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Employment Agreements Under Attack: Avoiding Potential Pitfalls

Jonathan Keselenko, Daniel Marx and Michael Rosen

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SEC Rule 21F-17 (effective August 12, 2011)

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.

Broadly worded:

"No person"

"Any action"

"To impede"

Narrowly worded:

"Directly with the *Commission*"

"Possible *securities law* violation"

The SEC has given no formal guidance about how to comply, and, presently, it does not intend to give any such guidance.

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- ***In the Matter of KBR, Inc.*** **(April 1, 2015)**
  - Facts
    - KBR used a standard confidentiality statement for its internal investigations
    - The SEC concluded that, in its view, the statement had the potential to "chill" whistleblowing
    - The SEC did not find, however, that the confidentiality statements had actually chilled any whistleblowing or that KBR ever attempted to enforce the confidentiality provision against any whistleblower:
      - "***[T]he Commission is unaware of any instances*** in which (i) a KBR employee was in fact prevented from communicating directly with Commission Staff about potential securities law violations, or (ii) KBR took action to enforce the form confidentiality agreement or otherwise prevent such communications . . ."
  - Remedy
    - Revision to standard confidentiality statement
    - Undertaking to contact all employees (including former employees) who had signed the standard confidentiality statement and to notify them of their whistleblower rights
    - Order to cease-and-desist from any violation of Rule 21F-17(a)
    - Payment of $130,000 as a civil monetary penalty

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- ***In the Matter of KBR, Inc.***
  - Old confidentiality language:

    "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."

  - New confidentiality language:

    "***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 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."

Why so broad???

1. Any agency (not only SEC)
2. Any violation of federal law or regulation (not only securities issues)
3. No requirement for after-the-fact notice

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In the Matter of KBR, Inc. – Key Takeaways

Do Not

- Prohibit or otherwise "impede" employees from whistleblowing
- Make blanket statements about the "confidentiality" of all company or client information (including any "facts" discussed during internal investigations)
- Threaten disciplinary actions against employees who engage in whistleblowing
- Require employees to obtain approval from the company (GC, CCO, supervisor or other personnel) *before* whistleblowing
- Require employees to notify the company *after* whistleblowing

Do

- Require employees to report to the company any suspected violation of applicable law, regulation or policy (through internal compliance processes)
- Require employees to notify the company if the SEC or other agency contacts them
- Take steps, in concert with in-house or outside counsel, to preserve the company's privilege claims [Note: *Upjohn* warnings may, and should, be given]

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But my company is a ***private company***, so why should I care?

***Lawson v. FMR LLC* (US 2013)**

The anti-retaliation provisions of the Sarbanes-Oxley Act apply to contractors, subcontractors and agents of U.S. public companies and their officers and directors. Therefore, if a private company that contracts or subcontracts with a U.S. public company retaliates against a whistleblower, the employee can file a retaliation complaint, and the company can be held liable.

Who is a whistleblower under the Dodd-Frank Act?

Asadi v. G.E. Energy
(5th Cir. 2013)
(SEC reports only)

Berman v. Neo@Ogilvy
(2d Cir. 2015)
(internal reports also)

Sweep Exam by the Boston Regional Office

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
BOSTON REGIONAL OFFICE
33 ARCH STREET, 23RD FLOOR
BOSTON, MA 02110

May 15, 2015

"Registrant")

The staff of the U.S. Securities and Exchange Commission (the "Commission") is conducting a limited-scope examination the Registrant pursuant to Section 204 of the Investment Advisers Act of 1940 (the "Advisers Act"). The purpose of this examination is to assess compliance with the provisions governing whistleblowing in Dodd-Frank Wall Street Reform and Consumer Protection Act and the Commission's rules promulgated thereunder.

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- **Sweep Exam by the Boston Regional Office**

Definition

"Confidentiality/Whistleblower Topics" means any of the following: (a) confidentiality or dissemination of information, (b) communications with outside parties, (c) communications with regulators, and (d) whistleblowing.

Requests

1. All compliance policies and procedures that were in effect during the Examination Period for the Adviser that pertain to Confidentiality/Whistleblower Topics.

2. A copy of the Adviser's code of ethics currently in effect.

3. Documents pertaining to communications with officers, directors, employees or contractors regarding any violations or potential violations of (a) the compliance policies and procedures

7. If the confidentiality and non-disparagement clauses (or clauses with similar effect) in the employment agreements you entered into during the Examination Period are standard, provide a copy of the agreement containing those clauses. However, if the confidentiality or non-disparagement clauses (or clauses with similar effect) have varied, provide all agreements containing such variations (with names of employees and amounts of payments redacted).

8. If the confidentiality and non-disparagement clauses (or clauses with similar effect) in the separation or severance agreements you entered into during the Examination Period are standard, provide a copy of the agreement containing those clauses. However, if the confidentiality or non-disparagement clauses (or clauses with similar effect) have varied, provide all agreements containing such variations (with names of employees and amounts of payments redacted).

