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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

CATHERINE A. ZULFER, PLAINTIFF, VS. PLAYBOY ENTERPRISES, INC. AND DOES 1 THROUGH 50, INCLUSIVE, DEFENDANTS.	) Case No.: 2:12-CV-08263-BRO- (SH))) **PLAINTIFF'S MEMORANDUM OF**) **CONTENTIONS OF LAW AND**) **FACT**)) Final Pretrial Conf.: Jan. 21, 2014) Time: 3:00 p.m.) Courtroom: 14 (Spring Street))) Trial: February 18, 2014)

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Pursuant to L.R. 16-4, Plaintiff Catherine Zulfer (Plaintiff or Zulfer) hereby submits her Memorandum of Contentions of Law and Fact.

CLAIMS AND DEFENSES TO BE PRESENTED:

A. SUMMARY STATEMENT OF THE CLAIMS PLAINTIFF HAS PLEAD AND PLANS TO PURSUE:

Claim 1: Defendant Retaliated Against Plaintiff in Violation of Section 806 of the Corporate and Criminal Fraud and Accountability Act of 2002, Title VIII of the Sarbanes-Oxley Act of 2002 [18 U.S.C. §1514A]

Claim 2: Defendant Retaliated Against Plaintiff in Violation of the Dodd-Frank Wall Street Reform and Consumer Protection Act [15 U.S.C. §78u-6].

Claim 3: Defendant Wrongfully Terminated Plaintiff's Employment in Violation of Public Policy

B. ELEMENTS REQUIRED TO ESTABLISH PLAINTIFF'S CLAIMS AND GENERAL SUMMARY OF SUPPORTING FACTS:

(1)(a) Elements of 1st Claim for Retaliation in Violation of Sarbanes-Oxley Act of 2002 (18 U.S.C. §1514A) (1st Claim in the First Amended Complaint):

(1) That Cathy Zulfer engaged in protected activity by providing information relating to conduct that she reasonably believed constituted a violation of a rule or regulation of the Securities and Exchange Commission (including the laws regarding internal controls).

(2) That Playboy Enterprises, Inc. knew or suspected that Cathy Zulfer provided information relating to conduct that she reasonably believed constituted a violation of a rule or regulation of the Securities and Exchange Commission (including the laws regarding internal controls);

(3) That Playboy Enterprises, Inc. subjected Cathy Zulfer to an unfavorable personnel action;

(4) That the circumstances were sufficient to raise an inference that Cathy Zulfer's protected activity was a contributing factor to the unfavorable personnel action; and

(5) That Cathy Zulfer was harmed by the unfavorable personnel action.

(6) If Plaintiff proves the above elements, then the burden shifts to Defendant to prove by clear and convincing evidence that it would have taken the same unfavorable personnel action against Cathy Zulfer even if she had not engaged in legally protected activity.

Authority: Elements 1 - 5 are taken from 29 C.F.R. §1980.104(b)(1)(i)-(iv), with the addition of the last question. *Van Asdale v. International Game Tech.* (9th Cir. 2009) 577 F.3d 989, 996 ("Regulations by the Department of Labor [29 C.F.R. §1980.104(b)(1)(i)-(iv)] set fourth four required elements of a prima facie case under §1514A…."). The "same-decision" defense comes from 49 U.S.C. §42121(b)(2)(B)(ii), which applies to SOX claims. *See* 18 U.S.C. §1514A(b).

(1)(b) Summary of Evidence Supporting 1st Claim for Retaliation in Violation of SOX:

i. SOX protected activity

SOX's whistleblower anti-retaliation provision prohibits covered employers from retaliating against an employee based on any lawful act done:

(1) to *provide information, cause information to be provided* … which the *employee reasonably believes constitutes a violation of … any rule or regulation of the Securities and Exchange Commission,* or any provision of Federal Law relating to fraud against shareholders, *when the information or assistance is provided to* or the investigation is

> conducted by ... (C) *a person with supervisory authority over the employee* (*or* such other person working for the employer *who has the authority to investigate, discover, or terminate misconduct*) .... 18 U.S.C. §1514A(a)(1)(C) (italics added).

The laws relating to internal controls are found in the Exchange Act and SEC regulations. 15 U.S.C. §78m(b)(2)(B) & (b)(3)(5); 17 C.F.R. §240.13a-15(f). These laws requires public companies to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that – (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization...." 15 U.S.C. §78m(b)(2)(B).[1] They also makes it unlawful to try to "knowingly *circumvent* or knowingly fail to

[1] SEC regulations further define internal controls as including "a process designed ... to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles...." 17 C.F.R. §240.13a-15(f). They further state that internal controls "includes those policies and procedures that" … "(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer; (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements." 17 C.F.R. §240.13a-15(f)(1) - (3).

implement *a system of internal accounting controls* or knowingly falsify any book, record, or account …." 15 U.S.C. §78m(b)(3)(5) (italics added).

