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ALERT MEMORANDUM

SEC Continues Enforcement of Whistleblower Protection Rules with Action Against Company for Improper Separation Agreement Language and Retaliation

January 5, 2017

On Tuesday, December 20, 2016, the SEC announced an enforcement action against a company for entering into separation agreements with employees containing provisions that restricted their ability to communicate potential securities law violations to the SEC, and for retaliating against a whistleblower who voiced concerns internally. The action against SandRidge Energy, Inc., an Oklahoma City-based oil and gas company, signals the SEC's continued commitment to enforcing Dodd-Frank's whistleblower protection provisions, including by bringing actions for retaliation against employees.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or any of our partners and counsel listed under White Collar Defense and Investigations in the "Our Practice" section of our website.

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Background

The Dodd-Frank Act and its implementing rules provide for the protection of company whistleblowers. Specifically, Rule 21F-17, which became effective on August 12, 2011, provides, in relevant part:

> (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.[1]

In addition, Section 21F(h)(1) of the Securities Exchange Act, added by Dodd-Frank, provides whistleblowers protection against retaliation from employers.[2] This provision applies to reports employees make internally to a supervisory or other authority as set forth in the Sarbanes-Oxley Act.[3]

The SEC has brought several enforcement actions involving these provisions. In April 2015, the SEC brought its first enforcement action under Rule 21F-17 against KBR, Inc. for using restrictive language in confidentiality agreements in connection with internal investigations.[4] The KBR action made clear that the SEC considers the existence of an agreement with the potential to impede communication with the SEC, and not its enforcement, to violate the rule. More recently, on December 19, 2016, the SEC announced an action against NeuStar Inc., a technology company, for using severance agreements with non-disparagement clauses which limited the ability of employees to communicate with the SEC.[5] With respect to the anti-retaliation provision, the SEC first brought an enforcement action in June 2014 against Paradigm Capital Management, a hedge fund advisory firm, alleging that retaliatory actions were taken against a trader who had reported potentially prohibited transactions to the SEC.[6] The order alleged that Paradigm removed the trader from his position, took away his supervisory responsibilities, moved him to compliance and had him investigate the very conduct he had reported.

In re SandRidge Energy, Inc.

According to the SEC's cease-and-desist order, from at least August 2011 through April 2015, SandRidge entered into separation agreements with departing employees containing three provisions of concern to the SEC.[7]

- First, a "Future Activities" provision required employees, in relevant part, not to "voluntarily contact or participate with any governmental agency in connection with any complaint or investigation pertaining to the Company," and prohibited employees from participating "in any . . . paid capacity in any litigation, arbitration, regulatory or agency hearing or other adversarial or investigatory proceeding involving the Company."

- Second, a provision on "Confidential Information" prohibited employees from "disclos[ing] to any other person or organization, *including any governmental agency*, any of the Company's confidential, proprietary information" absent the company's prior consent (emphasis added).

- Third, a provision called "Preserving Name and Reputation" prevented employees from making disparaging statements about SandRidge to, among others, any government or regulatory agency.

[1] 17 C.F.R. § 240.21F-17(a).

[2] 15 U.S.C. § 78u-6(h)(1).

[3] *See* 18 U.S.C. 1514A(a).

[4] *See* KBR, Inc., SEC Release No. 74619 (Apr. 1, 2015), available at https://www.sec.gov/litigation/admin/2015/34-74619.pdf

[5] *See* NeuStar Inc., SEC Release No. 79593 (Dec. 19, 2016), available at https://www.sec.gov/litigation/admin/2016/34-79593.pdf

[6] *See* Paradigm Capital Management, Inc., SEC Release No. 72393 (June 16, 2014), available at https://www.sec.gov/litigation/admin/2014/34-72393.pdf

[7] SandRidge Energy, Inc., SEC Release No. 79607 (Dec. 20, 2016), available at https://www.sec.gov/litigation/admin/2016/34-79607.pdf

The company had been made aware of the problematic language by employees but had not modified its standard separation agreement to correct it.

