EMPLOYMENT, LABOR & WORKFORCE MANAGEMENT

TAKE 5

VIEWS YOU CAN USE

April 2016

Restrictive Covenants: Do Yours Meet a Changing Landscape?

For the latest news and insights concerning trade secret and non-compete issues and trends, please visit and subscribe to Epstein Becker Green's *Trade Secrets & Noncompete Blog*.

Restrictive covenants are an important tool for businesses concerned about the protection of their confidential business information and the costs of employee training and turnover. When properly crafted and utilized, restrictive covenants help safeguard a business against the loss of valuable employees and the misuse of critical data (usually developed over a long period of time and through significant financial investment) by its competitors. For years, most jurisdictions, recognizing the delicate balance between protection and free competition, have typically enforced restrictive covenants under standards of reasonableness, without much public outcry or legislative interference.

The use of restrictive covenants has faced significant criticism lately, including in news articles from prominent media outlets[1] and a report by the U.S. Department of the Treasury[2] casting doubt specifically on the appropriateness of non-competition covenants. In this issue of *Take 5*, we examine some recent developments in this area, both in the courts and among legislatures, to apprise employers of this evolving landscape and assist them in navigating it:

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[1] *See* Clare O'Connor, *Does Jimmy John's Non-Compete Clause For Sandwich Makers Have Legal Legs?* Forbes (Oct. 15, 2014), http://www.forbes.com/sites/clareoconnor/2014/10/15/does-jimmy-johns-non-compete-clause-for-sandwich-makers-have-legal-legs/; *see also* Steven Greenhouse, *Noncompete Clauses Increasingly Pop Up in Array of Jobs,* New York Times (June 8, 2014) http://www.nytimes.com/2014/06/09/business/noncompete-clauses-increasingly-pop-up-in-array-of-jobs.html?_r=0.

[2] Karen Dynan, *The Economic Effects of Non-compete Agreements*, U.S. Department of the Treasury (3/31/2016), https://www.treasury.gov/connect/blog/Pages/The-Economic-Effects-of-Non-compete-Agreements-.aspx. Report available at https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf.

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1. Are Courts Still Willing to "Blue Pencil" Overbroad Restrictive Covenants to Make Them Enforceable?

By Anthony J. Laura and Matthew Savage Aibel

Restrictive covenant agreements are traditionally governed by state law and thus subject to various jurisdictions' rules regarding enforceability. They stand on a different footing than most other contracts, in that their enforcement is typically susceptible to a court's equitable powers, and may not always be enforced as written, if at all. States differ on whether their courts will deny enforcement of a restrictive covenant deemed overbroad as written by the parties or instead modify it to meet the particular state's standards of enforceability. In those states where such modification is authorized, a court may strike out (or "blue pencil") certain terms of the covenant and, in a few states, even insert or modify provisions as deemed necessary to validate the covenant (known as "equitable reformation").

Recent Court Decisions Involving Blue-Penciling

New York courts had traditionally been receptive to blue-penciling an overbroad restrictive covenant. However, in a recent case, the Court of Appeals (New York State's highest court) emphasized that under New York law, restrictive covenants will not be blue-penciled if there is "coercive use of dominant bargaining power" to achieve their formation.[3]

In *Brown & Brown*, the Court of Appeals remarked that because the employee was unemployed at the time that she signed the covenant, there were questions over whether that "caused her to feel pressure to sign the agreement rather than risk being unemployed."[4] The Court of Appeals further noted that a "case-specific analysis" is necessary to determine these surrounding circumstances and found factual issues precluding summary judgment there.

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[3] *Brown & Brown Inc. v. Johnson*, 25 N.Y.3d 364, 371 (2015).
[4] *Id.* at 372.