"[A]n effort to circumvent internal accounting controls constitutes a violation of the 1934 Exchange Act, 15 U.S.C. §78m(b)(5)," and "federal courts regularly hold that disclosure of a perceived violation of 15 U.S.C. §78m(b)(5) is SOX-protected as a disclosure related to a violation of a 'rule or regulation of the SEC…." Doc. 24 (Order re: Playboy's Motion to Dismiss, 12:13-20); *Collins v. Beazer Homes USA, Inc.* (N.D. Georgia 2004) 334 F.Supp.2d 1365, 1377; *Feldman v. Law Enforcement Associates Corp.* (E.D. N.C. 2011) 779 F.Supp.2d 472, 492 ("Disclosures made by employees concerning reasonably perceived violations of SEC rules governing internal control standards can constitute protected conduct under SOX."); *Hemphill v. Celanese Corp.* (5th Cir. 2011) 430 Fed.Appx. 341, 344 fn. 3; *Smith v. Corning, Inc.* (W.D. N.Y. 2007) 496 F.Supp.2d 244, 248-250; *Sequeira v. KB Homes* (S.D. Tex. 2009) 716 F.Supp.2d 539, 554.[2]

SOX uses a "*reasonable belief*" standard. The concerns disclosed need not have *actually or, in fact, been illegal*. Instead, "[t]o encourage disclosure, Congress chose statutory language which ensures that 'an employee's reasonable but mistaken belief that an employer engaged in conduct that constitutes a violation [of securities law] is protected.'" *Van Asdale v. International Game Tech.* (9th Cir. 2009) 577 F.3d 989, 1001. The "reasonable belief" standard is met if the employee had "(1) a subjective belief that the conduct being reported violated a [law listed in §1514A(a)(1)], and (2) this belief [was] objectively reasonable." *Id*. at 1000. The "objectively reasonable" test uses "the normal

[2] *See e.g., Morefield v. Exelon Services, Inc.* (Jan. 28, 2004) 2004-SOX-2; 2004 WL 5030303, *6; *Klopfenstein v. PCC Flow Technologies Holdings, Inc.* (May 31, 2006) ARB No. 04-149; 2006 WL 3246904, *12; *Leznik v. Nektar Therapeutics, Inc.* (Nov. 16, 2007) 2006-SOX-93; 2007 WL 5596626, **6-7; *Mallory v. JPMorgan Chase & Co.* (Nov. 20, 2009) 2009-SOX-29; 2009 WL 6470454, *30.

reasonable person standard used and interpreted in a wide variety of legal contexts." *Id.* at 1000-1001. Thus, "[o]bjective reasonableness is evaluated based upon the knowledge available to a reasonable person with the same training and experience." *Prioleau v. Sikorsky Aircraft Corp.* (Nov. 9, 2011) ARB No. 10-060; 2011 WL 6122422, *6.

Finally, a SOX plaintiff need not wait until a violation has occurred to speak up; rather, protected activity can consist of a disclosure of "*attempts* to circumvent the company's system of internal accounting controls." *Collins*, 334 F.Supp.2d at 1377; *see also* Doc. 24 at 9:8-11:22; *Bishop v. PCS Admin.* (N.D. Ill. May 23, 2006) No. 05 C 5683, 2006 WL 1460032, *8; *Sylvester v. Parexel, Int', LLC* (May 25, 2011) ARB No. 07-123, 2011 WL 2517148, *4 ("employee need not wait until a law has actually been broken to safely register his or her concern.").

ii. Summary of evidence supporting 1st and 2nd elements of SOX claim (protected activity and knowledge of it).

- Ms. Zulfer's protected activity consists of her disclosures to Christoph Pachler (Playboy's CFO) and Howard Shapiro (Playboy's Chief Compliance Officer and General Counsel) that she would not accrue certain discretionary executive bonuses without Board, or other appropriate, approval.
- On January 14, 2011, Pachler instructed Ms. Zulfer to accrue $1.1 million in bonuses, the majority of which were discretionary bonuses to senior executives. Trial Exh. 27. Ms. Zulfer declined to do so, citing the need for Board approval for certain of the bonuses.[3] Trial Exh. 21. Later that day, Ms. Zulfer and Mr. Pachler had a heated discussion about Pachler's instruction that she accrue the bonuses. Ms. Zulfer told Pachler that she would not accrue them without Board approval

[3] In October 2010, Pachler also requested that Ms. Zulfer accrue the bonuses. She refused then too citing the need for Board approval of them before she accrues.

because doing so would violate Playboy's internal controls, corporate governance control and GAAP.[4] Pachler became angry, agitated and frustrated insisting that CEO Flanders "will have a meltdown if he doesn't get this money," that he needed the year-end numbers complete to get them to Rizvi (the private equity group acquiring a majority interest in Playboy), and that he was "embarrassed" that they were having this disagreement. Pachler insisted three to four times that Ms. Zulfer "book" the entry, but she refused. Ms. Zulfer told Pachler that she would report the issue to Chief Compliance Officer Shapiro. Then, right after the meeting, Pachler sent Ms. Zulfer an instant message confirming his knowledge of her intent to speak to Shapiro about the bonuses. Trial Exh. 29.

- As she told Pachler she would, Ms. Zulfer then called Shapiro and reported her concerns regarding Pachler's conduct. Ms. Zulfer disclosed to Shapiro, *inter alia*, that: she had a "significant disagreement" with Pachler who "went off on her"; she was concerned about the company's financials and internal controls; what Pachler insisted she do was improper; etc. Shapiro brought Playboy's lead SEC compliance counsel onto the call and, according to Ms. Zulfer, Shapiro agreed she could not accrue the bonuses without Board approval.

- Ms. Zulfer will offer evidence that she was well qualified to determine if a request would violate Playboy's internal controls: (a) she has a degree in business administration with a focus in accounting; (b) she was previously a licensed Certified Public Accountant (CPA); (c) she attended internal and external trainings regarding SOX compliance, including internal control compliance; (d) since SOX was passed, she regularly worked with Playboy's internal auditors at Grant Thorton on SOX compliance issues; and (e) in 2010, as Corporate Controller, she worked with Grant Thorton to revise and update Playboy's internal controls.

