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SEC Settles Charges for Violation of Whistleblower Program's Prohibition of Impediments to Communications Regarding Possible Securities Law Violations

On August 10, 2016, the Securities and Exchange Commission (SEC) announced a settlement with BlueLinx Holdings Inc. concerning alleged violations of the Dodd-Frank Whistleblower Program's prohibition on impeding whistleblower communications.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, enacted on July 21, 2010, added Section 21F to the Exchange Act to create what is often referred to as the "Dodd-Frank Whistleblower Program." The SEC enacted Exchange Act Rule 21F-17(a) providing that no person may take any action to impede a whistleblower from communicating directly with the SEC about a possible securities law violation, including by enforcing or threatening to enforce a confidentiality agreement.

BlueLinx used several forms of severance, termination, release and separation agreements (referred to herein collectively as severance agreements) with employees departing the company. Departing employees were required to execute a severance agreement as a condition to receiving severance and other consideration from BlueLinx.

Most of the severance agreements contained some form of provision that prohibited the departing employee from sharing confidential information unless compelled to do so by law or legal process. Such provision also required the employee to either provide written notice to, or obtain written consent from, the company's legal department before providing confidential information compelled by law or legal process. Notably, the severance agreements did not contain any exemption for voluntary disclosures to regulatory agencies, such as the SEC. In addition, BlueLinx had added a provision to all of its severance agreements in mid-2013, nearly two years after adoption of Exchange Act Rule 21F-17, that permitted employees to make a whistleblower claim with the SEC or other agencies, but only while waiving their right to monetary recovery should they make such a claim.

The SEC found that these provisions raised impermissible impediments to participation in the Dodd-Frank Whistleblower Program in violation of Exchange Act Rule 21F-17(a). The SEC noted that requiring departing employees to notify the company's legal department before disclosure would force those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits. Further, requiring departing employees to forgo any monetary recovery in connection with providing information to the SEC would remove the financial incentives intended to encourage persons to communicate directly with the SEC staff about possible securities law violations, which Congress had explicitly stated was a critical component of the Dodd-Frank Whistleblower Program.

In the settled action, BlueLinx agreed to cease and desist from committing or causing any violation or future violation of Rule 21F-17 and to pay a \$265,000 civil penalty. BlueLinx also agreed: (a) to amend its severance agreements to make clear that employees may report possible securities law violations to

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the SEC and other regulatory agencies without prior approval and without having to forfeit any resulting whistleblower award, and (b) to make reasonable efforts to contact former employees who had executed severance agreements after August 12, 2011 to notify them that BlueLinx does not prohibit them from providing information to the SEC staff or from accepting SEC whistleblower awards.

The BlueLinx settlement is similar to the SEC's April 1, 2015 settlement with another company found to have violated Exchange Act Rule 21F-17. See our client alert dated April 3, 2015.

What does this mean for your business?

- Confidentiality clauses are often part and parcel of agreements entered into with employees, whether you are asking employees to sign them in connection with their continuing employment or termination of employment. You should make it clear that employees are free to make good faith reports of possible violations of statutes or regulations to governmental agencies, including the SEC.
- With respect to already existing employee agreements, you should ensure that they do not prohibit communications of the nature discussed herein or amend them as necessary.
- Note that it is still an open question whether courts will strike the entire offending confidentiality provision, thereby eliminating the confidentiality obligation for all purposes, especially in the absence of severability and reform provisions.

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