Case No. S266001

IN THE SUPREME COURT OF CALIFORNIA

WALLEN LAWSON,
Plaintiff and Appellant,

v.

PPG ARCHITECTURAL FINISHES, INC.,
Defendant and Respondent.

On a Certified Question from the
United States Court of Appeals for the Ninth Circuit
Case No. 19-55802

REQUEST FOR JUDICIAL NOTICE

State of California, Department of Industrial Relations,
Division of Labor Standards Enforcement

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Attorneys for Amicus Curiae, DIVISION OF LABOR STANDARDS ENFORCEMENT through its Chief, LILIA GARCÍA-BROWER, LABOR COMMISSIONER FOR THE STATE OF CALIFORNIA

Pursuant to California Rules of Court, rules 8.54, 8.252, and 8.520, and Evidence Code sections 452 and 459, the Labor Commissioner moves for judicial notice of the following selections from the legislative history for Senate Bill No. 777, which enacted Labor Code section 1102.6 in 2003:

1. Sen. Jud. Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as introduced Feb. 21, 2003
2. Assem. Com. on Jud. on Sen. Bill No. 777 (2003-2004 Reg. Sess.) as amended May 29, 2003
3. Sen. Rules Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as amended Aug. 18, 2003
4. Enrolled Bill Memorandum to Governor for Sen. Bill No. 777 (2003-2004 Reg. Sess.) Oct. 6, 2003; and
5. Stats. 2003, ch. 484, eff. Jan. 1, 2004.

True and correct copies of these selections from the legislative history are attached to the Declaration of Nicholas Patrick Seitz, Esq. as Exhibits A through E, respectively. This legislative history is relevant to whether the evidentiary standard set forth in Labor Code section 1102.6 replaced the *McDonnell Douglas* test as the relevant evidentiary standard for retaliation claims brought pursuant to Labor code section 1102.5.

MEMORANDUM OF POINTS AND AUTHORITIES

This Court may take judicial notice of the above selections from the legislative history. (Evid. Code §§ 452, subd. (c) [permitting judicial notice of "[o]fficial acts of the legislative . . . departments of the United States and of any state of the United States"], 459, subd. (a).) Although the language of Labor Code section 1102.6 dictates that the evidentiary standard in the statute replaced the *McDonnell Douglas* test as the relevant evidentiary

standard for retaliation claims brought under Labor code section 1102.5, the legislative history provides additional authority.

Specifically, the legislative history shows that proponents of Labor Code section 1102.6's burden-shifting standard argued that the *McDonnell Douglas* test "made it almost impossible for whistleblowers to win a challenged whistleblower lawsuit." (Sen. Jud. Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as introduced Feb. 21, 2003, p. 8.) This dissuaded employees from "blowing the whistle" despite being "in a unique position to report corporate wrongdoing to an appropriate government or law enforcement agency." (Stats. 2003, ch. 484, § 1; Sen. Jud. Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as introduced Feb. 21, 2003, at pp. 3, 8-10.) In view of the Enron, WorldCom, and other massive corporate fraud scandals of the time, the Legislature recognized that a different evidentiary standard was needed to ensure employees could effectively avail themselves of Labor Code section 1102.5's whistleblower protections and thereby be encouraged to speak out. (Sen. Jud. Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as introduced Feb. 21, 2003, pp. 3, 8-10.)

Thus, the Legislature enacted Labor Code section 1102.6 to replace the *McDonnell Douglas* test as the evidentiary standard for Labor Code section 1102.5 retaliation claims.[1] The Legislature made clear that this

[1] (See Sen. Rules Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as amended Aug. 18, 2003, p. 3; see also Sen. Jud. Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as introduced Feb. 21, 2003, p. 8 ["By *raising* the standard of proof that the employer must meet, potential whistleblowers, proponents state, would find a safer haven, encourage reporting, and thus foster the early detection of financial fraud by a company."] [emphasis added]; Enrolled Bill Memorandum to Governor for Sen. Bill No. 777 (2003-2004 Reg. Sess.) Oct. 6, 2003 ["This bill extends the current protection of the state whistleblower law by: . . . (4) increasing the burden

more solicitous standard "establish[es] the evidentiary burdens of the parties participating in a civil action or administrative hearing involving an alleged violation of [section 1102.5]." (Stats. 2003, ch. 484; see *People v. Canty* (2004) 32 Cal.4th 1266, 1280 [preamble statements of intent "properly may be utilized as an aid in construing a statute"].) The legislative history thus confirms that Labor Code section 1102.6 provides the evidentiary standard for Labor Code section 1102.5 retaliation claims, with no exceptions for any particular litigation stage.

The legislature history also shows that Legislature modeled Labor Code section 1102.6 after the burden-shifting frameworks for retaliation claims under the Sarbanes-Oxley Act (18 U.S.C. § 1514A), Whistleblower Protection Act (5 U.S.C. §§ 1214, 1221), and similar federal whistleblower protection laws. (Assem. Com. on Jud. on Sen. Bill No. 777 (2003-2004 Reg. Sess.) as amended May 29, 2003, p. 4.)

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of proof on the employer to a clear and convincing evidence standard in civil or administrative action . . . under the whistleblower statute, which is similar to the Sarbanes-Oxley Act of 2002."].)

Based on the foregoing, the Labor Commissioner respectfully requests that this Court grant this motion for judicial notice.

Dated: July 1, 2021

STATE OF CALIFORNIA,
DEPARTMENT OF INDUSTRIAL
RELATIONS, DIVISION OF LABOR
STANDARDS ENFORCEMENT

/s/ Nicholas Patrick Seitz

Nicholas Patrick Seitz
David L. Bell
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Attorneys for Amicus Curiae,
DIVISION OF LABOR STANDARDS
ENFORCEMENT

DECLARATION OF NICHOLAS PATRICK SEITZ, ESQ.

I, Nicholas Patrick Seitz, Esq., hereby declare:

(1) I am an attorney duly licensed to practice in the State of California.

(2) I am attorney of record for amicus curiae Division of Labor Standards Enforcement, through its Chief, Lilia García-Brower, Labor Commissioner for the State of California.

(3) I have personal knowledge of the facts stated herein, which are known by me to be true and correct, and if called as a witness I could and would testify competently thereto.

(4) A true and correct copy of Sen. Jud. Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as introduced Feb. 21, 2003 is attached hereto as Exhibit A.

(5) A true and correct copy of Assem. Com. on Jud. on Sen. Bill No. 777 (2003-2004 Reg. Sess.) as amended May 29, 2003 is attached hereto as Exhibit B.

(6) A true and correct copy of Sen. Rules Com. on Sen. Bill 777 (2003-2004 Reg. Sess.) as amended Aug. 18, 2003 is attached hereto as Exhibit C.

(7) A true and correct copy of Enrolled Bill Memorandum to Governor for Sen. Bill No. 777 (2003-2004 Reg. Sess.) Oct. 6, 2003 is attached hereto as Exhibit D.

(8) A true and correct copy of Stats. 2003, ch. 484, eff. Jan. 1, 2004, is attached hereto as Exhibit E.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed at City of Rancho Cucamonga, County of San Bernardino, State of California, on July 1, 2021.

/s/ Nicholas Patrick Seitz

Nicholas Patrick Seitz, Esq., Declarant

PROOF OF SERVICE

Lawson v. PPG Architectural Finishes, Inc.,
California Supreme Court Case No. S266001

I, Mary Ann Galapon, declare as follows:

I am employed in the County of San Francisco, I am over 18 years of age and not a party to this action, and my business address is 455 Golden Gate Avenue, 9th Floor, San Francisco, CA 94102.

On July 1, 2021, I served the following document(s):

REQUEST FOR JUDICIAL NOTICE

✓ **By United States mail.** I enclosed the document(s) in sealed envelope or package to the person(s) at the address(es) below. I placed the envelope for collection and mailing, following our ordinary business practices. I am readily familiar with this business's practice for collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course with of business with the United States Postal Service, in a sealed envelope with postage fully prepaid. I am a resident or employed in the county where the mailing occurred. The envelope or package was placed in the mail at San Francisco, CA.

Molly Dwyer, Clerk of Court
Office of the Clerk
U.S. Court of Appeals for the Ninth
Circuit
P.O. Box 193939
San Francisco, CA 94119-3939

✓ **By TrueFiling.** I electronically served the document(s) through TrueFiling.

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed at County of San Francisco, State of California, on July 1, 2021.