In January 2016, *Brown & Brown* was applied when a New York Supreme Court, in *Aqualife Inc. v. Leibzon*, found such unequal bargaining power in the creation of an overbroad restrictive covenant and refused to blue-pencil it, granting instead defendants' motion to dismiss.[5]

New York is not alone in its judicial philosophy regarding the blue-pencil doctrine. In late October 2015, an Illinois Appellate Court refused to judicially modify overbroad restrictive covenants because the court deemed their deficiencies "too great to permit modification."[6] Even though that agreement contained a clause allowing for judicial modification, the court refused to do so, explaining that "[i]n determining whether modification is appropriate, the fairness of the restraints contained in the contract is a key consideration."[7]

At least one other state has taken a dim view lately of a non-compete agreement in which the parties agreed to allow a court to modify any provision deemed overbroad. In *Beverage Sys. of the Carolinas, LLC v. Associated Bev. Repair, LLC*, the Supreme Court of North Carolina recently refused to modify an overbroad agreement, notwithstanding the agreement containing a clause empowering the court to rewrite the offending provisions.[8] The court determined that such a clause was in violation of the state's "strict blue-pencil" doctrine, which only allowed for provisions to be stricken and did not allow for any equitable reformation.[9]

While there appears to be a growing hesitancy among courts to blue-pencil or equitably reform agreements that may be overbroad, some recent decisions show that there is still a place for the practice. In *Turnell v. CentiMark Corp.,* the U.S. Court of Appeals for the Seventh Circuit recently applied Pennsylvania law to modify an overly broad agreement.[10] Similar to New York law, the Seventh Circuit initially noted that where "the restrictions are so 'gratuitous[ly]' overbroad that they 'indicate[] an intent to oppress the employee and/or to foster a monopoly,' a court of equity may refuse to enforce the covenant at all."[11] But generally, "absent bad faith, Pennsylvania courts do attempt to blue-pencil covenants before refusing enforcement altogether."[12]

What Employers Should Do Now

(i) As has always been the case, look at the provisions within your restrictive covenants to ensure that they are tied to protecting a legitimate business interest and that their scope is narrowly tailored such that they would not be viewed as oppressive or overreaching.

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[5] *Aqualife Inc. v. Leibzon*, 2016 N.Y. Misc. LEXIS 6, 2016 NY Slip Op 50002(U), 1, 50 Misc. 3d 1206(A) (N.Y. Sup. Ct. Jan. 5, 2016).
[6] *AssuredPartners Inc. v. Schmitt,* 2015 IL App. (1st) 141863 (Ill. App. 2015).
[7] *Id.* at ¶ 51.
[8] B*everage Sys. of the Carolinas, LLC v. Associated Bev. Repair, LLC*, 2016 N.C. LEXIS 177, *6 (N.C. Mar. 18, 2016).
[9] *Id.* at *17.
[10] *Turnell v. CentiMark Corp.*, 796 F. 3d 656, 664 (7th Cir. 2015).
[11] *Id.* at 663 (citations omitted).
[12] *Id.*

(ii) Consider the interaction between the forum selection clause, the choice-of-law provision, and the covenant itself in terms of what state law might apply to any potential blue-penciling or equitable reformation.

(iii) In states that allow for equitable reformation, make sure that the agreement itself indicates that it can be modified by a court.

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2. Should You Be Wary of the Overzealous Use of Trade Secret Claims?

By James A. Goodman and Ted Gehring

High-stakes trade secret cases are typically aggressively prosecuted. But plaintiffs (and their attorneys) who prosecute these claims face substantial risks if the evidence does not support the contention that a trade secret has been misappropriated. Even a plaintiff who may have initiated a misappropriation action in good faith risks attorneys' fees and malicious prosecution liability by continuing to prosecute the matter after it learns that the case is not substantiated.

Section 4 of the Uniform Trade Secrets Act authorizes a court to award costs and attorneys' fees if the court determines that a claim for misappropriation is made in bad faith, and most jurisdictions include this provision. For example, California Civil Code § 3426.4 provides that "[i]f a claim of misappropriation is made in bad faith, a motion to terminate an injunction is made or resisted in bad faith, or willful and malicious misappropriation exists, the court may award reasonable attorney's fees and costs to the prevailing party."