8. If the confidentiality and non-disparagement clauses (or clauses with similar effect) in the separation or severance agreements you entered into during the Examination Period are standard, provide a copy of the agreement containing those clauses. However, if the confidentiality or non-disparagement clauses (or clauses with similar effect) have varied, provide all agreements containing such variations (with names of employees and amounts of payments redacted).

9. If not otherwise produced, provide all policies regarding whistleblowers.

Sample Exam Findings

EXAMINATION FINDINGS

[redacted]

I. Language in Certain Documents is Inconsistent with the Commission's Whistleblower Regulations

Rule 21F-17(a) of the Commission's whistleblower regulations states: "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation . . ." See Rule 21F-17(a) under the Securities Exchange Act of 1934.

The staff noted language in documents used by the registrant that appears to be inconsistent with Rule 21F-17. For example, Section 1.5 ("Confidentiality") of Registrant's Employee Handbook states, in relevant part:

> All information regarding [redacted], its business, operations and condition and all information with respect to its clients and client accounts, including the identities thereof, is confidential and may only be used by you in connection with your duties as an employee of [redacted]. All Employees are required to maintain the obligations of confidentiality set forth in the Employee Handbook and to continue to abide by any ongoing obligations of confidentiality arising as a result of, or in connection with, any agreement or undertaking entered into on behalf of [redacted] or any client (e.g. confidentiality agreements) or by which [redacted] or any client is

This language may impede Registrant's current or former personnel from communicating with the staff and, accordingly, may be inconsistent with Rule 21F-17(a). The staff also noted similar language in Registrant's employment agreements and offer letters.

In your response, please describe any corrective actions you intend to take. Specifically, please address any changes you will make to these documents and steps you will take to ensure that your current and former employees are apprised of any such changes.

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Recent Statements by the SEC

- "The SEC as the Whistleblower's Advocate," Chair White (April 30, 2015)
  - "In addition to protecting whistleblowers from retaliation once they have reported information to the SEC, ***Rule 21F-17 also prevents individuals and entities from taking steps to silence potential whistleblowers before they contact us***, including through the threatened enforcement of confidentiality agreements."
  - "Under the rule, the Commission is not required to establish that the confidentiality agreement actually prevented employees from communicating with the SEC. ***The potential and significant chilling effect of blanket prohibitions on reporting information is also prohibited by the rule***."
  - "The SEC is not trying to dictate the language of these agreements or warnings – that is the company's responsibility. But ***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."
- Comments at ACA Whistleblower Forum, Director McKessy (July 28, 2015)
  - McKessy called Rule 21F-17 his "new favorite rule," because if companies use internal policies, employment agreements or other means to chill whistleblowing, they will "contract out of entire whistleblower system."
  - McKessy commented that "some very ambitious and creative lawyers have tried to circumvent Rule 21F-17(a)," but he advised that ***companies "should not try to find the line and stop just short of it***."
  - McKessy warned: "I promise if you are not looking at your agreements and thinking about this, we will bring a case. KBR is not going to be the last case . . . ***if you haven't looked at your agreements since August 2011, you need to do that now***."

EEOC Scrutinizing Employment Agreements

- The EEOC is currently focused on challenging once-common provisions in employment agreements
- The EEOC 2013-2016 Strategic Enforcement Plan priorities include:
  - "Preserving Access to the Legal System. The EEOC will target policies and practices that discourage or prohibit individuals from exercising their rights under employment discrimination statutes, or that impede the EEOC's investigative or enforcement efforts."

EEOC Scrutinizing Severance Agreements

- In 2014, the EEOC sued CVS Pharmacy alleging its standard severance agreement violated Title VII by deterring employees from filing administrative charges, communicating voluntarily with the EEOC and participating in its investigations.
- Provisions challenged:
  - Cooperation
  - Non-disparagement
  - Non-disclosure of confidential information
  - General release of claims
  - Covenant not to sue

EEOC Scrutinizing Severance Agreements

- **Cooperation Clause**: employees must "promptly notify the Company's General Counsel by telephone and in writing" of legal matters including an "administrative investigation."
- **Non-Disparagement:** "Employee shall not make any statements that disparage the business or reputation of [CVS]."
- **Non-disclosure of confidential information**: "Employee shall not disclose to any third party or use for himself/herself or anyone else any Confidential Information without the prior written authorization of [CVS]."
- **General release of claims**: a release of all "causes of action, lawsuits, proceedings, complaints, charges, debts, contracts, judgments, damages, claims, and attorney fees," including "any claim of unlawful discrimination of any kind...."