/s/ Mary Ann Galapon
Mary Ann Galapon, Declarant

EXHIBIT A

SENATE JUDICIARY COMMITTEE
Martha M. Escutia, Chair
2003-2004 Regular Session

SB 777	S
Senator Escutia	B
As Introduced	
Hearing Date: April 8, 2003	7
Labor Code	7
GMO:cjt	7

SUBJECT

Whistleblower Protections

DESCRIPTION

This bill would:

1) Expand protections for whistleblowers by prohibiting an employer from retaliating against an employee for refusing to participate in illegal employer activity or for having been a whistleblower in any former employment, and by imposing a new civil penalty of up to $10,000 per violation if the employer is a corporation or limited liability company (LLC);

2) Provide that in a civil action or an administrative proceeding pursuant to the whistleblower statute, once the employee has demonstrated by preponderance of the evidence that a proscribed activity was a contributing factor to the adverse employer action, the employer must show by clear and convincing evidence that the adverse action would have occurred for legitimate, independent reasons even if the employee did not engage in whistleblowing;

3) Create a whistleblower hotline in the Attorney General's office and require employers to post at the workplace a notice of employee's rights and responsibilities under the whistleblower laws, including the Attorney General's whistleblower hotline number;

4) Impose civil penalties of up to $10,000 on an officer or director of a corporation or member of an LLC and up to $5,000 on a financial manager of a corporation or LLC for failing to disclose to the Attorney General within 15 days of actual knowledge that the corporation or LLC, officer, director, member, manager or its agent is engaging or has engaged in specified finance-related activity intended to give a greater or lesser value of the company than it possesses or to deceive a regulatory agency;

(more)

5) Impose a civil penalty of up to $1,000,000 on a corporation or LLC for failing both to disclose to the Attorney General and to warn its shareholders and/or investors within 15 days of actual knowledge that the corporation or LLC, officer, director, member, manager or its agent is engaging or has engaged in specified finance-related activity intended to give a greater or lesser value of the company than it possesses or to deceive a regulatory agency.

The provisions for civil penalties would not apply:

- where a disclosure by an officer or director of a corporation, or LLC member, would violate client-lawyer privilege; or
- where the corporation, LLC, or officer, director, LLC member, or manager reasonably believed in good faith that notification to an appropriate agency was in compliance; or
- where disclosure would affect Fifth Amendment rights against self-incrimination of an officer, director, LLC member, or manager;
- the wrongful or inappropriate conduct to be reported was abated within 15 days of actual knowledge of the wrongful or inappropriate conduct.

The bill would apply only to corporations and LLCs that are required to register securities with the Securities and Exchange Commission and are publicly traded on a stock exchange.

The bill would clarify that under the whistleblower statute, a report made by a government employee to his or her agency is a disclosure of information made to a government or law enforcement agency, thus codifying Gardenhire v. City of Los Angeles Housing Authority (2000) 85 Cal.App.4th 236.

BACKGROUND

Except for two provisions and some clarifying changes, this bill is identical to SB 783 (Escutia, 2002). SB 783 contained the entire language of SB 1452 (Escutia, 2002), which was passed by this Committee and the Senate prior to the summer recess. SB 783 was vetoed by the Governor, with a message that he would sign legislation this year that would incorporate all of the components of SB 783, except for the provision imposing civil liability on "individuals who did not actually commit the wrongful act themselves." The Governor's veto message specifically objected to the civil liability of officers, directors and managers of corporations and members of limited liability companies for failing to report certain activities to the Attorney General or the shareholders.

Between the time SB 1452 was heard in this Committee and the enrollment of SB 783 to the Governor, Congress enacted the Sarbanes-Oxley Act of 2002. Sarbanes-Oxley addressed accounting industry reform and oversight, some corporate governance and financial reporting issues, and increased the penalties

for criminal conduct by executives. Comparison of SB 777 and the Sarbanes Oxley Act is further detailed in Comment 5.

The sponsor of this bill, the Foundation for Taxpayer and Consumer Rights, contends that while the Sarbanes-Oxley Act addresses major corporate accounting and reporting problems, the Act imposes penalties on corporate executives mostly for actions related to SEC filings and, where fraud is involved, only after damage has been done to shareholders, investors and employees. The sponsor states that SB 777 is needed in order to prevent the kind of damage to shareholders, investors, employees and the market that Enron and WorldCom, and now HealthSouth (see Comment 1) continue to cause.

CHANGES TO EXISTING LAW

1. Existing law prohibits an employer from adopting or enforcing any rule, regulation, or policy that prevents an employee from disclosing information to a government or law enforcement agency where the employee has reasonable cause to believe that the information discloses a violation of state or federal law or regulation. [Labor Code Section 1102.5(a). All references are to the Labor Code, unless otherwise indicated.] This statute is commonly known as the "Whistleblower Protection Statute" or "whistleblower statute."

   Existing law prohibits an employer from retaliating against an employee for making these disclosures. [Section 1102.5(b).]

   This bill would provide that an employer may not retaliate against an employee for refusing to participate in illegal activity or activity that may result in violations of state or federal statute or regulation.

   This bill would provide that an employer may not retaliate against an employee for having exercised his or her whistleblower rights in any former employment.

2. Existing law, for purposes of the above provisions, defines an "employee" to include persons who are employed by a state agency or its political subdivisions, a county or city and county, municipal or public corporation or political subdivision, a school district or community college district, or the University of California. [Section 1106.]

   This bill would provide that for government agency employees, reporting by the employee to the employer shall be deemed reporting to a government agency.

3. Under existing law, a violation of Section 1102.5 (the whistleblower protection statute) as well as other prohibited employer activity, is a misdemeanor,

punishable by imprisonment of up to one year or a fine of up to $1,000 in the case of an individual and up to $5,000 in the case of a corporation, or both imprisonment and fine. [Section 1103.]

This bill would make an employer that is a corporation or limited liability company liable for a civil penalty not exceeding $10,000 for each violation.

4. Existing case law provides that, after a plaintiff shows by a preponderance of evidence that the action taken by the employer is proscribed by the whistleblower statute, the burden shifts to the employer to show by a preponderance of the evidence that the alleged action would have occurred for legitimate, independent reasons even if the employee had not engaged in activities protected by the whistleblower statute. [Morgan v. Regents of University of California (2000) 88 Cal.App.4th 52; McDonnell Douglas Corp. v. Green (1973) 411 U.S. 792.]

   This bill would instead require the employer to make that showing by clear and convincing evidence.

5. This bill would require the Attorney General to maintain a whistleblower hotline to receive calls about possible violations of state or federal statutes, rules or regulations, or violations of fiduciary responsibility by a corporation or LLC to its shareholders, investors or employees.

   This bill would require the AG to refer calls received on the whistleblower hotline to the appropriate government authority for review and possible investigation, and to hold in confidence information disclosed through the hotline.

   This bill would require an employer to display at the workplace a notice of an employee's rights and responsibilities under the whistleblower statutes, including the number of the Attorney General's whistleblower hotline.

6. Existing federal law, the Sarbanes-Oxley Act of 2002, imposes severe criminal penalties on various corporate fraud-related activities, including a provision for a maximum 25-year sentence and substantial fines for knowingly executing a scheme to defraud persons in connection with any security.

   This bill would make an officer or director of a corporation or a member of a limited liability company, liable for a civil penalty of up to $10,000 per violation, and a manager responsible for financial transactions in a corporation liable for a civil penalty of up to $5,000 per violation, to actually know and then to fail to notify the Attorney General or appropriate government agency within 15 days of acquiring that knowledge of specified

improper activity by the corporation or LLC, an officer or director, or a LLC member, or agent.

This bill would make a corporation or LLC liable for a civil penalty of up to $1,000,000 per violation for similar knowledge and inaction, including the failure to warn shareholders and investors in writing.

This bill would not require disclosure if the wrongful conduct is abated within the time period for reporting (15 days).

This bill would provide that the penalties would not apply for a failure to duly notify the Attorney General or appropriate government agency if the person has actual knowledge that the Attorney General or appropriate government agency has been notified, and, in the case of a corporation or LLC, that shareholders and investors have been warned. Further, no penalties would apply for the failure to duly notify the Attorney General if the corporation or LLC, officer, director, LLC member, or manager notified an appropriate governmental agency and reasonably and in good faith believed that such notification was compliance.

This bill would apply only to corporations and limited liability companies that are required to register securities with the United States Securities and Exchange Commission and are publicly traded on a stock exchange.

This bill would provide that the duty to disclose information is not intended to affect the Fifth Amendment right against self-incrimination of an officer or director of a corporation, LLC member, or financial manager, nor would it require a person to violate lawyer-client privilege.

This bill would provide that a civil action to assess the civil penalties under this bill may be brought by the Attorney General, a district attorney or a city attorney in the name of the people of the state.

COMMENT

1. Need for the bill

The sponsor of the bill, the Foundation for Taxpayer and Consumer Rights, states that if enacted, SB 777 would be the strongest whistleblower protection and corporate accountability law in the nation.