SASCO v. Rosendin Electric, Inc.

Several recent California cases highlight that the risk to employers (and the law firms representing them) is not simply in initiating actions for misappropriation but also for continuing to pursue them when the facts of the claim are not borne out in litigation.

In *SASCO v. Rosendin Electric, Inc.*, 207 Cal.App.4th 837 (2012), the California Court of Appeal affirmed a trial court's order awarding the defendants almost $485,000 in attorneys' fees and costs pursuant to California Civil Code § 3426.4. SASCO sued Rosendin Electric, Inc.; another licensed electrical contractor; and three individual defendants for misappropriation of trade secrets, among other things. The trial court accepted for the sake of argument that SASCO's computer program was a trade secret. The court concluded, however, that there was no evidence of misappropriation and that SASCO had sued the defendants based on the suspicion that they must have misappropriated trade secrets because the individual defendants went to work for a competitor, which subsequently secured a contract for which both companies were competing. The trial court concluded that the plaintiff engaged in bad faith pursuant to Section 3426.4, which consisted of both objective speciousness and subjective bad faith. The appellate court agreed with the trial court that continuing to prosecute the action without evidence of actual misappropriation constituted subjective bad faith.

FLIR Systems, Inc. v. Parrish

The risk to plaintiff employers (and their law firms) in pursuing claims in bad faith is not limited to attorneys' fees and costs under the statute. On April 6, 2012, Latham & Watkins was sued for malicious prosecution in Los Angeles Superior Court. The plaintiffs, William Parrish and Timothy Fitzgibbons, were former officers and shareholders of Indigo Systems Corporation, which was purchased by FLIR Systems, Inc., in 2004. From 2004 to 2006, the plaintiffs worked for FLIR, leaving in 2006 to start their own business. FLIR retained Latham and sued the plaintiffs for, among other things, misappropriation of trade secrets. After a summary judgment motion was denied, the case proceeded to trial on FLIR's claim for injunctive relief. The trial court denied FLIR's request for a permanent injunction, found that FLIR brought the trade secrets action in bad faith, and awarded attorneys' fees and costs of $1,641,216.78. The trial court's decision was affirmed on appeal.[13]

In the subsequent malicious prosecution suit, Latham & Watkins filed a motion contending that the plaintiffs' claims were barred by the statute of limitations and on their merits, contending that (i) a one-year statute of limitations applied to the plaintiffs' claims and the claims were untimely under that limitations period and (ii) the trial court's denial of summary judgment for the plaintiffs on the claims brought against them by FLIR established that the underlying action was brought with probable cause as a matter of law. The trial court granted Latham's motion on statute of limitations grounds and did not expressly address Latham's argument that the claims against the law firm were without probable cause.

On August 27, 2014, the Court of Appeal issued an opinion reversing the trial court. The Court of Appeal held that the applicable statute of limitations for malicious prosecution claims was not the one-year, but rather the two-year, limitation period set forth in Cal. Code Civ. Proc. Section 335.1.

The Court of Appeal then considered Latham's argument disputing the merits of the plaintiffs' malicious prosecution complaint. Key to Latham's argument was the fact that the plaintiffs had moved for summary judgment in the underlying case and that motion had been denied. Latham argued that the "interim adverse judgment rule" applied, under which claims that have succeeded at a hearing on the merits are deemed not so lacking in potential merit to serve as the basis for a malicious prosecution claim (unless such ruling is obtained by fraud or perjury). Prior courts had routinely applied the interim adverse judgment rule to bar claims for malicious prosecution where there had been a denial of a defendant's motion for summary judgment in the underlying action.

[13] *FLIR Systems, Inc. v. William Parrish, et al.*, 174 Cal.App.4th 1270 (2009).