[4] Playboy's internal controls required it to comply with GAAP. *See e.g.*, Trial Exh. 2 (Control Nos. 3900R-3 and 3900R-8); Trial Exh. 3-7 & 3-8.

● Ms. Zulfer will point to specific controls that she reasonably believed would be violated by the request to accrue absent Board approval or other appropriate authorization. Trial Exhs. 2-7. These controls, *inter alia*, require: (a) "segregation of duties" prohibiting the CFO or CEO from making journal entries; (b) that transactions occur only with appropriate approval; (c) that the Controller or the accounting department ensure that all accruals have appropriate supporting documentation; (d) that the company comply with GAAP; etc.

● Ms. Zulfer, and other witnesses, will explain that under the relevant accounting standard (ASC 450), one cannot book a contingent liability (bonus accruals) until the liability is probable and estimable. Ms. Zulfer will explain why here she reasonably believed the probable and estimable standard was not met. Among other things, historically at Playboy, executive bonuses were approved as part of a Board-approved management incentive compensation plan (MIP), which set goals and was then used as the basis of accruals throughout the year as results were compared to goals. The Board-approved MIP, coupled with a comparison of results to goals, provided a basis to accrue. But in 2010 there was no MIP. For certain executive, the Board did approve a limited incentive compensation plan in September 2010; but Flanders, Pachler and Briggs were not part of this. Trial Exh. 25. Rather, all three of their contracts merely provided eligibility to participate in a Board-approved incentive compensation plan; but, there was no Board-approved incentive compensation plan for them in 2010. Trial Exhs. 17 & 23-24.

● Ms. Zulfer will also offer evidence of her reasons for suspecting that Pachler and/or Flanders were up to no good. For example, *inter alia*, she had seen what she believed was suspecting accounting practices just weeks earlier in connection with a litigation settlement by Playboy involving Direct TV. Trial Exhs. 10-11, 45-46, 72-73, 76-78. Ms. Zulfer believed that Flanders and Pachler were trying to achieve improper, suspect accounting treatment of this settlement.

Similarly, the month before, Pachler instructed that bills not be paid promptly because of an expectation that the company would have more cash-on-hand – another instance that Ms. Zulfer saw as a dishonest financial and accounting practice. Trial Exh. 85, 212, 221. Finally, Pachler had asked Ms. Zulfer to make these accruals originally in October 2010, and she told him they required Board approval. The fact that three months passed and Board approval was not secured made raised a concern to Ms. Zulfer that perhaps the Board approval was not likely given that it had not been secured over this long period of time.

● Ms. Zulfer will also support the objective reasonableness of her belief with testimony of other Playboy employees and/or consultants who will admit that: (1) "segregation of duties" controls – a key check and balance or separation of powers – prevent the CEO or CFO from making entries on the company's books; (3) certain "segregation of duties" controls exist so that accounting employees have the final internal say on whether or not an item gets booked; etc.; (3) a senior-level finance executive trying to force the corporate controller to make an entry that she believes is not proper may violate Playboy's internal controls; (4) making an accrual on Playboy's books without appropriate supporting documentation may violate Playboy's internal controls; etc.

● Ms. Zulfer will also support the objective reasonableness of her belief with expert testimony from Gerald Thorpe, an expert in Sarbanes-Oxley compliance programs and internal controls. Mr. Thorpe will testify not only that Ms. Zulfer perspective that the request to accrue would have violated Playboys internal controls and GAAP was reasonable, but also that it was correct – accruing as Pachler asked would have violated the controls and GAAP.

● Ms. Zulfer will also offer evidence suggesting that her disclosures were successful in stopping the attempt to violate the company's internal controls.

Following her disclosure to Shapiro, Flanders immediately began the process of obtaining Board approval of the bonuses. Trial Exhs. 49, 50, 51, 65, 66, 67, 93.

iii. Summary of evidence supporting 3rd and 5th elements of SOX claim ("unfavorable personnel action" | harm):

These elements are not seriously in dispute.

SOX broadly defines "unfavorable personnel action" as including discharging, demoting, suspending, threatening, harassing or discriminating in any other manner in the terms and conditions of employment. 18 U.S.C. §1514A(a). Case law expansively construes this standard so that any negative or adverse action likely to deter a reasonable employee from engaging in protected activity is likely sufficient. *See e.g., Allen v. Admin. Review Bd.* (5th Cir. 2008) 514 F.3d 468, 476 fn. 2; *but see Guitron v. Wells Fargo Bank, N.A.* (N.D. Cal. 2012) No. C 10-3464 CW, 2012 WL 2708517, **16-17 (adopting broader test: "unfavorable employment actions that are more than trivial, either as a single event or in combination with other deliberate employer actions").

● Here, Ms. Zulfer suffered the ultimate "unfavorable personnel action" – she was terminated and then the Corporate Controller position was given to John McDonald. This, alone, will satisfy these elements. Moreover, Ms. Zulfer will also testify to retaliatory "unfavorable personnel action" that predated her termination. For example, Ms. Zulfer will testify that immediately after her dispute with Pachler on January 14, 2011, he began to treat her differently, and worse, than he did before – *e.g.*, excluding her from projects or meetings; accusing her of misconduct; being abrupt with her; etc.