According to the sponsor, "while little can be heard above the din of war coverage, day after day, [newspaper] business sections around the country report new stories of corporate chicanery and financial fraud. Time and again, however, the information comes too late to prevent the damage and

protect workers, pensioners, investors, and others hurt by corporate fraud and misbehavior." Besides last year's major corporate newsmakers, they cite recent cases involving firings and guilty pleas from top executives of healthcare giant HealthSouth that surfaced only after more than a billion dollars' worth of accounting fraud was discovered, and "accounting trickery at an El Segundo, California-based technology firm [that] may cost retirees and other investors tens of millions of dollars."

The sponsor and other supporters of the bill state that despite passage of the Sarbanes-Oxley Act of 2002, these stories of corporate wrongdoing continue to surface because the new law largely ignored the invaluable role played by whistleblowers and the importance of requiring corporations to disclose fraud as soon as it becomes apparent. "Without an effective early warning system in place, the public cannot effectively preempt the devastation that comes with corporate fraud." SB 777, proponents hope, would give California an "early warning system."

2. SB 777 compared to enrolled version of SB 783/SB 1452

As stated above, SB 777 differs in only two respects from SB 1452, the bill passed by this Committee last year that was later amended into and became SB 783, which was enrolled to the Governor together with several other bills dealing with corporate responsibility:

a) the standard of proof to be applied in a civil action or administrative proceeding under the whistleblower statute is changed from "preponderance of evidence" to "clear and convincing evidence" for the employer to demonstrate that the alleged proscribed action would have been taken for other independent, legitimate reasons (see Comment 3c); and

b) the civil liability of corporate officers and directors and LLC members is reduced to $10,000, and to $5,000 for managers. (See Comment 5a.)

3. Expansion of whistleblower protections

a. Employer retaliation prohibited

In 1984 the Legislature enacted Labor Code Section 1102.5, commonly known as the "whistleblower protection statute" or "whistleblower statute." In 1992, AB 3486 (Friedman, Chapter 1230, Statutes of 1992) included employees of the state and its subdivisions and other public agencies under the protective umbrella of Section 1102.5.

Section 1102.5 prohibits an employer from adopting or enforcing any rule that prevents an employee from disclosing information to a government or law enforcement agency where the employer has reason to believe that the information discloses a violation of state or federal law or regulation. The law also prohibits an employer from retaliating against an employee for making these disclosures.

SB 777 would expand the protections of the whistleblower statute to employees who refuse to participate in employer activity that is in violation of state or federal law or rule or regulation, or who exercised his or her whistleblower rights in a former employment.

Under SB 777, an employee would not have to be an actual whistleblower, but could have simply refused to participate in the improper activities to be protected under the proposed change. Thus, Sharon Watkins, the former Enron employee who blew the whistle on Enron, for example, may not be retaliated against, or treated differently or in a negative way, by a new employer because of blowing the whistle on top Enron executives who knew of questionable activities the company engaged in that affected the value of the company in the marketplace.

This bill also would codify the appellate court's ruling in Gardenhire v. City of Los Angeles Housing Authority, supra, that a government employee who has made a disclosure to his or her employing agency is deemed to have made the disclosure to a government or law enforcement agency under the whistleblower statute. Thus, a Department of Insurance employee's report of inappropriate activities at the department, for example, to his or her superior at the department would be deemed to be a protected whistleblower activity under this bill (but note that disclosures made by government attorneys regarding their agency-clients are covered by ethics rules governing attorneys generally and would probably be subject to other rules).

b. Additional civil penalty for corporate employers

A violation of the whistleblower statute and other prohibited employer activities under the Labor Code is a misdemeanor, punishable by imprisonment in county jail for up to one year or a fine of up to $1,000 in the case of an individual or a fine of up to $5,000 in the case of a corporation, or both imprisonment and fine. [Sec. 1103.]

This bill would add a civil penalty, assessable against corporate employers only, of up to $10,000 for each violation of the whistleblower statute. This new civil penalty, according to proponents, would add a measure of deterrence to the whistleblower's corporate employer, because the

standard of proof that would be required for a civil penalty would be less than the "beyond a reasonable doubt" required for the misdemeanor penalty under Section 1103. The usual standard of proof for prosecuting a civil penalty is "preponderance of the evidence," unless a statute specifically states otherwise. [Evidence Code Sections 115,160, 500.]

c. Standard of proof in whistleblower suit is raised

According to proponents, one of the problems encountered in civil actions or administrative proceedings where an employee was retaliated against or discharged for whistleblowing activities is the standard of proof used by the courts. The rule has been, in California and in most states, that after the employee makes a showing, by preponderance of evidence, that an employer's adverse action is prohibited under Section 1102.5, the burden shifts to the employer to show, by preponderance of evidence, that the alleged action would have occurred for legitimate, independent reasons even if the employee had not engaged in whistleblowing activities. This, proponents state, has made it almost impossible for whistleblowers to win a challenged whistleblower lawsuit under Section 1102.5.

SB 777 would raise the standard of proof required for the employer to overcome the employees showing to proof by clear and convincing evidence.

By raising the standard of proof that the employer must meet, potential whistleblowers, proponents state, would find a safer haven, encourage reporting, and thus foster the early detection of financial fraud by a company.

This standard is currently in use by some jurisdictions, the District of Columbia, for example. Proponents state that national watchdog organizations are encouraging other states to enact the same change to their whistleblowing statutes.

d. Notice re: employee whistleblower rights and responsibilities, hotline number

This bill would require an employer to post a notice, in 14-point pica type, of an employee's rights and responsibilities under the whistleblower statute, including the Whistleblower Hotline number in the Attorney General's office. (For a discussion of the hotline, see Comment 4.)

The notice, proponents contend, would alert employees to their rights under the whistleblower statute and encourage those who would

otherwise be dissuaded by fears of retaliation to make relevant and substantive reports. Hopefully, they say, reports on this hotline will lead to substantive changes in the workplace or the prevention of Enron-type situations from occurring again. Specific notice of the employee's responsibilities would also give fair notice to employees and encourage them to act.

4. Whistleblower hotline in the Attorney General's office

This bill would establish a Whistleblower Hotline in the Attorney General's office. The hotline is for persons who have information regarding possible violations of state or federal statutes, rules, or regulations, or violations of fiduciary responsibility by a corporation or limited liability company (LLC) to its shareholders, investors, or employees. It is expected that this hotline would be used mainly by persons who would have no obligation to report under another section of this bill (see Comment 5, regarding obligation of officers, directors, and managers to report to the Attorney General).

So that the Attorney General (AG) would not be burdened with having to investigate every call received on the hotline, SB 777 gives the AG the authority to refer any call to an appropriate authority, including to itself, for review and possible investigation. Any information disclosed through the hotline would be held in confidence by the AG or the appropriate agency to whom the call may have been referred, during the initial review of the call. The information held confidential would include the name of the caller and the name of the employer. Thus, this hotline would not process anonymous calls.

The sponsor states that this is an extremely important component of a multi-pronged approach to the Enron-type situations that seem to pervade corporations in these times. As examples, they cite numerous emails posted on the Enron Message Board, recovered only after Enron filed for bankruptcy. One email, published in an article by James Felton, Associate Professor of Finance, Central Michigan University, in the Journal of Investing, states:

"It will soon be revealed that Enron is nothing more than a house of cards that will implode before anyone realizes what happened. Enron has been cooking the books with smoke and mirrors. The Enron executives have been operating an elaborate con scheme that has fooled even the most sophisticated analysts. When the truth is uncovered, those analysts and ENE investors will feel like a raped school girl. The first sign of trouble will be an earnings shortfall followed by more warnings. Criminal charges will be brought against ENE executives for their misdeeds. Class action lawsuits will complete the demise of ENE."

This email was number 11,460 on the message board, dated April 12, 2001, written by someone called "enron is a scam" and titled "Enron will soon collapse."

"ENE the virtual company. Profits for 10 years forward being taken in current years. When you shake it down what do you have? The paper mache company."

This was email number 238 from JanisJoplin298, dated June 17, 1998.

"Dig deep behind the Enron financials and you'll see a growing mountain of off-balance sheet debt which will eventually swallow this company. There's a reason they layer so many subsidiaries and affiliates. Be careful."

This email was posted on March 1, 2000 by arthur86plz.

The sponsor states that if the Whistleblower Hotline were in place at the time, whoever wrote these emails could have called in, knowing that his or her identity would be confidential as well as Enron's, during a review and possible investigation by the Attorney General or the Department of Corporations. The anonymity provided by the email, together with the privacy of the message board posting, makes it unlikely that a government agency with oversight responsibility over corporate reporting and disclosures could have ever discovered these warnings and initiated any investigation or review, the sponsor contends.

Last year's SB 1452/SB 783 contained similar hotline provisions, deemed by the Appropriations Committee to generate only minimal costs.

