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SEC Settles Two More Whistleblower Protection Cases

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Continuing its efforts to bring enforcement actions for violations of whistleblower protections, the Securities and Exchange Commission recently settled two more cases. Both cases involved severance agreements that contained provisions that, the SEC asserted, expressly prohibited former employees from communicating with the government about possible violations of law. One of the cases also represented the SEC's first case involving retaliation for internal whistleblower reporting, as opposed to retaliation for reporting to the SEC. These cases demonstrate again the SEC's resolve to seek out and sanction corporate actions that it believes could chill reporting of possible legal violations. The orders once again highlight the importance of compliance with the SEC's whistleblower rules.

Non-Disparagement Clause Prohibiting Government Reporting—Neustar

On December 19, 2016, Neustar, Inc., settled a charge that it violated Rule 21F-17[1] when it included in severance agreements a broad non-disparagement clause that expressly prohibited the employee from communicating negative information about the company and others to, among others, government agencies including the SEC.[2] The company was fined $180,000 and agreed to a cease-and-desist order.

The non-disparagement provision at issue read:

> [E]xcept as specifically authorized in writing by Neustar or as may be required by law or legal process, I agree not to engage in any communication that disparages, denigrates, maligns or impugns Neustar or its officers, directors, shareholders, investors, potential investors, partners, predecessors, subsidiaries, employees, consultants, attorneys, or any others associated with Neustar, including but not limited to communications with accountants, investment bankers, commercial bankers, insurance brokers or carriers, media, journalists, reporters, equity analysts, investors, potential investors, customers, suppliers, competitors, joint venture partners and regulators (including but not limited to the ***Securities and Exchange Commission***, the Federal Communications Commission, the Canadian Radio-television Telecommunications Commission, the North American Numbering Council, the Canadian LNP Consortium, Inc., the LNPA Working Group, the United States Department of Commerce, the Internet Corporation for Assigned Names and Numbers, the Alliance for Telecommunications Industry Solutions, the

> North American Portability Management, LLC, public utility commissions and industry associations (including but not limited to the GSM Association, the United States Telecom Association, CTIA-The Wireless Association and COMPTEL)) (emphasis added).[3]

The form of severance agreement also provided that, in the event of a breach, the employee would forfeit all but $100 of the severance compensation payable under the agreement.[4] Neustar included this language in at least 246 agreements between August 2011 and May 2015.[5] The SEC stated that while the company did not attempt to enforce the non-disparagement clause, "at least one" former employee was impeded from communicating with the SEC.[6]

The order notes that Neustar dropped references to "regulators" from the clause promptly and voluntarily after the SEC's investigation began.[7] The company also revised the clause to include affirmative language advising former employees of their right to contact regulators: "[N]othing herein prohibits me from communicating, without notice to or approval by Neustar, with any federal government agency about a potential violation of a federal law or regulation."[8] The company agreed to make reasonable efforts to contact the former employees who signed the agreement with the violative language and tell them that the company does not prohibit the former employees from communicating with the SEC about legal violations.[9]

Prohibition on Contacts with SEC and Retaliation Against Internal Whistleblower—SandRidge Energy

On December 20, 2016—the day after the Neustar order—SandRidge Energy, Inc., settled SEC charges that SandRidge had violated Rule 21F-17 by including covenants in separation agreements that prohibited communications with government agencies and that, in violation of section 21F(h) of the Exchange Act,[10] SandRidge had retaliated against a whistleblower who had attempted to raise concerns internally about the company's processes for valuing oil reserves.[11] According to SEC Whistleblower Office Chief Jane Norberg, this case represented "the first time a company is being charged for retaliating against an internal whistleblower."[12] SandRidge agreed to a $1,400,000 penalty and a cease-and-desist order.

Prohibitions on Communications with Government Agencies

> According to the SEC order, SandRidge used a form of separation agreement from August 2011 to April 2015 that precluded the former employee from voluntarily cooperating with a government agency in any complaint or investigation concerning the company. The agreement provided that a former employee could not at any time in the future voluntarily contact or participate with any governmental agency in connection with any complaint or investigation pertaining to the Company, and [may] not be employed or otherwise act as an expert witness or consultant or in any similar paid capacity in any litigation, arbitration, regulatory or agency hearing or other adversarial or investigatory proceeding involving the Company.[13]

The form separation agreement also contained a confidentiality provision that required employees to agree not to disclose any of the company's confidential or proprietary information to any other person or organization, "including any governmental agency."[14] The agreement also prohibited the former employee from making disparaging statements about the company and others to, among

others “any governmental or regulatory agency.”[15]

The SEC stated that after Rule 21F-17 was adopted, several employees or officers requested that the problematic language be modified in severance agreements submitted to them. SandRidge agreed to modify the language when an employee explicitly required it, but the company continued to use the violative language in agreements that were provided to employees who did not identify the issue.[16] From August 2011 through April 2015, approximately 546 employees signed separation agreements with some or all of the problematic provisions. Another 240 employees received a form including some or all of the provisions. As part of a planned reduction in force, SandRidge entered into 113 separation agreements on or after April 1, 2015, the day the SEC announced its settlement with KBR for violating Rule 21F-17.[17] Although SandRidge's in-house counsel received “multiple client alerts” on *KBR* and asked SandRidge's employment counsel to revise the form separation agreement, SandRidge did not change the violative language in the agreements used for the reduction in force.[18]

