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SEC Continues Enforcement Initiative, Finds Non-Disparagement Clauses in Severance Agreements Restricting Communications with Regulators Violate Whistleblower Protections.

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The U.S. Securities and Exchange Commission's ("**SEC**") Rule 21F-17 prohibits any action impeding an individual from communicating directly with the SEC about a possible securities law violation.

In October 2016, the SEC Office of Compliance Inspections and Examinations announced that enforcement of this Rule would be a priority for the SEC. Two recent SEC orders demonstrate that the SEC intends to pursue this initiative by taking action involving severance agreements that ostensibly prohibit former corporate employees from communicating with the SEC.

On December 19, 2016, the SEC issued a cease-and-desist order (the "**NeuStar Order**"), finding that NeuStar, Inc. violated Rule 21F-17 by including a non-disparagement clause in its severance agreements that prohibited former employees from communicating with regulators, including the SEC. The NeuStar Order was part of a settlement in which NeuStar paid a $180,000 fine and undertook to revise the agreement and notify all former NeuStar employees of their right to communicate with federal agencies.

A day later, on December 20, 2016, the SEC issued a cease-and-desist order (the "**SandRidge Order**"), finding that SandRidge Energy, Inc. violated Rule 21F-17 by including provisions in its form separation agreements that prohibited cooperation or contact with government agencies. SandRidge also allegedly retaliated against an internal whistleblower. SandRidge settled with the SEC, consenting to the entry of the SandRidge Order and agreeing to pay a US$1.4m fine.

In light of these decisions, employers should closely review their severance agreements for similar clauses restricting former employees from communicating with the SEC and, where necessary, revise those agreements to comply with whistleblower protections, as discussed below.

Dodd-Frank's Whistleblower Protection and Rule 21F-17

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") amended the Securities Exchange Act of 1934 by adding Section 21F, titled "Whistleblower Incentives and Protection," which encourages whistleblowers to report possible securities law violations by offering, among other things, bounties and confidentiality guarantees.

To protect whistleblowers, the SEC adopted Rule 21F-17, which provides, in part, that "[n]o 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."

This Rule became effective on August 12, 2011.

Enforcement of Rule 21F-17 has recently become a priority for the SEC, as highlighted in a "Risk Alert" promulgated in October 2016 by the SEC's Office of Compliance Inspections and Examinations. This is reflected in a number of recent actions by the SEC to enforce Rule 21F-17.

In a 2015 enforcement action, the SEC found that KBR Inc. violated Rule 21F-17 where a confidentiality agreement threatened discipline against employees who communicated with federal agencies about the subject of an internal investigation without approval from general counsel. This year, the SEC has brought a number of similar actions, including against Health Net, Inc. (regarding severance agreements) and Merrill Lynch (regarding confidentiality agreements). In August, the SEC found BlueLinx Holdings, Inc., violated this Rule where a severance agreement prohibited disclosure of financial or business information to any third parties, without expressly exempting the SEC.

The whistleblower bounty program has been an important component of the SEC's enforcement strategy. Since the program's inception, the SEC has awarded more than US$130m to whistleblowers. In the last year alone, the SEC has issued at least 11 whistleblower awards, including a US$17m award in June, a US$22m award in August, and a US$20m award in November.

NeuStar's Non-Disparagement Clause and Settlement

Beginning in 2008, NeuStar's voluntary severance agreements with departing employees included a non-disparagement clause, which provided, in relevant part:

[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 . . . regulators (including but not limited to the Securities and Exchange Commission . . .).

Under the severance agreements, violation of this non-disparagement clause would compel former employees to forfeit all but US$100 of any severance compensation.

Beginning May 21, 2015, promptly after the SEC began its investigation, NeuStar revised the language in its severance agreements to strike any reference to “regulators,” and to expressly inform former employees of their right to communicate with federal agencies.

Between August 12, 2011 and May 21, 2015, at least 246 employees signed severance agreements with the problematic non-disparagement clause. The SEC conceded that it was unaware of any instances in which NeuStar sought to enforce the faulty provision, but apprehension about the severance agreement impeded at least one former employee from communicating with the SEC.

In anticipation of proceedings, NeuStar proactively settled with the SEC, agreeing to entry of a cease-and-desist order and to a fine of US$180,000, though it neither admitted nor denied the SEC’s findings.