5. Civil penalties for failure to disclose knowledge of specified activity that distorts value of business

Section 6 of this bill would provide for civil penalties assessable against a corporation or its officers and directors or a limited liability company (LLC) or its members, and against managers who are responsible for financial transactions of the corporation or LLC, for having actual knowledge and then failing to disclose that knowledge of specific activities and statements that distort the value of the company or its shares.

This part of SB 777 is similar to provisions of the Corporate Criminal Liability Act of 1990 (Penal Code Section 387), which makes it a felony to know about and fail to report a hidden danger in the workplace setting or a product. SB 777 however would impose only civil penalties on offending corporations or

their officers and directors or limited liability companies and their members and managers.

a. For officers or directors of corporations, members of a limited liability company (LLC), or financial managers of a corporation or LLC

This bill would provide civil penalties of up to $10,000 for an officer or director of a corporation or a member of an LLC, and up to $5,000 for a manager responsible for financial transactions, for failing to make a disclosure to the Attorney General within 15 days of acquiring actual knowledge of specific improper activities of the corporation or LLC.

These specified activities are similar to those listed in Corporations Code Section 2254 and are related to material statements or omissions designed to give a distorted value to a company or its shares. Corporations Code Section 2254 is part of California's "blue skies" securities laws. Under SB 777, disclosure would be required if the corporation or its officers or directors, LLC or its members, or their agent:

i) is making or has made, published or concealed material facts about the condition of the company that are false and intended to give the company a greater or lesser apparent market value than it really possesses, whether made orally, or by written or electronic communication; or
ii) is refusing or has refused to make any book entry or post any notice as required by law; or
iii) is misstating or concealing or has misstated or concealed material facts in order to deceive or mislead a regulatory agency so as to avoid a regulatory or statutory duty or prohibition or limitation.

Under this bill, the duty to disclose would be excused if, within the 15-day period, the activity that creates a distorted value or deceives a regulatory agency was abated or the disclosure would violate a lawyer-client privilege. The latter provision was added to ensure that an officer or director of a corporation (or an LLC member) who is also legal counsel to the corporation or LLC would not be subject to the civil penalty when the lawyer-client privilege prevents him or her from making such a disclosure.

Also, under this bill an officer or director or an LLC member or a financial manager would not be relieved of the duty to disclose to the Attorney General if another person is also obligated to make the same disclosure. This, according to the sponsor of the bill, is important in order to

encourage all of those with actual knowledge of what is going on with the financial condition of the corporation or LLC to come forward with information. Thus, the AG or appropriate agency would have more information, rather than less, to work with in reviewing or investigating the disclosure.

b. For the corporation or LLC, a higher civil penalty

SB 777 would impose a civil penalty of up to $1 million per violation on a corporation or LLC that has actual knowledge of the same actions or information as described above and failed to do two things: (1) make the disclosure to the Attorney General in writing, and (2) warn its affected shareholders and investors in writing, unless the corporation or LLC has actual knowledge that the affected shareholders and investors have been warned.

Under the bill, the requirement to warn shareholders and investors is limited to the corporation or LLC, since it would have access to those who need to be warned and the facility for sending the warnings out.

This part of SB 777 is patterned after Section 387 of the Penal Code, which makes it a felony for a corporation to know about and then fail to report hidden dangers in the workplace or a product. That law, the only one of its kind in the country according to proponent Consumers Union (CU), has been used sparingly over the last twelve years since its enactment (only six times) and only in the most egregious cases of corporate wrongdoing. The CU believes that the existence of Penal Code Section 387 has had a deterrent effect on corporate crime. Therefore the group supports this bill as an "effort to prevent financial fraud before it grows large enough and serious enough to harm shareholders, pensioners, and consumers in the marketplace."

c. Limitations on liability for civil penalty

The bill limits applicability of the civil penalties imposed for failure to disclose as follows:

- The duty to disclose would be excused if the specified conduct, knowledge of which triggered the duty to warn the Attorney General, was abated before the 15-day period expired.
- The penalties would not apply for failure to notify the Attorney General if the corporation, LLC, officer, director, member or manager reasonably and in good faith believed that notification of an appropriate governmental agency was sufficient compliance with the duty to report to the Attorney General.

- It would apply only to corporations or LLCs that issue stocks or shares or other securities that are regulated by the federal Securities and Exchange Commission and are publicly traded on a stock exchange.
- It would not require disclosure that would result in a violation of the lawyer-client privilege. (See Comment 5a, page 11.)
- It may not be interpreted to deprive a person of the privilege against self-incrimination (i.e., one would not be obligated to report his or her own criminal wrongdoing) or to prevent a person from exercising that privilege.

By limiting the application of this part of the bill to publicly traded companies, the bill casts a smaller net to catch egregious conduct such as what executives in Enron and similarly situated companies did or did not do, yet leave the smaller, private corporations alone to conduct their business. The rationale, according to the sponsor, is that the effect of WorldCom and Enron-type situations on the market and the economy as a whole is more widespread, catastrophic even, and should be abated without creating a new duty, hence a burden, on smaller private corporations going about their business in compliance with the law.

d. Action for civil penalty may be brought by Attorney General, district or city attorney, acting on behalf of the people

This bill would allow the Attorney General (AG), district or city attorney, acting on behalf of the people, to file a civil suit to assess the civil penalties provided under this bill.

Opponents contend that the civil penalties imposed by the bill would encourage the filing of lawsuits under Business and Professions Code Section 17200, thus resulting in "legal shakedown lawsuits." Because this bill does not provide a private cause of action by a private citizen acting as a private attorney general, this contention has no merit.

5. Sarbanes-Oxley Act and SB 777

Opponents of SB 777 state that the passage of the Sarbanes-Oxley Act makes SB 777 unnecessary. Below are some comments regarding pertinent provisions of both pieces of legislation.

A. Whistleblower protections

(1) Federal protection only for disclosures in limited cases

The federal Act would protect corporate whistleblowers only if information is disclosed to Congress or to a federal agency. The

protections are also available when disclosure is made to a supervising internal authority in the corporation; however, this would apply only when the protected disclosure is made in connection with an investigation by a Congressional committee or federal agency (see Comment 2A(3) below.)
SB 777 would create a whistleblower hotline for financial fraud directly to the Attorney General, would require that the employer post whistleblower rights, and provide that the initial information provided on the hotline is confidential. Thus the protections afforded employees are greater than that available under the federal Act.

(2) Federal Act allows attorneys fees and costs, but not SB 777

The federal Act remedies for whistleblower violations allow for recovery of all "compensatory damages" (reinstatement with same seniority, back pay with interest, special damages, litigation costs and reasonable attorney's fees), and retention of rights under any state or federal law or collective bargaining agreement.

SB 777 does not provide for reasonable attorney's fees or costs of litigation (current Section 1102.5 does not), while current law already provides the rest of "compensatory damages" mentioned in the federal Act. SB 777 would not create any new recoverable damages for an employee who is discriminated against for whistleblowing.

(3) Federal Act protects only whistleblowers who provide information or participate in corporate fraud investigation; SB 777 does more

SB 777 would protect employees who refuse to perform illegal acts or conduct that would result in violations of law or regulations, whether state or federal. SB 777 also would protect from discrimination employees who were whistleblowers in former employment.

(4) Federal Act imposes more severe fines and jail terms; SB 777 imposes higher civil penalties

For violations of the federal whistleblowing statutes, Sarbanes-Oxley imposes severe fines and prison terms of up to 10 years, while SB 777 maintains the current penalties for misdemeanor violations but increases civil penalties on corporate or LLC employers from $5,000 to $10,000 per violation.

B. Obligations of officers, directors, LLC members and managers

(1) Federal Act focuses on financial statement filings; SB 777 on reporting specified acts to prevent fraud

Sarbanes-Oxley requires chief executive officers (CEOs) and chief financial officers (CFOs) only to certify financial statements submitted to the Securities and Exchange Commission or published for public consumption. It punishes officers, directors or their agents who coerce or influence an independent auditor for the purpose of rendering financial statements materially misleading.

SB 777 would require the CEO, CFO, and other directors and financial managers to report financial fraud to the Attorney General within 15 days, if they cannot stop the fraud internally. It also would require a warning to shareholders and investors. Proponents of SB 777 contend that this will help prevent corporate financial fraud while the federal Act will only come into play after the damage is done to investors and shareholders.

(2) Federal Act penalties for violations much heavier, but do not affect the goal of preventing fraud

Sarbanes-Oxley imposes penalties of up to 10 years in prison and/or up to $1 million in fines for violations regarding certification of the financial statements; for willful violations the penalty could be as high as 20 years imprisonment and/or up to $5 million in fines. The Act also requires disgorgement of certain profits and bonuses by a CEO/CFO, received during the 12-month period following the public issuance or filing of the misleading financial document with the SEC

SB 777 subjects a corporate executive or director or LLC member to a civil penalty of up to $10,000 and a manager to a penalty of up to $5,000 for a violation of the duty to warn the AG. For the corporation or LLC itself, the civil penalty could be as high as $1 million. The bill requires that the corporation or its officers/directors or the LLC or its members or financial managers have actual knowledge of fraudulent or misleading disclosures and that they each warn the Attorney General within 15 days (and in the case of corporations, shareholders also within the same 15 days), as a means of preventing financial disasters for investors, shareholders, and employees.