● Finally, Ms. Zulfer obviously suffered both economic and non-economic harm from the termination of her employment of three decades with Playboy.

iv. Summary of evidence supporting 4th element of SOX retaliation claim ("contributing factor") and rebutting 6th step above ("same decision" defense)"[5]

To meet her prima facie case, Ms. Zulfer must merely show that her protected activity was "a contributing factor" to the "unfavorable personnel action" taken against her. "A contributing factor" is "any factor, which alone or in combination with other factors, tends to affect in any way the outcome of the decision." *Lockheed Martin Corp. v. Admin. Review Bd.* (10th Cir. 2013) 717 F.3d 1121, 1136. This requires a minimal showing: "[T]he contributing factor standard was 'intended to overrule existing case law, which requires a whistleblower to prove that his protected conduct was a 'significant,' 'motivating,' 'substantial,' or 'predominant' factor in a personnel action in order to overturn that action.'" *Klopfenstein v. PCC Flow Techs. Holdings, Inc.* (ARB May 31, 2006) ARB No. 04-149, 2006 WL 3246904, at *13; *see also Lockheed Martin*, 717 F.3d at 1136.

Once it is shown that the protected activity was a "contributing factor" to the "unfavorable personnel action," the burden then shifts to the employer to prove by clear and convincing evidence that it would have made the same decision at the same time for wholly legitimate reasons even if the employee had not engaged in the protected activity. 18 U.S.C. §1514A(b); 49 U.S.C. §42121(b)(2)(B)(ii).

Like most retaliation victims, Ms. Zulfer will prove the connection between her protected activity and termination circumstantially, including:

● It will be undisputed that: (a) in 2010, Pachler (with Flanders' support) promoted Ms. Zulfer to the Corporate Controller position; (b) Pachler considered McDonald as a candidate at that time, but selected Ms. Zulfer instead; and (c)

[5] The same evidence that will show Ms. Zulfer's protected activity contributed to the decision to terminate her employment and promote Mr. McDonald into the Corporate Controller position will also rebut Playboy's same-decision defense.

Playboy's internal auditor (Stippich from Grant Thornton) recommended that Ms. Zulfer (rather than McDonald) receive this promotion having worked with both of them. The fact that less than one year later (on the heels of her heated dispute with Pachler over the bonus accrual issue) Pachler terminated Ms. Zulfer and effectively gave her job to McDonald is circumstantial evidence that her intervening protected activity was the real reason for her termination.

● Ms. Zulfer's positive work performance following her promotion to the Corporate Controller position, and before she blew the whistle in January 2011, is further evidence suggesting that her eventual termination was retaliatory. Ms. Zulfer will offer evidence of her positive feedback, even being acknowledged by Pachler, which contrasts with Pachler's post-protected activity criticisms of her.

● Ms. Zulfer will explain that the previously cordial, positive relationship she enjoyed with Pachler changed immediately when she opposed him on January 14, 2011. From that point forward, he began to treat her differently, and worse.

● Ms. Zulfer will also offer evidence that Pachler was unhappy with McDonald's work performance and, in fact, suggested McDonald would be terminated as part of closing down the Chicago office where McDonald worked (Pachler and Ms. Zulfer worked in Los Angeles).

● Pachler tries to link the decision to terminate Ms. Zulfer to the signing of the Manwin deal in August 2011. Ms. Zulfer will point to evidence that Pachler wanted to replace Ms. Zulfer soon after she engaged in the protected activity in January 2011, but falsely denies this fact to cover-up the true temporal proximity between her protected activity and his decision to get rid of her.

● Ms. Zulfer will also point to testimony that her protected activity was mentioned when Flanders, Pachler and/or Briggs were talking about whether to terminate Ms. Zulfer and give McDonald the Corporate Controller position instead.

● To negate or rebut this causal connection or nexus showing between the protected activity and termination, Playboy will try to argue that, with the closing of the "go private" Rizvi transaction in March 2011 and the sale of the entertainment and digital content to Manwin in August 2011, Ms. Zulfer's job duties (public corporate accounting and entertainment division accounting) were no longer needed, while McDonald's licensing and publishing departments remained. Thus, Playboy will assert it made sense to select McDonald for the corporate controller position in 2011 and terminate Ms. Zulfer from it. To prove the pretextual nature of these assertions, Ms. Zulfer will point to evidence including the following:

a. Playboy's senior management knew the company may likely "go private" and sell its entertainment and digital assets, before Ms. Zulfer was promoted to the Corporate Controller position in 2010. Thus, the fact that these events did eventually happen does not legitimately justify terminating her from this position.

b. Playboy's claim that all or virtually all of McDonald's work in the publishing division remained (while the duties Ms. Zulfer did were no longer required) is exaggerated. In truth, the remaining Corporate Controller duties were a mix of both of their duties.

c. Ms. Zulfer was well qualified to handle the remaining of McDonald's licensing or publishing duties if they had been transferred to her.

(2)(a) Retaliation in Violation of the Dodd-Frank Act [15 U.S.C. §78u-6] (5th Claim stated in the First Amended Complaint).

(1) That Cathy Zulfer made a disclosure that is protected under SOX;

(2) That Playboy Enterprises, Inc. knew or suspected that Cathy Zulfer made a disclosure that is protected under SOX;

(3) That Playboy Enterprises, Inc. subjected Cathy Zulfer to an unfavorable personnel action;

(4) That Playboy Enterprises, Inc. subjected Cathy Zulfer to an unfavorable personnel action because of her SOX protected disclosure; and

(5) That Cathy Zulfer was harmed by the unfavorable personnel action.

Authority: There is no standard for instruction for this claim in either the *Manual of Model Jury Instructions for the Ninth Circuit*, the *Federal Jury Practice and Instructions*, or California's CACIs.

The foregoing elements are taken from 15 U.S.C. section 78u-6(1)(A)(iii) as explained in case law and the regulations of the Securities and Exchange Commission interpreting this section. A more detailed discussion of the legal issues in connection with this claim, and why these elements are properly stated, appears in section (E)(2) below in connection with the anticipated legal disputes.