SandRidge’s Separation Agreement and Settlement

SandRidge’s standard separation agreement likewise contained a number of clauses purporting to prohibit former employees from communicating with federal agencies. Among these clauses were:

> **A “Future Activities” provision** stating that a former employee may 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.”

> **A “Confidential Information” provision** requiring that employees agree “not to make any independent use of or disclose to any other person or organization, including any governmental agency, any of the Company’s confidential, proprietary information unless [the employee] obtain[ed] the Company’s prior written consent.”

> **A “Preserving Name and Reputation” provision** requiring that employees “not at any time in the future 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 government or regulatory agency or to the press or media."

As early as April 2012, SandRidge revised the form separation agreement for individual employees when modification was requested, but all separation agreements included at least one of the above problematic provisions, and SandRidge never modified its form separation agreement to comply with Rule 21F-17.

From August 2011 through April 2015, approximately 546 former employees of SandRidge signed separation agreements that contained all or some of the above provisions, and 240 additional employees received a form of the separation agreement attached to their employment agreement. Many of the problematic separation agreements were signed after announcement of the KBR decision, referenced above. Further, SandRidge continued to enter into these separation agreements even after the SEC had begun its investigation.

Ultimately, SandRidge agreed to modify its form separation agreement to comply with Rule 21F-17, removing references to government agencies in the agreement's "Future Activities," "Confidential Information," and "Preserving Name and Reputation" provisions, and including a new "Exceptions to Restrictions on Communications, Confidentiality and Future Activities" provision. Even so, at least one witness continued to refuse cooperation with the SEC, citing concerns about the "Future Activities" provision in the employee's separation agreement.

Separately, the SEC claimed that SandRidge terminated an internal whistleblower in retaliation for raising concerns about the company's process in calculating oil and gas reserves, as reported in periodic reports filed with the SEC.

In anticipation of proceedings, SandRidge proactively settled with the SEC, agreeing to entry of a cease-and-desist order and to a fine of US$1.4m, though it neither admitted nor denied the SEC's findings. In the SandRidge Order, the SEC determined that SandRidge's separation agreements violated Rule 21F-17, and that its retaliation against the whistleblower violated Section 21F(h) of the Exchange Act.

While not articulated specifically by the orders, the disparity in the fines between SandRidge (US$1.4m) and NeuStar (US$180,000) likely reflects the additional allegations of whistleblower retaliation against SandRidge, as well as SandRidge's evident intent to avoid and delay compliance with Rule 21F-17.

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Conclusion

The NeuStar and SandRidge Orders make clear that clauses prohibiting former employees from communicating with the SEC violate Rule 21F-17 of the Exchange Act. In the NeuStar Order, the SEC recognized the following revision to the severance agreement as a remedial measure:

In addition, 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.

The SandRidge Order endorsed a similar "Exceptions to Restrictions on Communications, Confidentiality and Future Activities" provision.

In light of the potential for SEC investigation, fines and reputational harm, employers should review their standard severance agreements to ensure compliance with whistleblower protections.

Companies should also refrain from taking any action that could be seen to discourage whistleblower complaints, including threatening to retaliate or enforce severance agreements against whistleblowers.

Non-U.S. companies should also consider reviewing their severance agreements, as the law is not yet settled regarding the extraterritorial application of Rule 21F-17. In 2014, the Second Circuit Court of Appeals held in *Liu Meng-Lin v. Siemens AG* that the anti-retaliation provisions of the Dodd-Frank whistleblower program do not apply outside the United States. The court questioned, but did not decide, whether this territorial restriction would also apply to the SEC's regulations with respect to the bounty program (as opposed to the anti-retaliation provisions). Later that year, the SEC issued a bounty to a foreign claimant, finding that Rule 21F-3 had extraterritorial reach. In so doing, the SEC found that *Liu Meng-Lin* was not controlling, as "the whistleblower award provisions have a different Congressional focus than the anti-retaliation provisions." (Release No. 34-73174). This distinction, and how it would apply specifically to Rule 21F-17, has not yet been tested in the courts.

Please do not hesitate to reach out to any of your Linklaters contacts for further discussion or for advice.

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