

# Memorandum

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## SEC Brings Enforcement Action For Violation of Its Whistleblower Protection Provision

August 16, 2016

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On August 10, 2016, the Securities and Exchange Commission (“SEC”) instituted and settled cease-and-desist proceedings against BlueLinx Holdings Inc. for allegedly violating Rule 21F-17 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) by incorporating in severance agreements “impediments to participation by its employees in the SEC’s whistleblower program.”<sup>1</sup> This action follows the SEC’s April 2015 settlement with technology and engineering firm KBR, Inc. in connection with confidentiality agreements that the SEC described as “improperly restrictive” under Rule 21F-17.<sup>2</sup>

Section 21F of the Exchange Act was added by the Dodd-Frank Act in order to “encourage whistleblowers to report possible violations of the securities laws by providing financial incentives, prohibiting employment-related retaliation, and providing various confidentiality guarantees.”<sup>3</sup> To effectuate this purpose, the SEC adopted Rule 21F-17, which provides 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.”

According to the SEC’s order instituting cease-and-desist proceedings, for the past five years BlueLinx entered into severance agreements with departing employees, most of which prohibited the employee from

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<sup>1</sup> Securities and Exchange Commission, *In the Matter of BlueLinx Holdings Inc.*, Release No. 78528, File No. 3-17371 (Aug. 10, 2016), at 4.

<sup>2</sup> For more information regarding the enforcement action against KBR, see Simpson Thacher & Bartlett LLP, [“The SEC Brings Its First Enforcement Action Involving Confidentiality Provisions That Have the Potential to Silence Employees From Reporting Suspected Misconduct to the SEC”](#) (Apr. 3, 2015).

<sup>3</sup> Securities and Exchange Commission, “Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934,” Release No. 34-64545; File No. S7-33-10, at 197 (Aug. 12, 2011).

sharing confidential information concerning the company with any third party, “unless compelled to do so by law or legal process.” Additionally, some of these confidentiality provisions required the employee “either to provide written notice to the company or to obtain written consent from the company’s legal department prior to providing confidential information pursuant to such legal process.” As noted by the SEC, “[n]one of the confidentiality provisions contained an exemption permitting an employee to provide information voluntarily to the Commission or other regulatory or law enforcement agencies.”

Around June of 2013 – “nearly two years after the Commission had adopted Rule 21F-17” – BlueLinX allegedly reviewed and revised its severance agreements and “either added or amended a number of provisions that a departing employee was required to accept as a condition for receiving monetary severance payments and other consideration from BlueLinX.” Most notably, BlueLinX added the following clause to all of its form severance agreements:

Employee further acknowledges and agrees that nothing in this Agreement prevents Employee from filing a charge with . . . the Equal Employment Opportunity Commission, the National Labor Relations Board, the Occupational Safety and Health Administration, the Securities and Exchange Commission or any other administrative agency if applicable law requires that Employee be permitted to do so; however, Employee understands and agrees that Employee is waiving the right to any monetary recovery in connection with any such complaint or charge that Employee may file with an administrative agency.<sup>4</sup>

According to the SEC, through this provision BlueLinX “removed the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations.” In addition, explained the SEC, “[b]y requiring departing employees to notify the company’s Legal Department prior to disclosing any financial or business information to any third parties without expressly exempting the Commission from the scope of this restriction, BlueLinX forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits.” The SEC found all of these provisions to “undermine the purpose of Section 21F” and violate Rule 21F-17 “by impeding individuals from communicating directly with the Commission staff about possible securities law violations.”

BlueLinX agreed to settle the charges against it without admitting or denying the SEC’s findings. In addition to a \$265,000 penalty, the company has agreed to two undertakings.

1. BlueLinX agreed to amend its severance agreements and any other agreements containing confidentiality provisions by specifying that (a) employees may report possible securities law

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<sup>4</sup> *In the Matter of BlueLinX Holdings Inc.*, at 4 (emphasis added by the SEC).

violations to the SEC or other government agencies without notice to the company, and (2) the agreement does not limit the employee's right to receive an award for information provided to any government agency.

2. BlueLinx agreed to "make reasonable efforts" to contact its former employees who signed severance agreements over the last five years, provide them with a link to the SEC's order and notify them that BlueLinx does not prohibit former employees from (a) providing information to, or communicating with, the SEC staff without notice to the company, or (b) accepting a whistleblower award from the SEC pursuant to Exchange Act Section 21F.

BlueLinx further agreed to certify and provide evidence of its compliance with these undertakings.

### **Significance of the Action**

Like the enforcement action the SEC brought against KBR last year, this action serves as a reminder that, under Section 21F and Rule 21F-17, agreements that contain confidentiality provisions may not, in any way, impede employees from communicating with the SEC with respect to suspected securities law violations. The BlueLinx action underscores in particular that issuers may not require employees to provide notice to or obtain consent from the company prior to disclosing confidential information to the SEC. Additionally, as observed by Jane Norberg, Acting Chief of the SEC's Office of the Whistleblower, "[c]ompanies simply cannot undercut a key tenet of [the SEC's] whistleblower program by requiring employees to forego potential whistleblower awards in order to receive their severance payments."<sup>5</sup> By contrast, it is presently permissible for individuals to waive in a release their right to monetary recovery with respect to charges they have brought with agencies such as the Equal Employment Opportunity Commission or National Labor Relations Board, which do not have whistleblower programs like the SEC.

In light of the SEC's enforcement action against BlueLinx, issuers are reminded again that they should review employment, separation, and other agreements containing confidentiality provisions and amend them, if necessary, to ensure that they do not have the effect of interfering with the ability of employees to report suspected violations to the SEC.

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<sup>5</sup> Securities and Exchange Commission Press Release, "[Company Paying Penalty for Violating Key Whistleblower Protection Rule](#)" (Aug. 10, 2016).

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or [yafit.cohn@stblaw.com](mailto:yafit.cohn@stblaw.com), **Andrew M. Kofsky** at +1-212-455-7437 or [andrew.kofsky@stblaw.com](mailto:andrew.kofsky@stblaw.com), **Daniel J. Venditti** at +1-212-455-7387 or [daniel.venditti@stblaw.com](mailto:daniel.venditti@stblaw.com), or any other member of the Firm's Public Company Advisory Practice or Labor and Employment Practice.

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