(2)(b) Brief Summary of Facts and Evidence Supporting Plaintiff's 2nd Claim for Retaliation in Violation of the Dodd-Frank Act [15 U.S.C. §78u-6] (5th Claim stated in the First Amended Complaint).

As a factual matter, the first, second and third claims are essentially indistinguishable other than some minor differences in the elements or differences in the relief available. Thus, the same evidence Plaintiff discusses in connection with the First Claim supports the Second and Third Claims as well.

The major legal dispute on the Dodd-Frank retaliation claim – which is briefly analyzed below – is whether internal SOX related disclosures, alone, are protected activity under the Dodd-Frank claim even if the employee does not make a report to the SEC. Plaintiff here did not make a report to the SEC. But she contends Dodd-Frank protects her disclosure as a SOX-protected disclosure.

Dodd-Frank was intended "to 'improve the accountability and transparency of the financial system,' and create 'new incentives and protections for whistleblowers.'" *Kramer v. Trans-Lux Corp.* (D. Conn. Sept. 25, 2012) 2012 WL 4444820, *4. A key aspect of the statute is its prohibition on retaliation against employees who report potential wrongdoing. 15 U.S.C. §78u-6(h)(1). Thus, section 78u-6(h)(1)(A)(iii) expressly makes actionable under Dodd-Frank retaliation for "disclosures that are required or protected under the Sarbanes-Oxley Act of 2002." 15 U.S.C. §78u-6(h)(1)(A)(iii). Relying on a minority line of cases, Playboy asserts nonetheless that Dodd-Frank only protects SOX disclosures if the person otherwise provides information to the SEC.[6] This minority line of cases misreads the statute, and directly conflicts with the SEC's administrative regulation on this point, which is entitled to *Chevron* deference. The SEC's regulation confirms that disclosures protected under SOX (*including internal disclosures*) are also protected under Dodd-Frank – even if the employee has *not* provided information to the SEC. 17 C.F.R. §240.21F-2(b)(1)(i-ii) (Rule 240.21F-2). Rule 240.21F-2 defines a whistleblower for anti-retaliation protection as one who reasonably believes that a "possible securities law violation" has occurred (or is about to occur) and who makes a disclosure as provided in 15 U.S.C. section 78u-6(h)(1)(A) – including a disclosure protected under SOX by section 78u-6(h)(1)(A)(iii). The rule states:

> (b) Prohibition against retaliation: (1) *for purposes of the anti-retaliation protections* afforded by Section 21F(h)(1) of the Exchange Act (15 U.S.C. 78u-6(h)(1)), *you are a whistleblower if*:
>
> (i) You possess a reasonable belief that the information you are providing relates to a possible securities law violation (or, where

[6] *Asadi v. G.E. General (USA), L.L.C.* (5th Cir. 2013) 720 F.3d 620 is typical of this minority line of cases.

applicable, to a possible violation of the provisions set forth in 18 U.S.C. 1514A(a)) that has occurred, is ongoing, or is about to occur; and

(ii) You provide that information in a manner described in Section 21F(h)(1)(A) of the Exchange Act (15 U.S.C. 78u-6(h)(1)(A)). 17 C.F.R §240.21F-2(b)(1)(i-ii) (italics added).

Thus, an employee is protected from retaliation under Dodd-Frank (and is a "whistleblower" for anti-retaliation purposes) if she provides information in the manners described in 15 U.S.C. section 78u-6(h)(1)(A) – including making an internal report to a supervisor or person with investigatory authority (*i.e.*, a SOX-protected disclosure). To qualify for Dodd-Frank anti-retaliation protection, the employee need *not* report to the SEC as long as the disclosure is SOX-protected.[7]

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[7] Notably, an earlier version of proposed Rule 240.21F-2 did not make this point clear. *See* http://www.sec.gov/rules/proposed/2010/34-63237.pdf. But after public comment, the SEC amended final Rule 240.21F-2 making explicit that disclosures protected under SOX are also protected under Dodd-Frank even if the employee has not made a report to the SEC:

> The second prong of the Rule 21F-2(b)(1) provides that, for purposes of the anti-retaliation protections, an individual must provide the information in a manner described in Section 21F(h)(1)(A). **This change to the rule reflects the fact that the statutory anti-retaliation protections apply to three different categories of whistleblowers, and the third category includes individuals who report to persons or governmental authorities *other than the Commission*.** Specifically, **Section 21F(h)(1)(A)(iii) – which incorporate the anti-retaliation protections specified in Section 806 of the Sarbanes-Oxley Act, 18 U.S.C. 1514A(a)(1)(C) – provides anti-retaliation protections for employees** of public companies ... **when these employees report to** ... (iii) **a person with supervisory authority over the employee or such other person working for the employer who has authority to investigate, discover, or terminate misconduct**. 76 Fed. Reg. 34300-01, Rules

The SEC's regulation is entitled to *Chevron* deference – it must be followed if it is a permissible (not an arbitrary or capricious) interpretation. *Chevron, U.S.A., Inc. v. Natural Res. Defense Council, Inc.* (1984) 467 U.S. 837, 844. Given the fact that the majority of courts have agreed with the SEC's position, the SEC's rule is clearly a permissible construction of the statute. *See e.g.*, *Kramer*, 2012 WL 4444820, *5 ("The SEC's rule [240.21F-2] is a permissible construction of the Dodd-Frank Act, and, accordingly, I must follow it.").[8]

Indeed, Rule 240.21F-2 faithfully construes the statute and reconciles the apparent ambiguity within it. Given the statute's "object and policy," it would make no sense for Congress to leave internal securities related disclosures outside of Dodd-Frank's protection. Dodd-Frank encourages all disclosures of potential securities violations because both internal and external disclosures are likely "to 'improve the accountability and transparency of the financial system...." *Kramer*, 2012 WL 4444820, *4. In its final regulations, the SEC "made additional changes to the rules to further incentivize whistleblowers to utilize their companies' internal compliance and reporting systems where appropriate" because "many commentators from the corporate community argued that whistleblowers would divert from internal reporting in response to the financial incentive of a potential

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and Regulations Securities and Exchange Commission, 17 CFR Parts 240 and 249, at *34304 (italics in original; bold added).