EEOC Scrutinizing Severance Agreements

- The district court dismissed the case for procedural reasons, and the EEOC appealed
- On December 17, 2015, the Seventh Circuit ruled against the EEOC:
  - EEOC cannot sue an employer over the terms of a separation agreement, absent allegations of actual discrimination or retaliation
  - As a matter of law, conditioning benefits on promises not to file charges with the EEOC does not constitute retaliation
- Despite this ruling, the EEOC and other agencies will undoubtedly continue to challenge agreements that they believe chill employees' rights

NLRB Scrutinizing Non-Union Policies and Employment Agreements

- NLRB is increasingly scrutinizing non-union employers
- NLRA protects employees engaged in "concerted protected activity"
- *Lutheran Heritage*: maintaining a work rule can still violate NLRA if "employees would reasonably construe the rule's language to prohibit Section 7 activity" – i.e., "concerted protected activity"
- NLRB General Counsel's March 2015 report on lawful/unlawful employer policies provides examples of the types of rules the NLRB's GC would prosecute

Confidentiality Rules

- NLRB GC has warned against rules that:
  - Prohibit employee discussions of terms and conditions of employment, such as wages, hours or workplace complaints
  - Restrict disclosure of employee information:
    - "Do not discuss customer or employee information outside of work, including phone numbers and addresses"
    - "You must not disclose proprietary or confidential information about the Employer or other Associates"

Confidentiality Rules

- According to the NLRB GC, however, rules that (1) do not prohibit disclosure of information about employees and (2) do not include an overbroad definition of the term “confidential” are lawful:
  - “Do not disclose confidential financial data, or other non-public proprietary company information. Do not share confidential information regarding business partners, vendors or customers.”

Non-Disparagement Rules

- NLRB GC has also warned against rules that deter employees from criticizing their employers
- The following rules have been deemed unlawful:
  - "Refrain from any action that would … cause damage to the Company's business or reputation"
  - "Never engage in behavior that would undermine the reputation of the employer, your peers or yourself"
  - "Be respectful of others and the Company"
- Labor law does not protect employee conduct aimed at disparaging an employer's products

Class Action Waivers in Arbitration Agreements

- In 2012 and 2014, the NLRB ruled that an employer cannot require employees, as a condition of their employment, to sign arbitration agreements precluding them from filing class claims about their wages, hours, or other working conditions
- The Fifth Circuit reversed both of these decisions. The appeals court held, most recently in October 2015, that individuals do ***not*** have a substantive right to litigate on a class-wide basis
- But the NLRB has refused to abide by the Fifth Circuit's decisions

Class Action Waivers in Arbitration Agreements

- In November 2015, in *Amex Card Service Co*., the NLRB held that Amex violated labor law by maintaining an arbitration policy and acknowledgement form that required employees to resolve all claims against the company through individual arbitration
- The NLRB ordered Amex to inform employees that they have not waived their right to bring joint employment-related claims in all forums
- Amex likely will appeal to the Ninth Circuit, and this issue could eventually be resolved by Supreme Court

Courts Scrutinizing Separation Agreements

- Courts will also scrutinize agreement terms that “interfere” with employees’ protected activities
- In Massachusetts, a release must be stated in “clear and unmistakeable terms” and understandable to the average person
- A release must expressly reference the following Massachusetts statutes:
  - Wage Act claims, Mass. Gen. Laws ch. 149, sec. 148 et seq.
  - Anti-discrimination statute, Mass. Gen. Laws ch. 151B
  - Age Discrimination in Employment Act, 29 U.S.C. § 621 et. seq.

Employment Agreements: Best Practices

- Avoid overly broad prohibitions that could be perceived as deterring employees from exercising their statutory rights, such as:
  - Prohibiting, or even “chilling,” whistleblowing to any government authorities
  - Waiving rights to participate in federal and state agency investigations
  - Prohibiting all communications about work-related information and/or terms and conditions of employment

Employment Agreements: Best Practices

- Simplify your agreements and use clear and understandable language
- Add prominent, explicit disclaimers
  - Confidentiality and Non-Disclosure: “Nothing in this agreement is intended, or shall be construed, to prohibit you from reporting any suspected illegal activity to, providing information to or participating in any investigation or proceeding conducted by any federal or state government agency.”
  - NLRA Section 7 Activities: “Nothing in this policy is designed to interfere with, restrain, or prevent employee communications regarding wages, hours or other terms and conditions of employment.”

Employment Agreements: Best Practices

- With regard to whistleblower issues, and the SEC in particular, think broadly about agreements and other communications with employees:
  - Employment agreements
  - Severance agreements
  - Employee handbooks
  - Codes of ethics/conduct
  - Compliance manuals
  - Offer letters
  - Any other confidentiality agreements
- Also, think broadly about other confidentiality-related provisions in agreements (e.g., non-disparagement)

Speakers

Jonathan A. Keselenko, *Partner*, Foley Hoag LLP
617 832 1208
jkeselenko@foleyhoag.com

Daniel Marx, *Partner*, Foley Hoag LLP
617 832 1202
dmarx@foleyhoag.com

Michael L. Rosen, *Partner*, Foley Hoag LLP
617 832 1231
mrosen@foleyhoag.com

Questions or Comments