The Court of Appeal noted that the plaintiffs had evidence that:

(i) Latham filed a complaint alleging actual misappropriation of a business plan, disregarding a claim that the plaintiffs had created the business plan prior to their employment with FLIR;

(ii) when plaintiffs presented that evidence to Latham, Latham changed the theory of the case to pursue a claim that the plaintiffs could not effectuate the business plan without inevitably using FLIR's intellectual property;

(iii) Latham knew that inevitable disclosure is not a viable legal theory in California and, therefore, knew that this theory lacked legal basis;

(iv) the factual basis for Latham's theory was expert testimony that considered only publicly available technology when Latham knew that the plaintiffs' business plan would be using non-public technology obtained lawfully from third parties; and

(v) FLIR's president testified that he had no factual basis to assert that the plaintiffs would use FLIR's intellectual property, strongly implying that the claim against them was a preemptive strike.

Critically, the Court of Appeal found that Latham had "sought an obviously anti-competitive injunction based on the speculative possibility that the [plaintiffs'] product might violate its client's trade secrets . . . ." The Court of Appeal held that these circumstances supported the conclusion that "no reasonable attorney would have believed [the] case had merit," and it reinstated plaintiffs' claim.

Latham filed a petition for re-hearing, which was denied on September 19, 2014, and then, on the court's own motion, was granted on September 25, 2014. On June 26, 2015, the Court of Appeal issued its decision, this time, affirming the trial court's order granting Latham's motion on the ground that the "interim adverse judgment rule" established Latham had probable cause to bring the action. The court held that exceptions to the interim adverse judgment rule did not apply in this case because (i) the summary judgment motion was not denied on procedural or technical grounds and (ii) the summary judgment motion was not obtained by fraud or perjury.[14]

But this ruling did not conclude the matter. On October 14, 2015, the California Supreme Court granted the plaintiffs' Petition for Review, and the case is pending.

Understand the Risk Before Prosecuting

There are substantial risks in pursuing trade secret actions if it appears that plaintiffs are using the Trade Secrets Act to mask an anti-competitive intent. If, during the course of the litigation, there is no evidence that a trade secret has been misappropriated or it does not look like a trade secret can be proven, plaintiffs and their attorneys must

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[14] *Parrish v. Latham & Watkins*, 238 Cal.App.4th 81, 97 (2015).

understand this risk in assessing whether, or to what extent, to continue to pursue the action.

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3. Will There Finally Be a Federal Private Right of Action for Trade Secret Misappropriation?

By Jennifer O'Connor and David J. Clark

On April 4, 2016, by a vote of 87-0, the U.S. Senate unanimously passed the Defend Trade Secrets Act. The legislation, originally proposed by a bipartisan group of legislators in July 2015, seeks to create a private right of action allowing companies to assert civil trade secret misappropriation claims under federal law (which would supplement the existing patchwork of state law remedies).

With approval from the full Senate, the Defend Trade Secrets Act has taken a big step that eluded similar bills in 2013 and 2014. The counterpart bill in the House of Representatives remains for now with the House Judiciary Committee, where it has been referred to the Subcommittee on Courts, Intellectual Property, and the Internet. Given the resounding vote in the Senate and the fact that 127 Representatives have already signed on as co-sponsors of the bill, passage in the House seems likely.

Protections of the Defend Trade Secrets Act

Similar to past legislative efforts, the Defend Trade Secrets Act would amend the Economic Espionage Act of 1996 (which allows prosecutors to bring criminal charges relating to trade secret theft) to empower private companies to bring civil suits to protect their trade secrets. As noted in a recent report of the Senate Judiciary Committee, a federal cause of action "will allow trade secret owners to protect their innovations by seeking redress in Federal court, bringing their rights into alignment with those long enjoyed by owners of other forms of intellectual property, including copyrights, patents, and trademarks."