[8] In addition to *Kramer*, the following cases have agreed with the SEC's interpretation either independently or through according it *Chevron* deference. *Murray v. UBS Secs., LLC* (S.D. N.Y. May 21, 2013) No. 12 Civ. 5914 (JMF); 2013 WL 2190084, **3-4; *Genberg v. Porter* (D. Colorado March 25, 2013) 935 F.Supp.2d. 1094, 1106-1107); *Nollner v. Southern Baptist Convention, Inc.* (M.D. Tenn. 2012) 852 F.Supp.2d 986, 993; *Egan v. Tradingscreen, Inc.* (S.D. N.Y. May 4, 2011) 2011 WL 1672066, *5.

whistleblower award from the Commission." 76 Fed. Reg. at 34301 & 34359.[9] It also agreed that "internal reporting to effective compliance programs can provide valuable assistance to [the SEC's] own enforcement efforts" because "[b]y providing a strong financial incentive for whistleblowers to report internally when appropriate" the SEC may "obtain the benefit of effective internal compliance programs that can respond to whistleblower tips by, among other things, undertaking prompt investigations that can lead to timely, well-documented reports of violations to the Commission." *Id*. at 34360-34361.

Given the importance of internal reporting to improving "the accountability and transparency of the financial system" (*Kramer*, 2012 WL 4444820, *4), Dodd-Frank must protect internal reporters from retaliation. Internal reports are often an effective precursor to a report to the SEC. By incorporating disclosures made under SOX as protected under Dodd-Frank, section 78u-6(h)(1)(A)(iii) protects internal reports regardless of whether or when the employee makes an external report to the SEC. Construing section 78u-6(h)(1)(A)(iii) in this manner "give[s] effect" to this distinct statutory subdivision. *Menasche*, 348 U.S. at 174.

In light of the above, the majority of cases to have considered this issue have concluded that Dodd-Frank independently protects disclosures that are otherwise protected under SOX either by so construing the statute or, alternatively, according *Chevron* deference to the SEC's rule given the ambiguity within the statute. "If a statute is ambiguous, and if the implementing agency's construction is reasonable, *Chevron* requires a federal court to accept the agency's construction of the statute,

[9] *See e.g.*, 17 C.F.R. §240.21F-6(a)(4)(i) (enhanced bounty award if employee first reported internally); 17 C.F.R. §240.21F-4(b)(7) (120 day lookback period; employee still eligible for bounty if reports to SEC within 120 days of internal report). According to the SEC, "[t]hese additional financial incentives for whistleblowers to report internally should make it less likely that significant numbers of tips will be diverted from internal reporting." 76 Fed. Reg. at 34360.

even if the agency's reading differs from what the court believes is the best statutory interpretation." *National Cable & Telecommunications Ass'n v. Brand X Internet Services* (2005) 545 U.S. 967, 980. With an ambiguous statute, "legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 843-844.

Here, at the very least, the SEC's interpretation is a permissible interpretation of an ambiguous statute, entitled to *Chevron* deference. *Kramer*, 2012 WL 4444820, *5. In fact, it is hard to imagine how the SEC's interpretation could be considered "arbitrary, capricious, or manifestly contrary to the statute" considering the fact that federal district courts have independently reached the same interpretation – both *before and after* the SEC's final regulations. *Kramer*, 2002 WL 4444820, **4-5; *Nollner*, 852 F.Supp.2d at 993; *Egan v. Tradingscreen, Inc.* (S.D. N.Y. May 4, 2011) 2011 WL 1672066, *5; *Murray*, 2013 WL 2190084, **3-4; *Genberg*, 935 F.Supp.2d at 1106-1107. For example, even before the SEC's regulation was enacted, *Egan* rejected the argument that Playboy makes here, reasoning that "a literal reading of the definition of the term 'whistleblower' in 15 U.S.C. § 78u-6(a)(6), requiring reporting to the SEC, would effectively invalidate § 78u-6(h)(1)(A)(iii)'s protection of whistleblower disclosures that do not require reporting to the SEC." *Egan*, 2011 WL 1672066, at *4.[10]

(3)(a) Wrongful Termination in Violation of Public Policy (3rd Claim for Relief in the First Amended Complaint):

(1) That Playboy Enterprises, Inc. discharged Cathy Zulfer;

[10] *Egan* reasoned that "[t]he contradictory provisions of the Dodd-Frank Act are best harmonized by reading 15 U.S.C. § 78u-6(h)(1)(A)(iii)'s protection of certain whistleblower disclosures not requiring reporting to the SEC as a narrow exception to 15 U.S.C. § 78u-6(a)(6)'s definition of a whistleblower as one who reports to the SEC." *Id*. at *5.

(2) That Cathy Zulfer's providing information relating to conduct that she reasonably believed constituted a violation of a rule or regulation of the Securities and Exchange Commission (including the laws regarding internal controls) was a substantial motivating reason for Playboy Enterprise, Inc.'s discharge of Cathy Zulfer; and

(3) That the discharge caused harm to Cathy Zulfer.

