Dodd-Frank and the SEC – Increasing Focus on Retaliation
Dodd-Frank and the SEC: The Basics

• Dodd-Frank Act (2010) established whistleblower bounty program (17 C.F.R. §§ 165, 240.21F, et seq.)
  – Provides for the payment of substantial financial rewards
    – employees who “voluntarily” provide the SEC with
    – “original information” about securities violations
    – that result in monetary sanctions of $1 million or more
  – Permits bounty to be sought anonymously

• Also amended the Securities Exchange Act of 1934 to prohibit retaliation against whistleblowers
17 CFR § 240.21F

• Adopted pursuant to Section 21F of the Securities Exchange Act of 1934 – enacted as part of Dodd-Frank

• “These rules describe the whistleblower program . . . and explain the procedures you will need to follow in order to be eligible for an award”
  – Bounty-seekers may submit information to the SEC anonymously, but must do so through counsel
  – With the exception of certain circumstances, the SEC will not disclose any information that would reveal the identity of a whistleblower
No “Pre-Taliation” – § 240.21F – 17(a)

• “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 communication”

• The SEC enacted this rule because:

  efforts to impede an individual’s direct communications with Commission staff about a possible securities law violation would conflict with the statutory purpose of encouraging individuals to report to the Commission.

Public Comments by Sean McKessy, Chief of the SEC’s Office of the Whistleblower

- November 26, 2012 *American Lawyer* interview: “If you’re dissuading or prohibiting individuals from reporting to us, you’re violating the rules.”

- March 14, 2014 Georgetown University Law Center Corporate Counsel Institute (as reported in *Law 360*):
  
  “. . . we are actively looking for examples of confidentiality agreements, separates [sic] agreements, employee agreements that . . . in substance say ‘as a prerequisite to get this benefit you agree you’re not going to come to the commission or you’re not going to report anything to a regulator.’”
SEC Asserts Retaliation Claims Under Dodd-Frank

- **Paradigm Capital Management and Candace King Weir** (2014)
  - First time SEC sought to enforce the anti-retaliation components of Dodd-Frank
  - SEC asserted that employer retaliated against employee who had made reports of improper trades to the SEC

- Accompanying press release: “[the SEC] will continue to exercise [its] anti-retaliation authority in these and other types of situations where a whistleblower is wrongfully targeted for doing the right thing and reporting a possible securities law violation.”
Outside Pressure on SEC to be Even More Aggressive

- July 18, 2014 Petition for Rulemaking by Government Accountability Project and Labaton Sucharow
- Proposes amending existing Regulation 21F-17 in several ways including:
  - Barring even the proposal of an offending confidentiality agreement
  - Precluding any waiver with respect to any monetary award that might be received from the SEC
  - Prohibiting the conditioning of any benefit on a promise not to communicate or provide documents to the SEC
  - Doing anything else that would “chill the exercise of activity” protected by the regulations
The KBR Order and Other Recent SEC Enforcement Efforts
The Background

• SEC announced on April 1 its first settlement of an enforcement action under Rule 21F-17

• SEC’s enforcement action challenged a confidentiality statement that KBR had required witnesses to sign in internal investigations

• The statement included language warning that witnesses could face discipline if they discussed the interview without the prior approval of KBR’s legal department:

  *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.*
KBR Order

• KBR agreed:
  – To pay $130,000 fine
  – To amend its notice to witnesses
  – To cease and desist from committing or causing any future violations of the Rule
  – To make reasonable efforts to locate KBR employees in the US who signed the statement after August 21, 2011

• SEC noted that it was not aware of any instance where:
  – Any employee had been prevented from communicating directly with the SEC
  – The Company had taken any action to enforce the provision to impede or chill any such communications
Amended Agreement

The Company agreed to amend its witness agreement as follows:

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 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.
Andrew J. Ceresney, Director of Enforcement Division:

- “SEC rules prohibit employers from taking measures through confidentiality, employment, severance, other type[s] of agreements that may silence potential whistleblowers before they can reach out to the SEC. We will vigorously enforce this provision.”
- “By requiring its employees and former employees to sign confidentiality agreements imposing pre-notification requirements before contacting the SEC, KBR potentially discouraged employees from reporting securities violations to us.”