While the penalties under SB 777 are mild compared to those under Sarbanes-Oxley, proponents contend that SB 777 would be more effective in preventing the damage that corporate wrongdoing could cause. Their argument states that Sarbanes-Oxley penalizes acts or omissions related to filings with the SEC, and in the case of fraudulent

activities, only after the damage is done. SB 777 would instead encourage early reporting of corporate misbehavior, thus perhaps giving investors, shareholders and employees the opportunity to reassess their investments in the corporation or LLC.

Support: Sierra Club of California; Older Women's League; Consumers Union; California Independent Public Employees Legislative Council; California Labor Federation, AFL-CIO; California Conference Board of the Amalgamated Transit Union; Hotel Employees and Restaurant Employees International Union; California Conference of Machinists; United Food and Commercial Workers Region 8 States Council; Engineers and Scientists of California, IFPTE Local 20; Professional and Technical Engineers, IFPTE Local 21; The Teamsters Union; Consumer Attorneys of California; California Public Interest Research Group (CALPIRG); Gray Panthers

Opposition: American Electronics Association

HISTORY

Source: Foundation for Taxpayer and Consumer Rights

Related Pending Legislation: None Known

Prior Legislation: SB 1452 (Escutia) and SB 783 (Escutia). See Background and Comment 2

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EXHIBIT B

Date of Hearing: June 17, 2003

ASSEMBLY COMMITTEE ON JUDICIARY
Ellen M. Corbett, Chair
SB 777 (Escutia) – As Amended: May 29, 2003

SENATE VOTE: 23-14

SUBJECT: WHISTLEBLOWER PROTECTIONS

KEY ISSUES:

1) SHOULD THE WHISTLEBLOWER PROTECTION STATUTE BE AMENDED TO MANDATE REPORTING OF IMPROPER ACTIVITY TO THE ATTORNEY GENERAL WHEN COMPANIES AND THEIR MANAGEMENT HAVE ACTUAL KNOWLEDGE OF WRONGDOING?

2) SHOULD THE ATTORNEY GENERAL MAINTAIN A HOTLINE FOR THE RECEIPT OF WHISTLEBLOWING COMPLAINTS?

SYNOPSIS

This bill is substantially similar to a vetoed measure carried by the author last year. It arises in response to the recent spate of false business reports and other illegal activity by Enron, WorldCom and others. It is designed to encourage earlier and more frequent reporting of wrongdoing by employees and corporate managers when they have knowledge of specified illegal acts. The bill seeks to do so by expanding employee protection against retaliation, requiring the Attorney General (AG) to maintain a whistleblower hotline, requiring employers to notify employees of their rights and remedies, requiring top company officials to report to the AG if they have actual knowledge of specified improper activity by the company, and permitting a court to impose a civil penalty against a company for failure to report. The bill provides for a civil action to be brought by the AG, district attorneys, and city attorneys. In response to the Governor's veto message last year, the author has removed a provision regarding individual liability for officers and directors. In addition, the author has added a new statutory affirmative defense to employer liability for retaliation in violation of the whistleblower statute when the employer can show that it would have made the same decision for legitimate and independent reasons. In opposition it is contended that the bill is duplicative of federal law and therefore unnecessary, and will unfairly expose companies to frivolous litigation.

SUMMARY: Amends the whistleblower protection statute. Specifically, this bill:

1) Extends the existing prohibition against employer retaliation to employees who report violations of state or federal rules, and to employees who refuse to participate in illegal activity or activity that may result in violations of state or federal statute, rule or regulation.

2) Provides that an employer may not retaliate against an employee for having exercised his or her whistleblower rights in any former employment.

3) Provides that for government agency employees, reporting by the employee to the employer shall be deemed reporting to a government agency.

4) Provides an affirmative defense against retaliation claims, even when the employee demonstrates that a proscribed activity was a contributing factor to the adverse employment action, if employer shows by clear and convincing evidence that the adverse action would have occurred for legitimate, independent reasons.

5) Requires the AG to maintain a Whistleblower Hotline to receive calls about possible violations of state or federal statutes, rules or regulations, or violations of fiduciary responsibility by a corporation or limited liability company to its shareholders, investors or employees.

6) Requires an employer to display at the workplace a notice of an employee's rights and responsibilities under the whistleblower statutes, including the number of the whistleblower hotline.

7) Makes an employer that is a corporation or limited liability company (LLC) liable for a civil penalty not exceeding $10,000 for each violation of the foregoing obligations.

8) Makes a corporation or LLC liable for a civil penalty of up to $1,000,000 per violation for similar knowledge and inaction, including the failure to warn shareholders and investors in writing. No such reporting is required if the wrongful conduct is abated within the time period for reporting (15 days). Further provides that the penalties would not apply for a failure to duly notify the AG or appropriate government agency if the person has actual knowledge that the AG or appropriate government agency has been notified, and in the case of a corporation or LLC, that shareholders and investors have been warned. Further, no penalties would apply for the failure to duly notify the AG if the corporation or LLC, officer, director, member, or manager notified an appropriate governmental agency and reasonably and in good faith believed that such notification was compliance.

9) Provides that a civil action to assess the civil penalties under this bill may be brought by the AG, a district attorney, or a city attorney.

EXISTING LAW:

1) Prohibits an employer from adopting or enforcing any rule, regulation, or policy that prevents an employee from disclosing information to a government or law enforcement agency where the employee has reasonable cause to believe that the information discloses a violation of state or federal law, or regulation. (Labor Code Section 1102.5(a). Whistleblower protection statute.) (All further statutory references are to this code unless otherwise indicated.)

2) Prohibits an employer from retaliating against an employee for making disclosures protected by the whistleblower protection statute. (Section 1102.5(b).)

3) For purposes of the whistleblower protection statute, defines an "employee" to include persons who are employed by a state agency or its political subdivisions, a county or city and county, municipal or public corporation or political subdivision, a school district or community college district, or the University of California. (Section 1106.)

4) Makes a violation of the whistleblower protection statute, as well as other prohibited employer activity, a misdemeanor, punishable by imprisonment of up to one year or a fine of up to $1,000 in the case of an individual and up to $5,000 in the case of a corporation, or both imprisonment and fine. (Section 1103.)

FISCAL EFFECT: As currently in print, this bill is keyed fiscal.

COMMENTS: The author states that, except for two provisions and some clarifying changes, this bill is identical to SB 783 (Escutia) of 2002. That bill was vetoed by the Governor, with a message that he would sign legislation this year that would incorporate all of the components of SB 783, except for the provision imposing civil liability on "individuals who did not actually commit the wrongful act themselves." This bill omits that provision.

The sponsor of the bill, the Foundation for Taxpayer and Consumer Rights (FTCR), states that if enacted, SB 777 would be the strongest whistleblower protection and corporate accountability law in the nation. According to the sponsor, "While little can be heard above the din of war coverage, day after day, [newspaper] business sections around the country report new stories of corporate chicanery and financial fraud. Time and again, however, the information comes too late to prevent the damage and protect workers, pensioners, investors, and others hurt by corporate fraud and misbehavior." Besides last year's major corporate newsmakers, FTCR cites recent cases involving firings and guilty pleas from top executives of healthcare giant HealthSouth that surfaced only after more than a billion dollars of accounting fraud was discovered, and "accounting trickery at an El Segundo, California-based technology firm [that] may cost retirees and other investors tens of millions of dollars."

Prevention and Early Warning. The sponsor and other supporters of the bill state that despite passage of the federal Sarbanes-Oxley Act of 2002, reports of corporate wrongdoing continue to surface because the federal law largely ignored the invaluable role played by whistleblowers and the importance of requiring corporations to disclose fraud as soon as it becomes apparent. "Without an effective early warning system in place, the public cannot effectively preempt the devastation that comes with corporate fraud," FTCR argues. SB 777, proponents hope, would give California an "early warning system."

Supporters argue that this bill is needed to provide for early detection of corporate fraud and protect the public from financial deception and other violations of the public trust. While existing state and federal laws provide penalties for those who engage in corporate fraud, existing law provides no incentive to report – or more accurately, disincentive not to report – wrongdoing at an early stage before more harm occurs. The sponsor states the public has reacted with outrage and frustration to the intertwining scandals involving Enron Corporation and its accounting firm, Arthur Andersen, not to mention the growing list of companies that appear to have engaged in suspect accounting practices. Pensioners who are suffering as a result of the Enron collapse ask why the executives who oversaw this debacle are not going to jail. It has been more than five months since Enron executives drove their company into the ground and a number of them have exercised their Fifth Amendment right against self-incrimination before Congress, yet nobody at that company has been arrested. And California ratepayers who are facing the highest electricity bills in the country read of internal price gouging strategies by Enron and other power companies wonder why nobody came forward before the disaster struck.

