SEC Announces Two Enforcement Actions Regarding Restrictive Language in Severance Agreements

December 22, 2016

The SEC issued two orders concerning violations of Exchange Act Rule 21F-17 this week. On December 19, the Commission issued an order concerning NeuStar Inc., a technology company based in Virginia, and on December 20 it issued an order for SandRidge Energy Inc., an oil-and-gas company based in Oklahoma City. In an interview with the Wall Street Journal, the Chief of the SEC's Office of the Whistleblower stated, "This is going to remain a focus for my office in 2017 and I expect you will see additional cases brought under this authority."

NeuStar

In a cease-and-desist order accompanied by a press release, the SEC charged NeuStar, Inc. with violating Rule 21F-17, which prohibits companies from taking any action to impede whistleblowers from reporting possible securities violations to the SEC.[1] NeuStar had entered into voluntary severance agreements with employees beginning in approximately 2008 through about May 21, 2015 that included a nondisparagement clause that explicitly limited, "except as specifically authorized in writing by NeuStar or as may be required by law or legal process," any communication with the SEC and other regulators that "disparages, denigrates, maligns or impugns" NeuStar by former employees who had signed the agreement. The severance agreement also contained a forfeiture clause that compelled former employees to surrender all but $100 of their severance compensation if they breached the nondisparagement clause.

While the SEC noted that it was not aware of any instances of NeuStar taking steps to enforce the nondisparagement clause, which was included in at least 246 severance agreements between August 12, 2011 through May 21, 2015, the order asserted that the agreement language impeded "at least one" former employee from communicating with the SEC.

In connection with the resolution, Antonia Chion, Associate Director of the Enforcement Division, stated: "Public companies cannot use severance agreements to impede whistleblowers from communicating with the SEC about a possible securities law violation. NeuStar's severance agreements broadly prohibited former employees from communicating any disparaging information about the company to the SEC, and unsurprisingly at least one former NeuStar employee was chilled by such language." Jane Norberg, Chief of the Office of the Whistleblower, said, "This action demonstrates our continued strong enforcement of this critically important whistleblower protection rule and underscores our ongoing commitment to ensuring that potential whistleblowers can freely communicate with the SEC about possible securities law violations."

[1] In re NeuStar, Inc., No. 3-17736 (December 19, 2016).

As part of the settlement, NeuStar agreed to pay a $180,000 penalty without admitting or denying the charges. NeuStar had, shortly after the investigation began, voluntarily amended its severance agreement template to remove references to regulators and to explicitly state that "nothing 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."

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Under the settlement, NeuStar has also undertaken to contact employees who had signed the severance agreement between August 12, 2011 and May 21, 2015 and provide those employees with the SEC order and an explanatory statement. NeuStar agreed to provide certification of its compliance with the undertaking to the SEC.

SandRidge Energy

One day following the release of the NeuStar settlement, the SEC issued a **cease-and-desist order**, also accompanied by a **press release**, charging SandRidge Energy Inc. with violating Rule 21F-17 along with Section 21F(h) of the Exchange Act, which prohibits companies from retaliating against whistleblowers.[2]

Rule 21F-17 Violations

The SEC focused on separation agreements SandRidge made with employees from at least August 12, 2011 through about April 2015 that included three clauses the SEC found problematic under Rule 21F-17: (1) a "Future Activities" provision, which stated that former employees could not voluntarily cooperate with any governmental agency with regard to any complaint or investigation concerning the company; (2) a "Confidential Information" provision, which required employees not to make independent use of or disclose "confidential, proprietary" information to government agencies without prior writer consent from the company; and (3) a "Preserving Name and Reputation" provision, which required employees not to "defame, disparage or make statements or disparaging remarks which could embarrass or cause harm to SandRidge's name and reputation or the names and reputation of any of its officers, directors, representatives, agents, employees or SandRidge's current, former or prospective vendors, professional colleagues, professional organizations, associates or contractors, to any governmental or regulatory agency [. . .]."