The Defend Trade Secrets Act's definition of "misappropriation" is consistent with the definition used under the Uniform Trade Secrets Act, which is currently enacted, at least in part, by 48 states. The available remedies are also similar. The legislation would allow for injunctions to preserve evidence and prevent disclosure, and for damages to account for economic harm to plaintiffs whose trade secrets are stolen. Attorneys' fees would also be recoverable if the misappropriation is willful or malicious.

Criticism of the Defend Trade Secrets Act

The previous bills were criticized for, among other things, allowing federal courts to issue relatively broad orders for seizure of purported trade secret materials and information. Mindful of such criticism, the 2015 Defend Trade Secrets Act narrows the circumstances in which an ex parte seizure order can be obtained and, to prevent hacking of seized devices, the bill bars a seized electronic storage medium from being connected to the Internet without the consent of both plaintiff(s) and defendant(s). The

bill also allows for defendant(s) to make a motion to encrypt any seized material that is stored on an electronic storage medium.

The 2015 Defend Trade Secrets Act is backed by a varied assortment of trade associations and corporations and has strong support from the White House. The proposed legislation is not without its critics, however. In a November 17, 2015, letter to Congress, more than 30 law professors raised a variety of concerns regarding the bill, including many that were previously raised in opposition to the 2014 version of the Defend Trade Secrets Act. They argue that the latest bill does not address cyber espionage directly and, rather, is "likely to create new problems that could adversely impact domestic innovation, increase the duration and cost of trade secret litigation, and ultimately negatively affect economic growth."

Can Employers Look Forward to Bringing Federal Claims of Trade Secret Misappropriation?

It appears that the currently pending Defend Trade Secrets Act may break the pattern established by past bills of failing to be enacted into law. The Defend Trade Secrets Act has already garnered far more legislative support and progressed farther than similar bills did in 2013 and 2014. The increase in cyber espionage and the threat to U.S. businesses posed by international theft of trade secrets have captured the public's attention. There is certainly support in the business community weighing in favor of the bill passing. Given the recent passage in the Senate and the growing concern over trade secret protection, it seems likely that the 2015 Defend Trade Secrets Act will succeed in creating the first private right of action for civil trade secret misappropriation under federal law.

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4. In Today's Environment, What Is "Adequate Consideration" for a Restrictive Covenant Signed by an Existing Employee?

By Peter A. Steinmeyer and Scarlett Freeman

Employers seeking to require an existing employee to sign a restrictive covenant should consider current litigation trends surrounding what constitutes "adequate consideration." Under the traditional rule followed by a majority of states, continued employment, standing alone, is adequate consideration for a restrictive covenant signed by an at-will employee. Several courts, however, have recently reexamined this issue, so employers must be aware of differences among the states as to whether some consideration beyond mere continued at-will employment is required.

Fifield v. Premier Dealer Services, Inc.

For example, the Illinois Appellate Court held in *Fifield v. Premier Dealer Services, Inc.*,[15] that, absent other consideration, at least two years of continued employment are required to constitute adequate consideration for a restrictive covenant. Under *Fifield*,

[15] *Fifield v. Premier Dealer Services, Inc.*, 2013 IL App. (1st) 120327.

the two-year rule applies regardless of whether the employee signed the restrictive covenant as a new or existing employee and regardless of whether the employee voluntarily resigned or was fired.

Although *Fifield* has been followed in subsequent Illinois state appellate decisions,[16] multiple federal district courts in Illinois have refused to apply *Fifield*'s bright line, two-year rule. For example, last month, the U.S. District Court for the Northern District of Illinois concluded that the Illinois Supreme Court, which has not yet ruled on the issue, "would reject a two year bright-line rule in favor of a fact specific test."[17] Therefore, while "[t]wo years may be sufficient to find adequate consideration," "it is not always necessary," particularly when considering other factors, like compensation, raises and bonuses, and the terms of the employee's termination.[18]

Differing State Rules

Since *Fifield*, other state courts have similarly grappled with the issue of what constitutes adequate consideration for a restrictive covenant. Kentucky, North Carolina, and Pennsylvania courts each have issued decisions requiring *some consideration* beyond mere continued employment to enforce a non-compete.[19]

In contrast, the Wisconsin Supreme Court recently held in *Runzheimer Int'l, Ltd. v. Friedlen*,[20] that employers may require existing at-will employees to sign non-compete agreements *without* offering additional consideration beyond continued employment, although the court did not provide clear guidance as to the period of time that the employment must continue after the non-compete is signed.