Employer Retaliation Prohibited. Current law prohibits an employer from adopting or enforcing any rule that prevents an employee from disclosing information to a government or law enforcement agency where the employee has reason to believe that the information discloses a violation of state or federal law or regulation. The law also prohibits an employer from retaliating against an employee for making these disclosures. SB 777 would expand the protections of the whistleblower statute to employees who refuse to participate in employer activity that is in violation of state or federal law or rule or regulation, or who exercised his or her whistleblower rights in a former employment. Thus, under SB 777, an employee would not have to be an actual whistleblower, but could have simply refused to participate in the improper activities to be protected under the proposed change. The author further states that this bill also would codify the appellate court's ruling in *Gardenhire v. City of Los Angeles Housing Authority* that a government employee who has made a disclosure to his or her employing agency is deemed to have made the disclosure to a government or law enforcement agency under the whistleblower statute. Thus, a Department of Insurance employee's report of inappropriate activities at the department, for example, to his or her superior at the department would be deemed to be a protected whistleblower activity under this bill.

Additional Civil Penalty For Corporate Employers. A violation of the whistleblower statute and other prohibited employer activity under the Labor Code is a misdemeanor, punishable by imprisonment in county jail for up to one year or a fine of up to $1,000 in the case of an individual or a fine of up to $5,000 in the case of a corporation, or both imprisonment and fine. This bill would add a civil penalty of up to $10,000, assessable only against corporate employers, for each violation of the whistleblower statute. This new civil penalty, according to proponents, would add a measure of deterrence for the whistleblower's corporate employer, because the standard of proof that would be required for a civil penalty would be less than the "beyond a reasonable doubt" required for the misdemeanor penalty under Section 1103. The usual standard of proof for prosecuting a civil penalty is "preponderance of the evidence," unless a statute specifically states otherwise.

Codification of a "Same-Decision" Defense for Employers. SB 777 codifies a new affirmative defense for employers. Under the bill, in a civil action or administrative proceeding brought pursuant to Section 1102.5, once an employee demonstrates that activity proscribed by section 1102.5 was a contributing factor in the alleged prohibited action against the employee, the employer may nevertheless prevail if it can show by clear and convincing evidence that the alleged action would have occurred for legitimate, independent reasons even if the employee had not engaged in activities protected by Section 1102.5. The sponsor states that this defense is borrowed from federal law, including the Sarbanes-Oxley act and the federal employee Whistleblower Protection Act. According to the sponsor, this defense is currently in use in other jurisdictions, including the District of Columbia, and national watchdog organizations are encouraging other states to enact the same change to their whistleblowing statutes.

Whistleblower Hotline In The Attorney General's Office. This bill would establish a Whistleblower Hotline in the Attorney General's office. The hotline is for persons who have information regarding possible violations of state or federal statutes, rules, or regulations, or violations of fiduciary responsibility by a corporation or LLC to its shareholders, investors, or employees. So that the AG would not be burdened with having to investigate every call received on the hotline, the author states, the bill gives the AG the authority to refer any call to an appropriate authority, including to itself, for review and possible investigation. The author adds that any information disclosed through the hotline would be held in confidence by the AG or the

appropriate agency to whom the call may have been referred. The information held confidential would include the name of the caller and the name of the employer. Thus, according to the author, this hotline would not process anonymous calls. The sponsor states that this is an extremely important component of a multi-pronged approach to the Enron-type situations that seem to pervade corporations in these times. As examples, they cite numerous emails posted on the Enron Message Board, recovered only after Enron filed for bankruptcy. The author and sponsor state that they have worked with the AG's staff on this portion of the bill, to ensure that the AG's office would not be unduly burdened with the creation and maintenance of a whistleblower hotline mandated by this bill. According to the Senate Appropriations Committee analysis, the costs would be minimal.

Notice Regarding Employee Whistleblower Rights And Responsibilities. This bill would require an employer to post a notice, in 14-pica type, of an employee's rights and responsibilities under the whistleblower statute, including the Whistleblower Hotline number in the AG's office discussed next. The notice, proponents contend, would alert employees to their rights under the whistleblower statute and encourage those who would otherwise be dissuaded by fears of retaliation to make relevant and substantive reports. Hopefully, supporters say, reports on this hotline will lead to substantive changes in the workplace or the prevention of Enron-type situations from occurring again. Specific notice of the employee's responsibilities would also give fair notice to employees and encourage them to act.

Civil Penalties On Companies For Failure To Disclose Knowledge Of Specified Activity That Distorts Value Of Business. Section 6 of this bill would provide for a civil penalty civil penalty of up to $1 million per violation on a corporation or LLC that has actual knowledge of and fails to disclose specific activities and statements that distort the value of the company or its shares. The author states that this part of the bill is similar to provisions of the Corporate Criminal Liability Act of 1990 (Penal Code Section 387), which makes it a felony to know about and fail to report a hidden danger in a workplace or a product. SB 777 however is more limited in that it would impose only civil penalties. Also, unlike last year's SB 783, the author has amended this bill to remove any civil penalties against officers, directors or managers.

The author states that current Penal Section 387 makes it a felony for a corporation to know about and then fail to report hidden dangers in the workplace or a product. That law, the only one of its kind in the country according to proponent Consumers Union (CU), has been used sparingly over the last 12 years since its enactment (only six times) and only in the most egregious cases of corporate wrongdoing. The CU believes that the existence of Penal Code Section 387 has had a deterrent effect on corporate crime. Therefore, the group supports this bill as an "effort to prevent financial fraud before it grows large enough and serious enough to harm shareholders, pensioners, and consumers in the marketplace."

Limitations On Liability For Civil Penalty. The bill provides several limitations to the applicability of the civil penalties imposed for failure to disclose: the duty to disclose would be excused if the specified conduct knowledge of which triggered the duty was abated before the 15-day period expired. The penalties would not apply for failure to notify the Attorney General if the corporation, LLC, officer, director, member or manager reasonably and in good faith believed that notification of an appropriate governmental agency was in compliance. It would apply only to corporations or LLCs that issue stocks or shares or other securities that are regulated by the federal SEC and traded on a stock exchange (*i.e.*, publicly traded companies only). By limiting the application of this part of the bill to publicly traded companies, the bill

casts a smaller net to catch egregious conduct such as what executives in Enron and similarly situated companies did or did not do, yet leaves the smaller, private corporations alone to conduct their business. The rationale, according to the sponsor, is that the effect of Enron-type situations on the market and the economy as a whole is more widespread, catastrophic even, and should be abated without creating a new duty, hence a burden, on smaller private corporations going about their business in compliance with the law.

Attorney General, District Or City Attorney May Bring Action For Civil Penalty – But Not a Citizen Acting As Private Attorney General. This bill would allow the AG, district or city attorney to file a civil suit by which a court may assess civil penalties. In response to concerns expressed by opponents regarding earlier incarnations of this measure, the author has deleted an earlier provision allowing enforcement by private attorneys general provision.

ARGUMENTS IN OPPOSITION: In opposition to the bill, the American Electronics Association (AEA) argues that it duplicates existing securities laws and regulations, as well as common law fraud and unfair competition laws, and unfairly exposes companies to frivolous litigation.

In particular, AEA argues that SB 777 is unnecessary because it overlaps the recently-enacted federal Sarbanes-Oxley Act. AEA states that under the Sarbanes-Oxley Act, all periodic financial statements filed with the SEC must be accompanied by a written certification stating that the information contained in the report fairly represents all material information relating to the financial condition and results from operation of the company. AEA further states that the federal act creates significant new penalties, including criminal sanctions, for corporate executives who violate securities laws, and requires disgorgement of executive bonuses and other incentive compensation as well as profits from the sale of securities.

Supporters respond that Sarbanes-Oxley requires chief executive officers (CEOs) and chief financial officers (CFOs) only to certify financial statements submitted to SEC or published for public consumption. It punishes officers, directors or their agents who coerce or influence an independent auditor for the purpose of rendering financial statements materially misleading. Proponents of SB 777 contend that it will help prevent corporate financial fraud, while the federal Act will only come into play after the damage is done to investors and shareholders.

In addition, supporters argue, the federal Act protects corporate whistleblowers only if information is disclosed to Congress or to a federal agency. The protections are also available when disclosure is made to a supervising internal authority in the corporation when the protected disclosure is made in connection with an investigation by a Congressional committee or federal agency. On the other hand, supporters state, SB 777 creates a whistleblower hotline for financial fraud directly to the AG, requires that the employer post whistleblower rights, and provides that the initial information provided on the hotline is confidential. Thus, supporters argue, the protections afforded employees are greater than those available under the federal Act.