Authority: California Approved Civil Jury Instructions (CACI), Instr. No. 2430.

(3)(b) Brief Summary of Facts and Evidence Supporting Plaintiff's 3rd Claim for Wrongful Termination in Violation of Public Policy.

As a factual matter, the first, second and third claims are essentially indistinguishable other than some minor differences in the elements or differences in the relief available. Thus, the same evidence Plaintiff discusses in connection with the First Claim supports the Second and Third Claims as well.

C. SUMMARY STATEMENT OF AFFIRMATIVE DEFENSES DEFENDANT HAS PLED AND PLANS TO PURSUE:[11]

Defense 1 "Same Decision" defense on Sarbanes-Oxley Claim

Defense 2 Failure to Mitigate

Defense 3 Avoidable Consequences

Defense 4 After-Acquired Evidence

(1)(a) Elements of "Same Decision" Affirmative Defense on 1st Claim for Retaliation in Violation of Sarbanes-Oxley.

See discussion in Section (B)(1)(b) above.

[11] Plaintiff's analysis of these issues is prejudiced by the fact that, despite repeated requests in the days leading up to this filing, Defendant did *not* provide a single statement of either (1) its disputes with Plaintiff's proposed claim elements [which Plaintiff served in proposed jury instructions on December 30, 2013] or (2) a single statement of elements of any of its defenses until 5:45 p.m. on January 6, 2014.

(1)(B) Brief Summary of Evidence Opposing "Same Decision" Affirmative Defense on 1st Claim for Retaliation in Violation of SOX.

See discussion in Section (B)(1)(b) above.

(2)(a) Elements of Failure to Mitigate Affirmative Defense.

Defendant bears the burden of proving that: (1) substantially similar work was available; (2) that Ms. Zulfer failed to make reasonable efforts to seek such employment; and (3) the amount of earnings she would have earned had she made reasonable efforts to mitigate. CACI 2407.[12]

(2)(b) Brief Summary of Facts and Evidence Opposing This Defense.

Plaintiff will offer evidence through her testimony and documents of her extensive job search. Trial Exhs. 267 & 270. In short, Plaintiff has networked and done all she could to try to find an alternative comparable job as a corporate controller. However, such efforts producing no success, she has accepted lesser temporary work as a production accountant.

To try to prove a failure to mitigate, Defendant has designated a purported mitigation expert. The methodology used by this purported expert is improper in multiple respects and will be the subject of an in limine motion including because:

1. The expert faults Plaintiff for not making a national job search. But, legally, the duty to mitigate does *not* require this. Rather, toe substantially similar work, the job must be "in the same locality." CACI 2407; *Cunningham v. Retail Clerks Union* (1983) 149 Cal.App.3d 296, 306-307 (employee's rejection of a job that

[12] California law as stated in CACI, which is based on *Parker v. Twentieth Century-Fox Film Corp.* (1970) Cal.3d 176, is consistent with federal mitigation law in the employment context. *See e.g., Kalkunte v. DVI Financial Services, Inc.* (ALJ July 18, 2005) 2004-SOX-56, 2005 WL 4889006, *53 ("the ARB has consistently imposed [a duty to mitigate], in keeping with the general common law 'avoidable consequences' rule and the parallel body of damages law developed under other anti-discrimination statutes.").

would have required her to "rent another place to live, imposed added financial burdens, and forced her away from her home and community of 25 years" was not a failure to mitigate); *NLRB v. Westin Hotel* (6th Cir. 1985) 758 F.2d 1126, 1130 (employee not required to accept position 25 miles from home).

2. The expert has not identified even a single substantially similar job that was available and Plaintiff *would have obtained with reasonable effort*. The expert merely points to statistical data that does not consider whether the work was actually comparable to Plaintiff's, whether Plaintiff would actually have been able to obtain a job, or other similar relevant considerations.

(3)(a) Elements of Avoidable Consequences Affirmative Defense.

Plaintiff disputes that this defense applies to the claims asserted in this case. However, if the Court rules it does apply, then Defendant would be required to prove that it took all reasonable steps to prevent and correct retaliation, that Plaintiff unreasonably failed to avail herself of these preventative procedures, and that, had she done so, she could have avoid some of her harm. *Department of Health Services v. Superior Court* (2003) 31 Cal.4th 1026, 1042.

(3)(b) Brief Summary of Facts and Evidence Opposing This Defense.

This defense will fail factually because: (1) Ms. Zulfer did report Pachler's conduct to Shapiro and nothing happened; (2) Ms. Zulfer did report the retaliation to Playboy; but (3) after she reported it, Playboy did nothing to correct it; rather, it engaged a biased investigator who conducted a biased investigation.

(4)(a) Elements of After-Acquired Evidence Affirmative Defense.

An after-acquired evidence defense comes into play where the employer alleges it discovered purported misconduct *after* the employee's termination that *would have* caused the employer to terminate the employee on that basis alone had

it known of the alleged misconduct. To prove it, the employer "must first establish that the wrongdoing was of such severity that the employee in fact would have been terminated on those grounds alone if the employer had known of it at the time of discharge." *McKennon v. Nashville Banner Pub. Co.* (1995) 513 U.S. 352, 362-363. That is, the employer must show that "as a matter of settled company policy, it would have fired [the plaintiff] immediately upon learning of" the alleged misconduct. *Murillo v. Rite Stuff Foods, Inc.* (1998) 65 Cal.App.4th 833, 847. If proven, the defense may limit front pay. *McKennon*, 513 U.S. at 362-363.