Courts in New York and New Jersey have been relatively consistent regarding the required consideration for a restrictive covenant. Both states consider continued employment to constitute adequate consideration for a restrictive covenant signed by a current employee, provided that the employer forbears from discharging the employee for a "substantial" period of time.[21]

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[16] *See, e.g.*, *Prairie Rheumatology Assocs., S.C. v. Francis*, 2014 IL App. (3d) 140338; *McInnis v. OAG Motorcycle Ventures, Inc.*, 2015 IL App. (1st) 142644).
[17] *R.J. O'Brien & Assocs., LLC v. Williamson*, No. 14 C 2715, 2016 U.S. Dist. LEXIS 32350, at *7 (N.D. Ill. Mar. 10, 2016).
[18] *Id.* at *7-9.
[19] *See, e.g., Charles T. Creech, Inc. v. Brown*, 433 S.W.3d 345 (Ky. 2014) (mere continued at-will employment does not constitute adequate consideration); *Emp't Staffing Grp., Inc. v. Little*, 777 S.E.2d 309, 314 (N.C. App. 2015) (upholding as adequate a $100 payment made to defendant in conjunction with signing a mid-employment non-compete); and *Socko v. Mid-Atl. Sys. of CPA, Inc.*, 126 A.3d 1266, 1275 (Pa. 2015) (an existing employee must receive some "new" and valuable consideration in exchange for signing a mid-employment non-compete agreement, even where the employee expressly "inten[ded] to be legally bound" by the agreement).
[20] *Runzheimer Int'l, Ltd. v. Friedlen*, 2015 WI 45 (Wis. 2015).
[21] *See Int'l Paper Co. v. Suwyn*, 951 F. Supp. 445, 448 (S.D.N.Y. 1997) (under New York law, continued employment for a "substantial period" following the execution of the agreement is sufficient consideration for a restrictive covenant); *Hogan v. Bergen Brunswig Corp.*, 153 N.J. Super. 37, 43 (Super. Ct. App. Div. 1977) (continued employment is sufficient consideration to support a restrictive covenant found in an original or post-employment contract).

What Employers Should Do Now

In light of this judicial focus on appropriate consideration and given the number of states that have recently addressed adequacy of consideration, employers nationwide should monitor this issue—even in states where the law is currently stable.

In terms of addressing this issue, employers should consider these options:

(i) Where there is a plausible nexus to a state with more favorable laws regarding the enforceability of restrictive covenants, include a choice-of-law provision designating the law of that state (e.g., the state where the employer's headquarters is located or where the employee actually works). Courts generally enforce contractual choice-of-law provisions unless they violate the fundamental public policy of a state with a materially greater interest in the situation or where the parties and contract do not have a substantial relationship with the chosen state.

(ii) Provide consideration in addition to an offer of employment or continued employment. Examples of such possible "additional consideration" include a cash payment, stock options, training, education, a raise, additional paid time off, guaranteed severance, or a promotion. In the absence of judicial guidance, it would be prudent to be as generous as possible and to provide consideration that is more than *de minimis*. Regardless of the "additional consideration" ultimately decided upon, the restrictive covenant itself should both explicitly recite the consideration provided to the employee for signing it and further provide that the employee acknowledges the consideration and its adequacy.

(iii) Agree to continue the employee's salary during any restricted period, thereby alleviating concern about consideration being illusory.