The SEC stated that the “potential for its officers and employees to communicate with the Commission was not merely a hypothetical concern for SandRidge,” because many of these agreements were in effect during a time when SandRidge was subject to investigation by the SEC. The SEC was not able to determine if any former officers or employers did not report to or communicate with the SEC because of the violative provisions. However, the SEC stressed that the violative provisions “expressly limited an employee's ability to communicate possible securities law violations with any governmental agency.”[19] The SEC staff contacted SandRidge in May 2015 about potential violations of Rule 21F-17, in response to which SandRidge took steps to remediate by amending the agreements and corporate policies and communicating with current and former employees about the change.[20] Still, in February 2016, the SEC contacted a former employee who, through counsel, declined to cooperate based on the prohibitions in the separation agreement. The employee adhered to this position even after the SEC pointed the employee to the company's notice to employees that the violative provisions were no longer in effect.[21]

Retaliation for Internal Reporting

Separately, the SEC alleged that SandRidge retaliated against an employee who, over a two-and-a-half-year period, raised concerns internally about the company's process for calculating oil and gas reserves that are reported in the company's periodic reports filed with the SEC. In the spring of 2014, SandRidge's internal audit department started an audit of the reserves process, but in December 2014, the whistleblower strongly disagreed with internal audit's draft report.[22] In January 2015, the draft report was revised to address the whistleblower's concerns and the whistleblower agreed with the changes, but the internal audit was never completed and a final version of the report was never disseminated to the company's board or audit committee.[23] The whistleblower continued to raise his concerns through mid-March 2015.[24] On or about March 31, 2015, SandRidge senior management decided to terminate the whistleblower. The order states that management “expressed among themselves their belief that the manner in which the Whistleblower was raising concerns regarding the reserve process was disruptive, and that the company could replace the Whistleblower with someone 'who could do the work without creating all of the internal strife.'”[25] The

company terminated the whistleblower on April 1, 2015, the same day it made the large scale reduction in force. The company and the whistleblower began negotiating a separation agreement which, according to the SEC, contained the violative provisions notwithstanding the SEC's *KBR* order (though the company ultimately agreed to delete it) and even though the company had provided the name of the whistleblower and a summary of the whistleblower's allegations to the SEC in response to a subpoena.[26]

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The SEC's two latest orders provide more confirmation—if any was needed—that the SEC considers illegal any severance agreement provisions that expressly preclude communications with government agencies about potential violations of law. Moreover, the SEC is prepared to sanction companies that included such provisions in severance agreements at any time after August 12, 2011, even before the SEC's April 2015 announcement of the *KBR* order. In addition, the SEC will hone in on surrounding facts that suggest that a company persisted in using violative provisions notwithstanding reasons to question their validity. In the *SandRidge* order, these circumstances included removing the clauses when an employee or counsel objected, but not when the employee did not raise the issue; continuing to use the violative clauses even during an active SEC investigation; and continuing to use the clauses even after in-house counsel received "multiple client alerts" about the *KBR* order. The SEC's citation of a former employee's unwillingness to cooperate due to the violative provisions serves to highlight this point. Finally, the *SandRidge* order provides another example of the SEC's aggressive approach to alleged retaliation against whistleblowers, whether they report possible legal violations to the SEC or just internally.

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[1] 17 C.F.R. § 240.21F-17. Rule 21F-17(a) provides that "[n]o person may take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation."

[2] Order Instituting Cease-and-Desist Proceedings, *In re Neustar, Inc.*, Exchange Act Release No. 79593 (Dec. 19, 2016), www.sec.gov/litigation/admin/2016/34-79593.pdf.

[3] *Id.* ¶ 5.

[4] *Id.* ¶ 6.

[5] *Id.* ¶ 7.

[6] *Id.* ¶ 8.

[7] *Id.* ¶ 10.

[8] *Id.*

[9] *Id.* ¶ 11.

[10] 15 U.S.C. 78u-6(h).

[11] Order Instituting Cease-and-Desist Proceedings, *In re SandRidge Energy, Inc.*, Exchange Act Release No. 79607 (Dec. 20, 2016), www.sec.gov/litigation/admin/2016/34-79607.pdf (SandRidge Order).

[12] SEC Press Release, *Company Settles Charges in Whistleblower Retaliation Case* (Dec. 20, 2016), www.sec.gov/news/pressrelease/2016-270.html.

[13] SandRidge Order, ¶ 6.

[14] *Id.* ¶ 7.

[15] *Id.* ¶ 8.

[16] *Id.* ¶ 9.

[17] *Id.* ¶ 12, citing In re KBR, Inc., No. 3-16466 (Apr. 1, 2015).

[18] SandRidge Order, ¶ 12.

[19] *Id.* ¶ 13.

[20] *Id.* ¶¶ 15-16.

[21] *Id.* ¶ 17.

[22] *Id.* ¶¶ 19-20.

[23] *Id.* ¶ 22.

[24] *Id.* ¶¶ 23-24.

[25] *Id.* ¶ 25.

[26] *Id.* ¶ 26.

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