Prior Related Legislation. As discussed above, SB 783 (Escutia) of 2002 was a substantially similar but farther-reaching measure that passed this Committee but was vetoed by the Governor.

REGISTERED SUPPORT / OPPOSITION:

Support

Foundation for Individual and Taxpayer Rights (sponsor)
California Conference Board of the Amalgamated Transit Union
California Conference of Machinists
California Employment Lawyers Association
California Independent Public Employees Legislative Council
California Labor Federation, AFL-CIO
California Nurses Association
California Public Interest Research Group (CALPIRG)
Congress of California Seniors
Consumer Attorneys of California
Consumers for Auto Reliability and Safety
Consumers Union
Engineers and Scientists of California, IFPTE Local 20
Gray Panthers
Hotel Employees and Restaurant Employees International Union
Older Women's League
Professional and Technical Engineers, IFPTE Local 21
Sierra Club of California
Teamsters Union
United Food and Commercial Workers Region 8 States Council

Opposition

American Electronics Association

Analysis Prepared by: Kevin G. Baker / JUD. / (916) 319-2334

EXHIBIT C

SENATE RULES COMMITTEE
Office of Senate Floor Analyses
1020 N Street, Suite 524
(916) 445-6614 Fax: (916) 327-4478

SB 777

UNFINISHED BUSINESS

Bill No: SB 777
Author: Escutia (D)
Amended: 8/18/03
Vote: 21

SENATE JUDICIARY COMMITTEE: 4-1, 4/8/03
AYES: Escutia, Cedillo, Kuehl, Sher
NOES: Morrow
NO VOTE RECORDED: Ackerman, Ducheny

SENATE APPROPRIATIONS COMMITTEE: Senate Rule 28.8

SENATE FLOOR: 23-14, 5/8/03
AYES: Alarcon, Alpert, Bowen, Burton, Cedillo, Chesbro, Ducheny, Escutia, Figueroa, Florez, Karnette, Kuehl, Murray, Ortiz, Perata, Romero, Scott, Sher, Soto, Speier, Torlakson, Vasconcellos, Vincent
NOES: Aanestad, Ackerman, Ashburn, Battin, Brulte, Denham, Hollingsworth, Knight, Margett, McClintock, McPherson, Morrow, Oller, Poochigian
NO VOTE RECORDED: Dunn, Johnson, Machado

ASSEMBLY FLOOR: 47-29, 8/21/03 - See last page for vote

SUBJECT: Whistleblower protections

SOURCE: Foundation for Taxpayer and Consumer Rights

DIGEST: This bill provides additional "whistleblower" protections for refusal to perform unlawful conduct and for an employee's acts on a previous job. This bill requires the State Attorney General to maintain a

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whistleblower hotline for corporate crime and regulatory misconduct and to refer calls to the appropriate investigative or regulatory agency.

Assembly Amendments (1) delete provisions imposing civil penalties on officers or directors of corporations or members of limited liability companies referenced in Section 1102.9 of the Labor Code and moved those provisions to SB 523 (Escutia), (2) delete language relative to self-incrimination, and (3) add provisions relating to state agency compliance.

ANALYSIS:

1. Existing law prohibits an employer from adopting or enforcing any rule, regulation, or policy that prevents an employee from disclosing information to a government or law enforcement agency where the employee has reasonable cause to believe that the information discloses a violation of state or federal law or regulation. [Section 1102.5(a) of the Labor Code. All references are to the Labor Code, unless otherwise indicated.] This statute is commonly known as the "Whistleblower Protection Statute" or "whistleblower statute."

   Existing law prohibits an employer from retaliating against an employee for making these disclosures.

   This bill provides that an employer may not retaliate against an employee for refusing to participate in an illegal activity or activity that may result in violations of state or federal statute or regulation.

   This bill provides that an employer may not retaliate against an employee for having exercised his or her whistleblower rights in any former employment.

2. Existing law, for purposes of the above provisions, defines an "employee" to include persons who are employed by a state agency or its political subdivisions, a county or city and county, municipal or public corporation or political subdivision, a school district or community college district, or the University of California.

   This bill provides that for government agency employees, reporting by the employee to the employer shall be deemed reporting to a government agency.

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This codifies the appellate court's rules in Gardenhire v. City of Los Angeles Housing Authority.

3. Under existing law, a violation of Section 1102.5 (the whistleblower protection statute) as well as other prohibited employer activity, is a misdemeanor, punishable by imprisonment of up to one year or a fine of up to $1,000 in the case of an individual and up to $5,000 in the case of a corporation, or both imprisonment and fine.

   This bill makes an employer that is a corporation or limited liability company liable for a civil penalty not exceeding $10,000 for each violation.

4. Existing case law provides that, after a plaintiff shows by a preponderance of evidence that the action taken by the employer is proscribed by the whistleblower statute, the burden shifts to the employer to show by a preponderance of the evidence that the alleged action would have occurred for legitimate, independent reasons even if the employee had not engaged in activities protected by the whistleblower statute. [Morgan v. Regents of University of California (2000) 88 Cal.App.4th 52; McDonnell Douglas Corp. v. Green (1973) 411 U.S. 792.]

   This bill instead requires the employer to make that showing by clear and convincing evidence.

5. This bill requires the AG to maintain a whistleblower hotline to receive calls about possible violations of state or federal statutes, rules or regulations, or violations of fiduciary responsibility by a corporation or LLC to its shareholders, investors or employees.

   This bill requires the AG to refer calls received on the whistleblower hotline to the appropriate government authority for review and possible investigation, and to hold in confidence information disclosed through the hotline.

   This bill requires an employer to display at the workplace a notice of an employee's rights and responsibilities under the whistleblower statutes, including the number of the AG's whistleblower hotline. This bill provides that any state agency shall be deemed in compliance with the

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above requirement if any posting already required by law also contains the whistleblower hotline number.

Background

Except for two provisions and some clarifying changes, this bill is identical to SB 783 (Escutia, 2002). SB 783 contained the entire language of SB 1452 (Escutia, 2002), which was passed by the Senate Judiciary Committee and the Senate prior to the summer recess. SB 783 was vetoed by the Governor, with a message that he would sign legislation this year that would incorporate all of the components of SB 783, except for the provision imposing civil liability on "individuals who did not actually commit the wrongful act themselves." The Governor's veto message specifically objected to the civil liability of officers, directors and managers of corporations and members of limited liability companies for failing to report certain activities to the AG or the shareholders.

Between the time SB 1452 was heard in the Senate Judiciary Committee and the enrollment of SB 783 to the Governor, Congress enacted the Sarbanes-Oxley Act of 2002 (Act). The Act addressed accounting industry reform and oversight, some corporate governance and financial reporting issues, and increased the penalties for criminal conduct by executives.

The sponsor of this bill, the Foundation for Taxpayer and Consumer Rights, contends that while the Act addresses major corporate accounting and reporting problems, the Act imposes penalties on corporate executives mostly for actions related to SEC filings and, where fraud is involved, only after damage has been done to shareholders, investors and employees. The sponsor states that SB 777 is needed in order to prevent the kind of damage to shareholders, investors, employees and the market that Enron and WorldCom, and now HealthSouth continue to cause.

Prior Legislation

SB 1452 (Escutia) passed the Senate Floor with a vote of 21-15 on 6/20/02 (NOES: Ackerman, Battin, Brulte, Haynes, Johannessen, Johnson, Knight, Machado, Margett, McClintock, McPherson, Monteith, Oller, Peace, Poochigian). The bill died in the Assembly Judiciary Committee.

SB 783 (Escutia) passed the Senate Floor with a vote of 21-11 on 8/30/02 (NOES: Ackerman, Battin, Brulte, Haynes, Margett, McClintock,

CONTINUED

McPherson, Monteith, Morrow, Oller, Poochigian). The bill was vetoed by the Governor.

In his veto message the Governor wrote:

> "While the vast majority of the bill's provisions have merit, our main focus should be on punishing wrongdoers and encouraging reporting of wrongdoing. Along those lines, I would sign legislation next year that includes the important provisions of this bill that establish a whistleblower hotline at the Attorney General's Office, further protect whistleblowers against retaliation, and require employers to post notices of whistleblower rights. I would also support the provisions in Section 5(b) of this bill that pins liability on the corporation for various acts and non-acts. However, I am concerned about the provisions in Section 5(a) that would place liability on individuals who did not actually commit the wrongful act themselves."
>
> "I am directing my Task Force on Corporate Governance, which I established last month and is chaired by the Secretaries of Business, Transportation, and Housing and State and Consumer Services Agencies, to work with the author on drafting this legislation."
>
> "I strongly support the highest corporate responsibility and accountability standards for our corporate executives."