The order notes that, after Rule 21F-17 had gone into effect, the company had conducted multiple reviews of its standard agreement language. The order states that SandRidge had revised the problematic language for some agreements, generally when it was flagged by an employee or an employee's counsel, but did not replace the standard form's language. Between August 2011 and April 2015, the SEC found that about 546 former employees had signed separation agreements with all or some of the three provisions mentioned above and that about 240 additional employees had received a form separation agreement, containing all or some of these provisions, attached to their employment agreement. The SEC noted that about 113 separation agreements were entered as part of a planned reduction-in-force on or after April 1, 2015, when the SEC announced its first enforcement action (against KBR Inc.) for violations of Rule 21F-17.[3] The order states that, despite SandRidge's in-house counsel receiving client alerts and other information about the KBR matter and directing outside counsel to change the standard language of its separation agreements, they did not change the language used in the agreements for the reduction in force that was ongoing at the time.

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[2] In re SandRidge Energy, Inc., No. 3-17739 (December 20, 2016).

[3] See In re KBR, Inc., No. 3-16466 (April 1, 2015).

The Commission noted that, in response to being contacted by the SEC on May 11, 2015, SandRidge had from June 2015 through July 2015 revised its form agreements and communicated the changes to current and former employees, advising them that the provisions were no longer in effect. Revisions included (1) removing from the "Future Activities" provision the prohibition on "contacting or participating with" a government agency in connection with a complaint or investigation about the company, (2) amending the "Confidential Information" and "Preserving Name and Reputation" provisions to remove reference to government agencies, and (3) adding an "Exceptions to Restrictions on Communications, Confidentiality and Future Activities" provision stating that nothing in the agreement is intended to prohibit reporting of possible violations of federal law or regulation to a government agency or entity. SandRidge also amended several corporate codes and policies, such as its Code of Business Conduct and Ethics, Anti-Retaliation Policy, Conflicts of Interest Policy, Legal Matters Policy, and Securities Trading Policy, to remove general prohibitions on third-party communications and requirements to notify the company about contact by the government.

Despite these changes, the order notes that in February 2016 the SEC contacted a former employee's counsel who refused to speak with the SEC, citing the "Future Activities" provision, even after the SEC informed the employee's counsel about the remediation letter SandRidge had sent employees.

Rule 21F(h) Violations

The order also describes an internal whistleblower (the "Whistleblower") at SandRidge who was fired after repeatedly raising concerns about SandRidge's calculation process regarding the oil and gas reserves it reported to the SEC, which led to an internal audit that was commenced but never completed. SandRidge had decided to offer The Whistleblower a promotion in December 2014. According to the SEC, the Whistleblower had seen a draft report describing the audit later that December, which he did not believe addressed his concerns. Afterward on the same day, the Whistleblower was offered the promotion conditioned in part on assurances that he would be supportive of the company and its management. He declined due to his ongoing concerns, which he raised again on several occasions in early 2015. By March 2015, SandRidge was considering possible termination of the Whistleblower and searched his emails for potential disparaging remarks about the company or the reserves calculation process and for terms including "SEC." On or about March 2015, the decision was made to terminate the Whistleblower, in part because of the way he had raised concerns, and replace him with someone who, in the words of senior management, "could do the work without creating all of the internal strife."

The Whistleblower was terminated on April 1, 2015, the same day the company began its large-scale reduction in force. The Whistleblower received the standard form separation agreement, which contained provisions that would have precluded him from communicating with the Staff. The Whistleblower's counsel requested on May 28, 2015 that the company "remov[e] the provisions that violate federal law." The order notes that the company stated it would not comply with the request until it had reviewed the matter, including by interviewing the Whistleblower, even though the KBR decision had been released nearly two months prior and SandRidge had already provided the Whistleblower's name and a description of his allegations to the SEC in response to a subpoena. SandRidge did remove the provisions from the agreement on June 9, 2015, but the agreement has not been signed.

Penalty

As part of the settlement, SandRidge agreed to pay a $1.4 million penalty without admitting or denying the charges and subject to its bankruptcy plan.

In the SEC press release, Shamoil T. Shipchandler, Director of the Fort Worth Regional Office, stated, "Ignoring a rule that protects communications between outgoing employees and the SEC, SandRidge flatly prohibited such contact in their separation agreements and at the same time retaliated against an employee who raised concerns about the company to its management." Norberg added, "Whistleblowers who step forward and raise concerns internally to their companies about potential securities law violations should be protected from retaliation regardless of whether they have filed a complaint with the SEC. This is the first time a company is being charged for retaliating against an internal whistleblower, and the second enforcement action this week against a company for impeding employees from communicating with the SEC."

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