and that it is unlawful for their supervisors or employers to retaliate against them.

In order to prevent this lack of understanding, employers should make notification of whistleblower protections a focus when creating and administering their compliance programs. Further, companies should notify employees of their right to report concerns not addressed in internal reviews and cooperate with government agencies conducting audits or investigations.

Ineffective Internal Investigations

Internal investigations will most likely provide the best opportunity for a company to identify and address alleged violations before a whistleblower turns to outside authority. However, companies often fail to appreciate the risks allegations of misconduct may pose for the business and utilize the resources necessary to conduct a thorough and valuable investigation. Ineffective internal investigations can be costly and inefficient, and can increase the risk of enforcement actions or litigation. Furthermore, in the unfortunate event that litigation occurs, companies are now typically judged by how thoroughly they responded to allegations of violations. Agencies and adjudicators may see any apparent failure to respond appropriately as a sign that the employer was trying to hide the alleged illegal behavior.

Excessive Reliance on Internal Investigations

Even if companies have established sound internal investigation policies and procedures, companies should be mindful of how they treat employees who come forward with allegations of misconduct. The KBR settlement is a good reminder that companies must be careful to not inadvertently restrict the ability of employees to contact government officials when conducting their own robust investigation of alleged wrongdoing.

Best Practices Moving Forward

In light of this new trend in enforcement, there are certain practices companies can engage in to avoid the appearance of impropriety with regard to potential whistleblower suppression. In particular, companies should focus on ensuring that their employment documents, compliance programs, and management actions capture all current whistleblower protections.

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Conduct Review of Employment Documents

Companies should immediately review corporate policies and amend any existing forms or agreements that may be seen as discouraging or deterring employees from reporting potential civil or criminal violations to the SEC or other governmental agencies. Although the recent enforcement action against KBR was tied to a confidentiality statement used in the narrow context of internal investigations, corporations should conduct a robust review of all company documents and manuals, including employment, separation, severance, and settlement agreements, and revise provisions that can be construed as impinging on whistleblower rights.

Use of Standard *Upjohn* Warnings

Given the potential reach of SEC whistleblower enforcement, companies should be cognizant of how *Upjohn* warnings are delivered in the course of internal investigations. In particular, companies should ensure that counsel recites the standard *Upjohn* warning and does not include variations that could be construed as preventing an employee from disclosing nonprivileged underlying facts—such as subject matter—to federal agencies without company approval. Accordingly, it may be in a company's best interest to have counsel provide a written copy of the standard *Upjohn* warning that clearly states privileged information may not be disclosed. In doing so, companies retain a record of the exact warning given to their employees and avoid any appearance of attempting to "silence" an employee concerning nonprivileged information.

Notification of Anti-Retaliation Protections

In addition to reviewing employment documents for language that might have a potential chilling effect on employee reporting of misconduct, companies should make sure their employment manuals and policies incorporate anti-retaliation provisions. Such provisions are a requirement for federal contractors. By including this information in standard employee documents, companies can not only educate employees about their rights, but also memorialize them in a readily accessible form.

Whistleblower Hotline

Companies should also consider implementing an effective whistleblower hotline as part of existing compliance programs. A hotline should be anonymous and should have multiple ways by which an employee can contact it, such as telephone and e-mail. Further, companies should have posters in high-traffic areas, like break rooms and the company's intranet, to ensure employees are aware of this mechanism. These posters should not only include hotline contact information, but should also provide the company's anti-retaliation policy.

A whistleblower hotline is a key component to an effective compliance program because it facilitates the detection of unlawful conduct. Employees who are aware that they can provide confidential and anonymous tips are more likely to come forward with information regarding illegal or unethical behavior. Companies who already have a hotline in place should evaluate their program to ensure that the hotline is operating smoothly and is an efficient and effective source of identifying potential fraud.

Culture of Compliance

While companies can notify employees of their rights and protections related to reporting misconduct, this message will be better understood if it flows down from "the top." In other words, employees will be more receptive to utilizing internal mechanisms for reporting wrongdoing if they hear the message from their direct supervisors on a consistent basis. To do this, employers need to create an ethics infrastructure that supports frontline managers and employees who bring attention to questionable behavior.

Management can demonstrate a company's commitment to its core values by "owning the process" and setting an example for employees with this "tone from the top" approach. Discussions on the importance of exercising ethical behavior should be routine and not just touched on upon hire or at an annual training conducted by outside counsel. For example, direct managers should be discussing the importance of ethics in business and reporting wrongdoing in each meeting they have with their staff. By doing so, employees will be encouraged and empowered to act with honesty and integrity. **CM**

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ENDNOTES

1. *Pub. L.* 111-203.
2. *Pub. L.* 73-291.
3. See *In the Matter of KBR. Inc.*, Order Instituting Cease-and-Desist Proceedings Pursuant to Sections 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order.
4. Brian Mahoney, "SEC Warns In-House Attys Against Whistleblower Contracts," *Law 360* (March 14, 2014).
5. Ameet Sachdev, "Severance agreements: EEOC suit against CVS could be test case," *The Chicago Tribune* (February 23, 2014).
6. As guided by *Upjohn Co. v. United States*, 449 U.S. 383 (1981).