

Changes to Confidentiality Clauses

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Why Pick This Topic?

- “Standard” types of confidentiality clauses may now be considered illegal
- The SEC has been aggressively enforcing
- Companies have agreed to penalties ranging from \$130,000 to \$6 million
- Trade secrets are often the significant value of the company
- New law requires new disclosures and carve-outs

Dodd-Frank Act (2011)

- Created a new “whistleblower” program under new Section 21F of the Securities Exchange Act of 1934
- Requires the SEC to pay cash awards to whistleblowers who provide original evidence about a securities law violation, leading to successful enforcement action
- More than \$140 million paid to date

SEC Rule 21F-17

- SEC implementing rules became effective August 12, 2011

Rule 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 communications.

- Individual means a human being, not a company
- Law may apply to private companies

KBR (2015) – No Surprise

- First SEC cease and desist order
- When doing internal investigations, KBR had employees sign a confidentiality agreement after interview, agreeing not to disclose anything to governmental authorities without pre-approval of the Law Department
- KBR agreed to pay \$130,000 fine and to tell current and former employees that they are free to communicate with government without pre-approval or any notice to company

SEC Cranks it Up

- Mid-2016 major change in approach
- Slew of new orders against public companies between June 2016 and January 19, 2017 (day before President Trump's inauguration)
- Merrill Lynch (6/16), Health Net (8/16), BlueLinx (8/16), Anhauser-Busch (9/16), SandRidge Energy (12/16), NeuStar (12/16), BlackRock (1/17), HomeStreet Bank (1/17)
- Doesn't matter if no whistleblower, no intent

What Violations Cited?

Focus on severance and separation agreements with departing employees that include:

- Confidentiality provisions without a clear exception to allow the individual to freely whistleblow to the SEC without notice/approval
- Similar non-disparagement provisions
- Similar restrictions on claims
- Waiver of right to recover whistleblower awards

Remedies Required

Usually:

- Cash penalties in 6 figures, occasionally 7 figures
- Fixing agreements and policies
- Contacting affected persons (including former employees) to inform them they can whistleblow and get awards

Logic Dictates ...

If separation agreements violate the law, then what about:

- Regular employment or consulting contracts with confidentiality provisions
- **Company** wide policies such as disclosure policies, codes of ethics, and other things that include confidentiality provisions

Unanswered Questions

- Will the SEC continue this policy under President Trump?
- Will the SEC go after private companies?
- Will the SEC go after people for other types of agreements and policies, or with respect to individuals who are not employees?

Recommendations

- Update your “forms” of employment agreement, consulting agreement, separation agreement, release of claims, etc. with individuals
- Update your company-wide policies
- Decide upon breadth of exception
- Consider how best to communicate
- Consider whether to amend existing agreements
- Consider what to do, if anything, regarding former employees

The Defend Trade Secrets Act

- Creates federal jurisdiction for trade secret misappropriation
- Effective for all misappropriation occurring after May 11, 2016
- Largely mirrors Uniform Trade Secrets Act
 - Similar definition of trade secret
 - Three year statute of limitations
 - Similar remedies
 - No requirement to state trade secrets with particularity
 - Prohibits injunctive relief based on inevitable disclosure doctrine
- Does not preempt state law

Fundamentals: Trade Secrets

- Includes formula, pattern, compilation, program, device, method, technique or process
 - Devices actual or patents with independent economic value from not being generally known
 - Is subject to efforts to maintain its secrecy
- Example of Trade Secrets
 - Proprietary data of regulated industry
 - Provide designs
 - Identities of suppliers
 - Precise types of materials preferred
 - Customer lists

The Defend Trade Secrets Act

- Provides *ex parte* seizure procedure
 - Extraordinary circumstances where the party against whom the seizure is ordered “would destroy, move, hide, or otherwise make such matter inaccessible to the court, if the applicant were to proceed on notice to such person....”
 - May be carried out immediately
 - Hearing not less than 7 days after issuance of order
- Protects whistleblowers who disclose trade secret information in confidence to government officials or private attorneys for purpose of reporting or investigating suspected violations of law

The Defend Trade Secrets Act— Responses

- Reevaluate tolerance for bringing trade secret claims
 - Federal courts have smaller case loads and less delay
- Review trade secret materials and evaluate protections to maintain their confidentiality
- Develop response plan for suspected misappropriation and seizure order
 - Decide in advance how you will respond to minimize business disruption and facilitate an immediate response to misappropriation

The DTSA & Confidentiality Agreements

- Immunity for whistleblowers must be disclosed when requiring confidentiality
- Failure to disclose defeats eligibility to recover double damages and attorneys' fees in litigation

What is “Confidential Information”?

- Broader than a trade secret
- Often formed by agreement
- Must be kept reasonably “confidential” – need to know basis
- Examples
 - Employment agreement
 - NDA
 - Severance agreement

Questions?



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