Sean McKessy, Chief of Office of the Whistleblower: “Other employers should similarly review and amend existing and historical agreements that in word or effect stop their employees from reporting potential violations to the SEC.”
Opinions Offered by McKessy at ABA Webinar Following Settlement

- Look to the KBR decision for guidance
- The language in the Order does not create a safe harbor:
  “The language that the company agreed to in this instance we felt was appropriate given the context of the company. Not every company has the same context . . . I haven’t been vested with super powers to say to a company that I’m blessing any language that you use, because ultimately we will look at the context . . .”

- SEC is taking affirmative steps to identify agreements that violate the Rule
  - Training staff to identify violations identified during investigations
  - Monitoring 8-K and other public filings

- SEC may have jurisdiction over non-public companies as a consequence of the Lawson decision
Other Regulatory Agencies Weigh In
Two days before the KBR Order was announced, OIG released a report expressing concerns about government contractors chilling “employees who wish to report fraud, waste or abuse to a Federal official”

Report expressed concerns about provisions that:
- Required employees to notify company officials if they are contacted by a government auditor
- Included broad non-disparagement provisions

Report encouraged contractors to develop programs to encourage reporting, including:
- Establishing a hotline for complaints and displaying hotline posters
- Cooperating with government audits and investigations
Pending and Anticipated Restrictions on Federal Government Contractors

- In late 2014, Congress prohibited as part of the CFCAA the appropriation of federal funds to contractors whose confidentiality policies restrict employees from reporting fraud, waste or abuse to investigative agencies.
- FAR Council is developing a new rule to implement the restrictions of the act that will amend five FAR parts:
  - Will apply to new contracts
  - Expected to extend to contractors and subcontractors
  - Expected to require amendment of existing policies and notification of employees
- DOD and Department of Treasury have already adopted contract provisions consistent with the CFCAA.
• In October 2014, FINRA issued Regulatory Notice 14-40, warning companies against the use of confidentiality provisions in settlement agreements that restrict customers or employees from communicating with the SEC, FINRA or any regulatory authority regarding a possible securities law violation.

• In 2004, NASD issued a similar warning on the use of confidentiality provisions in settlement agreements (NTM 04-44).

• This most recent notice supplements prior guidance by noting that confidentiality provisions also cannot prohibit or restrict an individual from **initiating communications** directly with FINRA or other securities regulators regarding settlement terms or the underlying facts of a dispute, **regardless** of whether the individual has received an inquiry from a regulatory authority.
FINRA provided the following example of an acceptable confidentiality provision in a settlement agreement:

“Any non-disclosure provision in this agreement does not prohibit or restrict you (or your attorney) from initiating communications directly with, or responding to any inquiry from, or providing testimony before, the SEC, FINRA, any other self-regulatory organization or any other state or federal regulatory authority, regarding this settlement or its underlying facts or circumstances.”

FINRA also cautioned against using confidentiality provisions in discovery stipulations that restrict the ability of a customer or employee to communicate directly with or in response to an inquiry from a regulatory authority.
March 18, 2015 Report of the NLRB General Counsel: focuses on recent case developments arising in the context of employee handbook rules

Employees have a Section 7 right to discuss terms and conditions of employment

Broad prohibitions on discussing “confidential” information are lawful so long as they do not reference information regarding employees or anything that would reasonably be considered a term or condition of employment, because employers have a substantial and legitimate interest in maintaining the privacy of certain business information.
Examples of Lawful Confidentiality Rules According to the NLRB (but SEC requires additional carve-out language discussed below):

- “No unauthorized disclosure of business secrets or other confidential information.”
- “Misuse or unauthorized disclosure of confidential information not otherwise available to persons or firms outside [Employer] is cause for disciplinary action, including termination.”
- “Do not disclose confidential financial data, or other non-public proprietary company information. Do not share confidential information regarding business partners, vendors or customers.”
• Example of an Unlawful Confidentiality Rule:
  – “Never publish or disclose [the Employer’s] or another’s confidential or other proprietary information. Never publish or report on conversations that are meant to be private or internal to [the Employer].”
  – The reference to “another’s” information, without further clarification, could be interpreted to include other employees’ wages and other terms and conditions of employment.
NLRB – Internal Investigations