(iv) Consider trying to evade consideration concerns entirely by having employees agree to a "garden leave" or "required notice" clause, rather than a traditional non-compete or non-solicit clause. Under such a provision, an employee is required to give advance notice of his or her resignation (e.g., 30 – 90 days) and, during the notice period, the employee remains on your payroll and owes you a fiduciary duty of loyalty (and therefore cannot work for a competitor during that period). Because the employee remains on the payroll and because garden leave provisions tend to be shorter in duration than traditional restrictive covenants, they are less onerous to the individual and thus more likely to be enforced.

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5. What Issues Might the SEC and/or NLRB Have with Employee Confidentiality Agreements?

By Aime Dempsey and Gregg Settembrino

It is a common practice for employers to obtain a written agreement from employees to refrain from disclosing company trade secrets and other confidential and proprietary information. Such agreements are structured to be effective after an employee departs, as well as while he or she is actively employed. Confidentiality and non-disclosure agreements can be an important tool in an employer's efforts to protect trade secret, business-sensitive, and other confidential information, but if they are not thoughtfully and carefully drafted, they could engender unwelcome scrutiny, or even enforcement action, from executive agencies, such as the U.S. Securities and Exchange Commission ("SEC") and the National Labor Relations Board ("NLRB"). The SEC and NLRB have shown interest in confidentiality provisions even in the absence of an existing action or a complaint from the employee.

The SEC, NLRB, and other executive agencies have expressed concerns that the prevalence and broad language of confidentiality agreements could prevent or discourage employees from engaging in lawful activities, such as whistleblowing, or otherwise reporting potential violations of law to outsiders, or engaging in concerted activity relating to the terms and conditions of their employment. Accordingly, the SEC and NLRB have each taken an aggressive stance that seeks to examine and limit the extent to which employers can require total confidentiality, even if such confidentiality agreements are not being enforced by the employer or otherwise involved in a dispute.

SEC Encourages Whistleblowing

The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted in 2010 ("Dodd-Frank"), among many other things, amended the Securities Exchange Act of 1934 ("Exchange Act") to encourage, and enhance protection of, whistleblowers who might have knowledge of a potential violation of securities and other laws. The new provision is Section 21F of the Exchange Act, entitled "Securities Whistleblower Incentives and Protection." The SEC adopted Regulation 21F, effective in August 2011, to implement the new provision, and established an Office of the Whistleblower to administer it. The SEC whistleblowing law provides for financial payments for whistleblowers who meet the appropriate standards, prohibits retaliation by employers against whistleblowers, and includes other protections. In 2014, as part of its administration of the Dodd-Frank whistleblowing provision, the SEC announced its intention to closely examine employee agreements that, in the agency's view, could discourage whistleblowers, in violation of Rule 21F-17 of the SEC's 2011 regulations.

Consistent with this expressed intent, on April 1, 2015, the SEC brought an enforcement action under Rule 21F-17 against KBR Inc. ("KBR"), a global-based technology and engineering firm. The enforcement action arose entirely out of the language of KBR's confidentiality agreements, even though the agreements were not enforced against any employee (i.e., no employee suffered any adverse action) and even though no employee appears to have complained to the SEC. During select internal investigations, including allegations of possible securities law violations, KBR required witnesses to sign confidentiality agreements that contained language warning that they could face discipline and even termination if they talked about the inquiries with outside parties without first receiving prior approval of KBR's legal department. Such terms are similar

to those in confidentiality agreements of numerous employers, but the SEC deemed the terms improperly restrictive language that could potentially impede whistleblowing.

As a result, the SEC obtained a settlement in which KBR agreed to (i) revise the confidentiality language to explicitly clarify that employees were free to report possible securities violations without employer approval or fear of retaliation, (ii) send out notices to that effect to current and former employees who had signed the confidentiality agreement containing the old language, and (iii) comply with a cease and desist order and pay a $130,000 fine to the SEC.

