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The government's carrot-and-stick approach to corporate confidentiality

As the SEC seeks to eliminate anti-whistleblowing clauses in employee confidentiality agreements, it offers both SEC enforcement and the DTSA to get what it wants.

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In recent years, corporate confidentiality agreements have come under fire from federal agencies, members of Congress, and the plaintiffs' bar out of concern that confidentiality restrictions may be impeding federal whistleblower programs by preventing individuals from coming forward with evidence of corporate misconduct. At the federal level, the ensuing government response has taken various forms, ranging from inducements to enforcement actions, in an effort to encourage (or force) companies to revise their confidentiality agreements.

Confidentiality restrictions are standard operating procedure for many companies. These provisions, which commonly appear in employment, severance and other agreements, restrict the use and disclosure of a company's trade secrets or other confidential information. In some cases, these agreements employ broad language that precludes an employee from disclosing confidential information to any third party outside of the company, usually with certain exceptions, such as disclosures required by law or made pursuant to a subpoena.

There are, of course, perfectly sensible reasons why a company would not want its confidential information to be disclosed to third parties. No company wants its sensitive information to fall into the hands of its competitors or others who might seek to exploit it, whether for profit or mischief. This is particularly true in the age of WikiLeaks, when a company's most sensitive information could be made available to the world with a single click of a mouse.

Many companies have also included provisions in their severance agreements that require departing employees to waive their rights to receive an award under government whistleblower programs or in a False Claims Act action in consideration for the receipt of severance benefits. In some cases, the departing employee is also required to disclose any misconduct of which they are aware, and to certify that they have made such a disclosure, as a condition of receiving severance benefits. (See William McLucas et al., Dispatches From the Whistleblower Front: Five Common Pitfalls For Companies to Avoid.)

This induces departing employees to disclose such information to the company so that the company can investigate and take corrective action, rather than allowing potential issues to fester undetected. Some courts have upheld the validity of these waiver-for-consideration provisions in certain circumstances. (See, e.g., U.S. ex rel. Radcliffe v. Purdue Pharma L.P., 2010 WL 1068229 (4th Cir. 2010); U.S. ex rel. Hall v. Teledyne Wah Chang Albany, 104 F.3d 230 (9th Cir. 1997).)

Over the last few years, however, concerns have been raised by government officials and whistleblower attorneys that these confidentiality and waiver provisions could be misunderstood by individuals as preventing them from reporting potential corporate misconduct to the government. The Securities and Exchange Commission has taken the most aggressive approach, in effect declaring war on these provisions in a series of public statements and settled enforcement actions. In August of this year, the SEC announced settlements with two different companies—BlueLinx Holdings, Inc. and Health Net Inc.—over provisions in the companies' severance agreements that required departing employees to waive their right to seek whistleblower awards as a condition of receiving severance benefits. In the BlueLinx Holdings case, such provisions also required former employees to notify the company's legal department in advance of making any disclosure of confidential information pursuant to law or legal process. These settlements followed the SEC's well-publicized April 2015 settlement with KBR Inc. over confidentiality agreements that restricted employees from disclosing the substance of investigative interviews without prior authorization.

In the SEC's view, these types of provisions—i.e., agreements that require advance notice or authorization of a disclosure to the Commission, or that waive an individual's right to a whistleblower award from the Commission—violate Exchange Act Rule 21F-17, which was adopted in the wake of the Dodd-Frank amendments to the Securities Exchange Act of 1934. Rule 21F-17 provides that "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." 17 C.F.R. § 240.21F-17(a). (The rule does provide a limited exception, however, for "agreements dealing with information…related to the legal representation of a client." 17 C.F.R. § 240.21F-17(a).)

The SEC has made no secret of its intention to vigorously enforce this rule. Last year, the SEC also issued broad document requests to a number of companies seeking several years' worth of employment and confidentiality agreements, presumably so it could scrutinize the contract language for provisions that, in the SEC's view, run afoul of the rule. That said, there is no indication whether Health Net, BlueLinx Holdings or KBR were among the companies that received such letters.