• *Banner Health System*, 358 N.L.R.B. No. 93 (July 30, 2012)
  - HR investigator “asks employees not to discuss the matter with co-workers while the investigation is ongoing.”
  - “To justify a prohibition on employee discussion of ongoing investigations, an employer must show that it has a legitimate business justification that outweighs employees’ Section 7 rights.”
  - “Generalized concern with protecting the integrity of its investigations is insufficient.”
  - Confidentiality *might* be justified if, in a particular investigation, it can be shown that a witness needs protection; evidence might be destroyed; testimony might be fabricated; risk of cover-up

• Note: Remanded to the NLRB for a new ruling because deemed an “illegal” Board decision
How Employers Can Mitigate the Risks of These Developments
“No Safe Harbor”

• This means there is no quick fix or “one-size fits all” approach
  – Employers should not take comfort that simply inserting the language the SEC approved in the *KBR* matter will suffice
  – Remember that “context matters” (SEC has signaled appropriate changes may depend on past statements)

• Rather, *all* relevant policies and agreements need to be reviewed; adjust any provisions that restrict employee rights to make disclosures/reports
Identify Existing “Stock” of Policies and Agreements

- Whistleblower Protection Policy
- Code of Conduct
- Confidentiality Policy
- Confidentiality and Non-Disclosure Agreements
- Employment Agreements
- Settlement Agreements
- Investigation Agreements
SEC May Expect the Following Types of Features

- Nothing in the policies prevents employees from reporting to, communicating with, contacting, responding to an inquiry from, or providing relevant information to or participating or assisting in an investigation conducted by the SEC or other governmental or regulatory body or official or self-regulatory organization.
- Employees need not obtain the Company’s *prior authorization* before making such reports or disclosures.
- Employees need not *notify the Company* before making such reports and disclosures.
- Agreement does not affect any right the employee may have to receive a monetary award from the SEC or any other federal or state agency pursuant to a similar program.
Additional Potential Provisions

• Consider noting that the agreement not to disparage does not limit the foregoing “permitted reporting” language.

• Consider noting that the agreement does not affect any right the employee may have to receive a monetary award from the SEC or any other federal or state agency pursuant to a similar program.

• “Employee organizing” language indicating that nothing shall be construed to prohibit an employee who is not in a management or supervisor role from using or sharing lawfully acquired information about terms and conditions of employment with others to engage in concerted activity as protected by law.
Employee Representations

• Consider including a representation and warranty that during employment with the Company:
  – Employee complied with all of the Company’s policies and procedures and has not engaged in any act of fraud, theft, or malfeasance
  – Employee has no knowledge of any current or former employee having ever engaged in any act of fraud, theft, or malfeasance

• Employer would need to show that representation was voluntary and knowing
Encourage Internal Reporting

- Employers may encourage employees to use internal compliance channels
- But, employers should not state (or insinuate) that this is to the exclusion of external reporting
- Reiterate anti-retaliation policy
- Again, identify the anonymous hotline and additional reporting channels (e.g., Chief Compliance Officer)
The Documents Conundrum: Are They “Information” That Can Be Shared
Agency Response

• When asked whether “information” includes documents, noted that SEC would “go out of business” if it could not rely on documents provided by whistleblowers

• Agencies do not want privileged documents
  – Emphasize value of the attorney-client privilege
  – Set up review teams to screen for privileged documents

• Agencies will accept non-privileged documents
  – Can use them in enforcement proceedings or litigation
  – Consider confidentiality agreements inapplicable to the agency
Split in Authority – *JDS Uniphase v. Jennings* (E.D. Va. 2007)

- Employer brought breach of contract claim against employee for taking confidential documents. Employee counterclaimed raising whistleblower claims under Sarbanes-Oxley.
- Court dismissed the Sarbanes-Oxley retaliation claim.
- Granted employer’s motion for summary judgment for liability on breach of contract claim.
- “By no means can the policy fairly be said to authorize disgruntled employees to pilfer a wheelbarrow full of an employer’s proprietary documents in violation of their contract merely because it might help them blow the whistle.” “[E]ndorsing such theft would effectively invalidate most confidentiality agreements” and cause litigation to “blossom like weeds in spring.”
- *Vannoy v. Celanese Corp.*, ALJ Case No. 2008-SOX-00064 (ALJ July 24, 2013) - the transmission of confidential company information to the government (specifically, the IRS) is protected activity under SOX.
Split in Authority – *Vannoy v. Celanese Corp.*, (ALJ July 24, 2013)