The clear message from the SEC is that any confidentiality provisions that may have the effect of discouraging whistleblowing, even by implication, could be problematic. Employees are not expected to automatically know or understand that, despite a general confidentiality requirement, they may bring potential violation of securities laws to SEC investigators. Rather, in order to be safe from enforcement action, such agreements should clearly provide that the employee is not only entitled to notify authorities of suspected violations of law but also does not have to seek permission from the employer before doing so, and cannot be subject to reprisals.

NLRB Protects Concerted Action

The NLRB has also moved on its own initiative to scrutinize confidentiality agreements, as well as employment manuals, handbooks, and other employee directives. In March 2015, the agency issued a General Counsel report ("Report") relating to employer rules. In its Report, the NLRB provided numerous examples of unlawful confidentiality provisions and rules.

For example, the NLRB indicated that an employer rule stating, "You must not disclose proprietary or confidential information about [the Employer, or] other associates (if the proprietary or confidential information relating to [the Employer's] associates was obtained in violation of law or lawful Company policy)" would be unlawfully overbroad because a reasonable employee would not understand how the employer determines what amounts to a "lawful Company policy."

In addition, a policy defining confidential information as "[A]ll information in which its [sic] loss, undue use or unauthorized disclosure could adversely affect the [Employer's] interests, image and reputation or compromise personal and private information of its members" is unlawful because employees have a National Labor Relations Act ("NLRA") Section 7 absolute right to complain about their wages and work conditions, and the right to discuss and share information in support of such complaints. As such, the NLRB found that a rule broadly prohibiting disclosure of employment information would reasonably, but unlawfully, lead employees to believe they could not even disclose information about the terms and conditions of employment, because it might negatively affect the employer's interest, image, or reputation.

The NLRB has enforced those policies very recently in a detailed decision regarding a challenge to numerous provisions of an employment manual maintained by employer Quicken Loans, Inc. and several other companies, colloquially known as the "Big

Book."[22] In *Quicken Loans*, the administrative law judge ("ALJ") painstakingly analyzed each of the challenged provisions separately and decided many of them violated Section 7 of the NLRA, while others did not.

For example, a rule in the employee handbook prohibiting disclosure of unspecified "confidential information" was deemed overly broad. Another rule was also found by the ALJ to unlawfully chill employees' rights to engage in protected activities, such as discussing workplace conditions and wages, in violation of Section 7, since the rule stated, in part, "[K]eep it confidential. What shouldn't you share? Non-public financial or operational information. This includes . . . anything with a dollar figure attached to it." Because employees unquestionably have a right, under the NLRA, to disclose and discuss salary and operation information, for example, the ALJ deemed the phrases "anything with a dollar figure attached to it" and "non-public financial or operational information" to be overly broad restrictions that employees would reasonably understand to prohibit protected activity.

In contrast, a more specific provision directing employees to keep confidential "private Company information, for example, information about financial performance, strategy, forecasts, etc.," was found to be permissible. The ALJ noted that employees would reasonably understand the more specific rule to be directed to the employer's interest in its own proprietary information, as opposed to information that employees are entitled to discuss and share.

Indeed, the lengthy *Quicken Loans* decision provides valuable guidance about the limitations on employers' efforts, through confidentiality agreements or otherwise, to protect confidential information from disclosure by employees.

What Employers Should Do Now

The more aggressive enforcement actions being taken by government agencies do not mean that employers must stop using confidentiality agreements. Employers, however, would be well advised to review existing agreements and revise them, if necessary, to ensure that they do not, intentionally or inadvertently, discourage or chill employees from taking lawful action, such as whistleblowing or engaging in concerted activity.

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[22] *In re Quicken Loans, Inc. et al*, Case 07-CA-145794 (2016).

For additional information about the issues discussed above, please contact the Epstein Becker Green attorney who regularly handles your legal matters or any of the authors of this *Take 5:*

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