Notably, the SEC does not appear to be concerned with whether any employees were actually impeded from participating in its whistleblower program, only the potential that this might occur. Indeed, in two of the settled cases, the SEC acknowledged that there was no allegation that any individuals were actually impeded from communicating directly with the SEC, or that any of the companies took action to otherwise prevent such communications. Moreover, in both BlueLinx and Health Net, the companies had recently amended their severance agreements to make clear that employees were not prevented from communicating with the SEC or other agencies. Even so, the SEC took the position that the relevant provisions violated Rule 21F-17.

In the SEC's view, even a provision requiring an employee to provide advance notice of a disclosure pursuant to law or legal process—for the purpose of seeking appropriate protection for confidential information—theoretically could chill departing employees from coming forward by causing them to choose between self-identification as a potential whistleblower or potentially risking their severance benefits. Similarly, while a departing employee's waiver of a whistleblower award in return for severance payments may not seem to fall within the plain language of Rule 21F-17, the SEC considers such provisions to directly target its whistleblower program by removing the financial incentives that are intended to encourage persons to come forward, thus undermining the purpose of the program and Rule 21F-17.

The SEC's position has not yet been adjudicated in a contested proceeding. In each of these cases, the allegations were settled through an administrative cease-and-desist order, with no admission or denial by the respective companies. Each of the companies agreed to pay a civil monetary penalty (ranging between $130,000 and $340,000) and undertook to amend the relevant language in its agreements. For companies falling within the SEC's jurisdiction, however, these settlements are a reminder that the SEC continues to take a jaundiced view of confidentiality and waiver provisions, and that agreements should be reviewed and revised as needed.

At the other extreme, the U.S. Congress has passed legislation that takes a more nuanced approach to reconciling the competing corporate and governmental interests in confidentiality. The Defend Trade Secrets Act of 2016 (DTSA), Pub. L. 114–153, which President Obama signed into law on May 11, 2016, creates a new private right of action under 18 U.S.C. § 1836(b) for employers to pursue claims for misappropriation of trade secrets. The DTSA provides an expansive definition of the term "trade secret," borrowed from the Economic Espionage Act. To qualify as a trade secret under the DTSA, the information at issue must satisfy two statutory conditions: (1) the owner must have taken "reasonable measures to keep such information secret"; and (2) the information must "deriv[e] independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information." 18 U.S.C. § 1389(3)(A), (B).

The DTSA has several features that are particularly favorable to employers, including the ability to seek ex parte seizures of misappropriated property and the right to seek exemplary damages and attorneys' fees, which are two extraordinary remedies that are not available under many state trade-secret laws.

At the same time, Congress also provided protections for whistleblowers. The DTSA amends 18 U.S.C. § 1833 to confer immunity from civil or criminal liability "under any Federal or State trade secret law" to individuals who disclose a trade secret in confidence to a federal, state or local government official solely for the purpose of reporting or investigating a suspected violation of law. The DTSA also requires employers to notify employees of this immunity "in any contract or agreement with an employee that governs the use of a trade secret or other confidential information." Importantly, the DTSA does not impose a statutory penalty for non-compliance with this notice requirement. Instead, if an employer fails to provide the statutory notice in agreements after the enactment of the statute, it cannot recover the new statutory remedies—exemplary damages and attorneys' fees—in an action involving a non-protected disclosure.

In essence, Congress appears to have intended the DTSA to provide a carrot for companies to revise their confidentiality agreements: notify employees of the immunity for protected disclosures, in return for a new cause of action with significant new remedies to pursue those who make non-protected disclosures. Thus, even for companies that do not fall within the SEC's jurisdiction, there is good reason to consider reviewing and amending confidentiality agreements going forward to take full advantage of the DTSA. ■

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