- Employee transmitted sensitive company data to the IRS to support his claims of tax fraud.
- ALJ originally grants employers motion for summary decision.
- Administrative Review Board reverses, finding that taking company documents may be considered protected activity
- On remand, the ALJ concludes employee’s actions are protected activity under SOX
- *Cafasso v. Dynamic CF Systems, Inc.* (D. Ariz. 2009) – False Claim Act does not allow employee to breach confidentiality agreement to provide documents to the government
- *Head v. Kane Co.* (D.D.C. 2009) – Court voided breach of contract counterclaim against *qui tam* relator
Split in Authority – Other Cases

- *Cafasso v. Dynamic CF Systems, Inc.* (D. Ariz. 2009) – False Claim Act does not allow employee to breach confidentiality agreement to provide documents to the government

- *Head v. Kane Co.* (D.D.C. 2009) – Court voided breach of contract counterclaim against *qui tam* relator
Recommendations

• Maintain confidentiality agreements regarding documents and data
• Secure and monitor confidential documents and data
• **Consistently** require that documents be returned after employment and enforce contractual obligations
• If faced with theft of documents and data, consider each case individually:
  - Previous actions taken for similar violations
  - Claims alleged by the potential whistleblower
  - To whom disclosed and how used
Senators Push For President Obama To Issue Executive Order Providing Federal Contractor Preference To "Model Employers"

By Connie Bertram and Alex Weinstein on May 15th, 2015
Posted in Compensation, Federal Acquisitions

On May 15, 2015, a group of Democratic Senators sent a letter (available here) to President Obama, urging him to provide incentives to federal contractors to become what they call “model employers.” According to the letter, model employers are contractors who provide “a living wage, offer fair healthcare and retirement benefits, grant paid leave for sickness and care-giving, provide full-time hours and stable schedules, and give workers a voice through collective bargaining.”

This push comes exactly one month after members of the Congressional Progressive Caucus (“CPC”), a group of House Democrats, made identical requests of President Obama. The CPC is the same group that advocated raising the minimum wage for employees of federal contractors to $10.10 per hour and for the recent Fair Pay and Safe Workplaces Executive Order. While the May 15 letter did not set a specific benchmark of fair wages, the CPC has advocated that workers should make at least $15.00 an hour, a view that is echoed by Good Jobs Nation, the labor organization leading the charge for model employer incentives. The May 15 letter states that currently ‘taxpayers are double-billed’ — once for the cost of the contract and then again for the cost of public programs like food stamps and Medicaid — upon which many employees of contractors rely. The Senators, the CPC, and Good Jobs Nation believe that incentivizing model employers will increase the quality of life for employees of federal contractors and, accordingly, decrease the reliance on federal subsidies.
CFTC Whistleblower Awards On The Horizon

By Harris Mufson and Noa Baddish on May 7th, 2015
Posted in Dodd Frank

In a recent interview with Lev360 (subscription required), Chris Ehrman, the Director of the U.S. Commodity Futures Trading Commission’s Whistleblower Office, predicted that the number and size of the CFTC’s whistleblower awards will increase in the near future. Ehrman also said that the agency will conduct “strategic marketing” to ensure that potential whistleblowers are aware of the agency’s whistleblower bounty program.

The CFTC’s Whistleblower Program is similar to the SEC’s program in that whistleblowers who voluntarily provide the CFTC with original information about violations of the Commodity Exchange Act resulting in a $1 million or greater recovery are eligible to receive 10 to 30 percent of the monies collected. Ehrman acknowledged that the CFTC’s whistleblower program, which paid its first award in May 2014 and has received only 227 whistleblower tips in fiscal year 2014 versus the SEC’s 3,620, has gotten off to a slower start than the SEC’s program. Ehrman attributes the slow start to the fact that the CFTC, which is limited in regulating the commodities industry, has a “smaller footprint than the SEC.” Ehrman also noted that, unlike the SEC, the CFTC does not have the authority to enforce Dodd-Frank’s anti-retaliation provision.

In the interview, Ehrman stated that he remains focused on marketing the CFTC’s Whistleblower Program to increase the number of whistleblower tips and complaints. Ehrman touted the importance of the agency’s marketing efforts, noting that the CFTC’s functions are highly technical and, even within the financial services industry, there is a lack of familiarity and understanding of the agency’s purpose and jurisdiction.

In light of Ehrman’s statements, we can expect to see the number and frequency of CFTC whistleblower awards increase in the near future.

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