(4)(b) Brief Summary of Facts and Evidence Opposing This Defense.

This defense will go nowhere. Among other things:

● Preliminarily, Defendant has failed to preserve this defense for trial. First, Defendant alleged no facts regarding this defense in its answer and never amended its answer to provide any factual basis for it. Second, and more important, it failed to provide *any facts, witnesses or documents* as supporting this defense in its disclosures – including it is second supplemental disclosures served as recently as November 22, 2013. Literally, Defendant's disclosures say not a word about this issue. Thus, Plaintiff was not put on notice of this being an issue in the case on a timely basis, was denied the ability to conduct discovery on it and, thus, it should be preclude at trial.

In any event, on the merits the defense would fail too.

● First, the threshold predicate of the defense is that the employer actually discovered the alleged wrongdoing *after* Plaintiff's termination. This is not the case here. Rather, Defendant's IT department assisted Plaintiff in downloading the materials at issue. Defendant thus knew she did so before her termination.

● Second, Ms. Zulfer did not "steal" anything as Playboy wants to call it. Every item Ms. Zulfer retained a copy of was an item she lawfully came into possession of in the course of performing her job duties. This is *not* a situation

where an employee opens his boss' file cabinet and sneaks through private files, or sits at his boss' computer and obtains confidential information he was never entitled to see in the first place. The materials were relevant to the ongoing investigation and, thus, collecting them was actually protected activity.

- Third, Ms. Zulfer's only disclosures of these materials have been to her lawyers or in the context of this case. Nothing has been disseminated, and everything has been treated as useable solely for purposes of this case.
- Fourth, Playboy did not have any "settled company policy" that would have led to termination. Testimony will fatally undermine this contention.

D. IDENTIFICATION OF ANTICIPATED EVIDENTIARY ISSUES

(D)(1): Evidentiary Agreements

The parties agree to admission of numerous exhibits as stated on the joint exhibit list. The parties have agreed that settlement communications or discussions (whether occurring before or after Ms. Zulfer's termination) are inadmissible.

(D)(2): Evidentiary Disputes

The parties have a series of evidentiary disputes that will the subject of in limine motions being filed by both sides. Plaintiff is currently aware of no evidentiary disputes other than those covered by the in limine motions.

E. IDENTIFICATION OF ANY ISSUES OF LAW:

(E)(1): Legal Issues on Claim 1 (Sarbanes-Oxley Retaliation):

While Plaintiff is again prejudiced in the ability to meaningfully analyze legal disputes given Defendant's lack of cooperation (see fn. 11 above), Plaintiff understands that Defendant intends to try to re-litigate whether a disclosure of an attempt to circumvent internal controls is SOX protected activity and whether

scienter is required for such a claim. The Court's ruling on the motion to dismiss resolved both of these issues. Doc. 24 at 9:8-11:22 & fn. 37 at 17:11-19:25.

(E)(2): Legal Issues on Claim 2 (Dodd-Frank Retaliation):

As discussed in Section (B)(2)(b) above, a legal issue the Court will have to rule on is the scope of protected activity under the Dodd-Frank Act.

(E)(3): Legal Issues on Affirmative Defenses:

Known legal disputes on the affirmative defenses include:

1. The standard for Defendant's mitigation defense. Plaintiff submits that Defendant's proposed formulation of this defense is contrary to the rules applicable to such a defense used in the employment setting.
2. Whether the "avoidable consequences" defense applies to the claims asserted;
3. Whether the "after acquired evidence" defense: (a) was preserved in pretrial litigation; (b) applies to the facts of this case versus whether Plaintiff's alleged "misconduct" was actually legally protected; and (c) whether the issue is submitted to the jury versus decided by the Court.

F. BIFURCATION OF ISSUES:

Amount of Punitive Damages: Punitive damages are available on Plaintiff's state law wrongful termination in violation of public policy claim. The parties agreed to bifurcate the amount of punitive damages from liability, compensatory damages and entitlement to punitive damages under California Civil Code section 3295(d). The details of this stipulation, which is subject to Court approval, are set forth in the Final Pretrial Conference Order. The parties have also stipulated for a

process for production of financial condition evidence should the jury impose punitive damages.

After Acquired Evidence Defense: As detailed above, Plaintiff submits that this defense should not be permitted based on discovery violations, and Plaintiff will be filing an in limine on the issue. But, if the Court permits the defense, it is an equitable defense to be decided by the Court. *McKennon v. Nashville Banner Publishing Co.* (1995) 513 U.S. 352, 361-362. As an equitable defense that only comes into play after Plaintiff proves liability, the Court should bifurcate this issue and hold a post-verdict hearing to address it.

G. JURY TRIAL:

Plaintiff has demanded jury (*see* Doc. 1 [Jury Trial Demand on p. 20]; Doc. 5 [Jury Trial Demand]; and Doc. 27 [Jury Trial Demand on p. 19]. Plaintiff submits that pre-judgment interest and doubling of backpay on the Dodd-Frank claim are matters for the Court to handle post-trial and need not be submitted to the jury.

H. ATTORNEY'S FEES:

Plaintiff's First and Second Claims (that is, the Sarbanes-Oxley and Dodd Frank retaliation claims) provide for statutory attorney's fees to the prevailing Plaintiff, as well as enhanced litigation costs. 18 U.S.C. §1514A(c)(2)(C) (SOX remedies include "litigation costs, expert witness fees, and reasonable attorney fees."); 15 U.S.C. 78u-6(h)(1)(C) (same).

Dated: January 6, 2014 **The deRubertis Law Firm, APC**

/ s / David M. deRubertis

By_____

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