The SEC order concluded that SandRidge's separation agreements violated Rule 21F-17 because they "expressly limited an employee's ability to communicate possible securities law violations with any governmental agency," and by "impeding" communication with the SEC.

Separately, the order also detailed SandRidge's retaliation against an internal whistleblower who had expressed concerns to senior management about the company's calculation of oil and gas reserve amounts. In 2014, SandRidge responded by beginning an internal audit of the process at issue, but never completed the audit or reported its results to the Board.

In December 2014, SandRidge offered the whistleblower a promotion but asked for assurances of the whistleblower's commitment to support management and the company. The whistleblower refused to provide such assurances and turned down the promotion based on concerns about the reserves process. After the whistleblower continued to raise concerns, in March 2015 senior management discussed terminating the whistleblower as part of a reorganization process. The company also conducted a search to see if the whistleblower had emailed the SEC or other external parties about the concerns.

The company fired the whistleblower in April 2015 in order to find someone "who could do the work without creating all of the internal strife." The SEC order found that these actions violated Section 21F(h).

Pursuant to the SEC order, SandRidge agreed to pay a penalty of $1.4 million, and neither admitted nor denied the SEC findings.

Takeaways

The SandRidge action signals the SEC's intention to continue to enforce the Dodd-Frank whistleblower protection provisions, following up on its prior orders in the KBR, NeuStar and Paradigm Capital Management actions. In particular, the order reaffirms the Enforcement Division's view that the existence of routine confidentiality, non-disparagement and other provisions in company agreements or policies that could impede communication with the SEC violates Rule 21F-17. While the SEC found that SandRidge's language was explicit in prohibiting communication with governmental agencies, the order and the SEC actions in KBR and NeuStar make clear that the SEC will also treat as violations any provisions that, in the absence of an express prohibition, could be read to imply a limitation on such communication. Nonetheless, SEC Chair Mary Jo White has been clear that "[c]ompanies may continue to protect their trade secrets or other confidential information through the use of properly drawn confidentiality and severance agreements."[8]

Given the SEC's continued enforcement, companies should consider several options for reducing the risk of running afoul of the rule in employment, confidentiality and separation and release agreements, as well as other routine agreements with, and policies applicable to, employees. The clearest way to avoid this risk is to include language in each such agreement or policy that expressly carves out from any restrictions the ability of an employee to make reports of possible violations of federal law or regulation to any governmental agency or entity in accordance with Section 21F or other whistleblower protection provisions of federal law or regulation. Companies should also consider proactively updating their policies and employee handbooks to include such carve-outs. Though this approach is advisable in respect of prospective agreements, it may be impractical in respect of existing agreements. In that circumstance, an alternative approach is to provide written notice to all employees, and former employees bound by any such agreements, that nothing in any agreement, employee handbook, or other policy should be interpreted to prohibit or in any way impede the ability of an employee to make reports of the nature described above. Indeed, SEC Chair White voiced approval after

[8] Mary Jo White, Chair, SEC, The SEC as the Whistleblower's Advocate (Apr. 30, 2015), available at https://www.sec.gov/news/speech/chair-white-remarks-at-garrett-institute.html

KBR, in its agreement with the SEC, agreed to follow such a notification approach.[9]

The order also demonstrates the SEC's intention to enforce the anti-retaliation provision broadly. In the press release announcing the action, the SEC highlighted that it is "the first time a company is being charged for retaliating against an internal whistleblower," stating that "[w]histleblowers 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."[10]

Accordingly, companies should continue to make sure they have appropriate policies and procedures in place that specifically prohibit retaliation against employees who raise concerns internally and protect such employees. In particular, companies should undertake reasonable investigations of whistleblower concerns and document those efforts. Moreover, if a company later decides to take action against an employee who had previously raised concerns, there should be a clear record showing the action is unrelated to the employee's activity as a whistleblower.

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[9] *Id.*

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