For more details see the Senate Judiciary Committee analysis.

FISCAL EFFECT: Appropriation: No Fiscal Com.: Yes Local: Yes

SUPPORT: (Verified 8/21/03)

California Conference Board of the Amalgamated Transit Union
California Conference of Machinists
California Independent Public Employees Legislative Council
California Labor Federation, AFL-CIO
California Public Interest Research Group (CALPIRG)
Consumer Attorneys of California
Consumers Union
Engineers and Scientists of California, IFPTE Local 20
Gray Panthers
Hotel Employees and Restaurant Employees International Union

CONTINUED

Older Women's League
Professional and Technical Engineers, IFPTE Local 21
Sierra Club of California
The Teamsters Union
United Food and Commercial Workers Region 8 States Council

ARGUMENTS IN SUPPORT: The bill's sponsor states that if enacted, this bill would be the strongest whistleblower protection and corporate accountability law in the nation.

According to the sponsor, "while little can be heard above the din of war coverage, day after day, [newspaper] business sections around the country report new stories of corporate chicanery and financial fraud. Time and again, however, the information comes too late to prevent the damage and protect workers, pensioners, investors, and others hurt by corporate fraud and misbehavior." Besides last year's major corporate newsmakers, they cite recent cases involving firings and guilty pleas from top executives of healthcare giant HealthSouth that surfaced only after more than a billion dollars' worth of accounting fraud was discovered, and "accounting trickery at an El Segundo, California-based technology firm [that] may cost retirees and other investors tens of millions of dollars."

The sponsor and other supporters of the bill state that despite passage of the Act, these stories of corporate wrongdoing continue to surface because the new law largely ignored the invaluable role played by whistleblowers and the importance of requiring corporations to disclose fraud as soon as it becomes apparent. "Without an effective early warning system in place, the public cannot effectively preempt the devastation that comes with corporate fraud." Proponents hope this bill gives California an "early warning system."

ASSEMBLY FLOOR:
AYES: Berg, Bermudez, Calderon, Canciamilla, Chan, Chavez, Chu, Cohn, Corbett, Correa, Diaz, Dutra, Dymally, Frommer, Goldberg, Hancock, Jerome Horton, Jackson, Kehoe, Koretz, Laird, Leno, Levine, Lieber, Liu, Longville, Lowenthal, Matthews, Montanez, Mullin, Nakano, Nation, Negrete McLeod, Nunez, Oropeza, Parra, Pavley, Reyes, Ridley-Thomas, Salinas, Simitian, Steinberg, Vargas, Wiggins, Wolk, Yee, Wesson

CONTINUED

NOES: Aghazarian, Bates, Benoit, Bogh, Campbell, Cogdill, Cox, Daucher, Dutton, Garcia, Haynes, Shirley Horton, Houston, Keene, La Malfa, Leslie, Maddox, Maldonado, Maze, McCarthy, Mountjoy, Nakanishi, Pacheco, Plescia, Richman, Runner, Samuelian, Strickland, Wyland

RJG:mel 8/22/03 Senate Floor Analyses

SUPPORT/OPPOSITION: SEE ABOVE

****** END ******

EXHIBIT D

484

ENROLLED BILL MEMORANDUM TO GOVERNOR

BILL NO: SB 777 **AUTHOR:** Escutia **DATE:** 10/06/03 **DATE DUE:** 10/12/03

SENATE: 23-14 **ASSEMBLY:** 47-29 **CONCURRENCE:** 22-12

REVIEWED BY: **RECOMMENDATION:** **Sign** ☐ **Veto** ☐

SUMMARY: This bill extends the current protection of the state whistleblower law by: (1) providing that an employer may not retaliate against an employee for refusing to participate in an activity that would result in a violation of state or federal statute or regulation (2) establishing an Attorney General whistleblower "hotline," (3) requiring employer to post notices of employee's rights and responsibilities under the whistleblower laws, and (4) increasing the burden of proof on the employer to a clear and convincing evidence standard in civil or administrative action related under the whistleblower statute, which is similar to the Sarbanes-Oxley Act of 2002. According to the author, the liability on the corporation portion of the bill had to be placed into SB 523 (Escutia) because it would have violated the single-subject rule (pursuant to Ca Constitution Art. IV Sec. 9)

SPONSOR: Foundation for Taxpayer and Consumer Rights

SUPPORT: Business, Transportation and Housing Agency
Department of Corporations
State and Consumer Services Agency
Public Employees' Retirement System
Youth and Adult Correctional Agency
Department of Corrections
Department of Finance
Consumer Federation of California/ Consumer Attorneys of California
California Nurses Association
Congress of California Seniors/ Gray Panthers
Sierra Club of California
Various Labor (AFL/CIO, Teamsters, Professional Engineers, Hotel Employees)

OPPOSITION: None received.

FISCAL IMPACT: The Attorney General indicates an absorbable cost of $70,000 associated with establishing and maintaining the whistleblower hotline.

ARGUMENTS IN SUPPORT: In light of the Enron and WorldCom scandals, the purpose of the bill is to protect employees who refuse to act at the direction of their employer or refuse to participate in activities that would result in a violation of the law. Current whistleblower law prohibits an employer from enforcing any rule that would prevent an employee from disclosing state or federal violation, and prohibits employer from retaliating if he or she discloses a wrongdoing.

EXHIBIT E

Senate Bill No. 777

CHAPTER 484

An act to amend Sections 1102.5 and 1106 of, and to add Sections 1102.6, 1102.7, 1102.8, and 1102.9 to, the Labor Code, relating to whistleblowers.

[Approved by Governor September 22, 2003. Filed with Secretary of State September 22, 2003.]

LEGISLATIVE COUNSEL'S DIGEST

SB 777, Escutia. Whistleblowers.

Existing law prohibits employers from making, adopting, or enforcing a policy that prevents an employee from disclosing violations of a state or federal statute, or a violation or noncompliance with a state or federal regulation to a government or law enforcement agency, or from retaliating against an employee who makes a disclosure. It makes a violation punishable as a misdemeanor.

This bill would extend these protections to employees who report a violation of a state or federal rule, who refuse to participate in an activity that would result in a violation of state or federal statute, or a violation or noncompliance with a state or federal rule or regulation, or who exercised these rights in former employment. This bill would prohibit an employer from retaliating against an employee for exercising any of these rights, including those provided under existing law, would add an additional civil penalty for violations, and would establish the evidentiary burdens of the parties participating in a civil action or administrative hearing involving an alleged violation of the bill's provisions. This bill would establish a "whistleblower hotline" within the office of the Attorney General to receive telephone reports of violations of state or federal statutes, rules, or regulations, or fiduciary responsibilities, by an employer. The bill would require the Attorney General to refer calls received on this hotline to the appropriate government authority, as specified.

This bill would also require an employer to display, as specified, a list of an employee's rights under whistleblower laws, including the telephone number of the hotline created by the bill.

Because a violation of the provisions added by this bill would constitute a misdemeanor, this bill would create a state-mandated local program.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state.

Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

The people of the State of California do enact as follows:

SECTION 1. The Legislature finds and declares that unlawful activities of private corporations may result in damages not only to the corporation and its shareholders and investors, but also to employees of the corporation and the public at large. The damages caused by unlawful activities may be prevented by the early detection of corporate wrongdoing. The employees of a corporation are in a unique position to report corporate wrongdoing to an appropriate government or law enforcement agency.

The Legislature finds and declares that it is the public policy of the State of California to encourage employees to notify an appropriate government or law enforcement agency when they have reason to believe their employer is violating laws enacted for the protection of corporate shareholders, investors, employees, and the general public.

It is the intent of the Legislature to protect employees who refuse to act at the direction of their employer or refuse to participate in activities of an employer that would result in a violation of law.

SEC. 2. Section 1102.5 of the Labor Code is amended to read:

1102.5. (a) An employer may not make, adopt, or enforce any rule, regulation, or policy preventing an employee from disclosing information to a government or law enforcement agency, where the employee has reasonable cause to believe that the information discloses a violation of state or federal statute, or a violation or noncompliance with a state or federal rule or regulation.

(b) An employer may not retaliate against an employee for disclosing information to a government or law enforcement agency, where the employee has reasonable cause to believe that the information discloses a violation of state or federal statute, or a violation or noncompliance with a state or federal rule or regulation.

(c) An employer may not retaliate against an employee for refusing to participate in an activity that would result in a violation of state or federal statute, or a violation or noncompliance with a state or federal rule or regulation.

(d) An employer may not retaliate against an employee for having exercised his or her rights under subdivision (a), (b), or (c) in any former employment.

(e) A report made by an employee of a government agency to his or her employer is a disclosure of information to a government or law enforcement agency pursuant to subdivisions (a) and (b).

(f) In addition to other penalties, an employer that is a corporation or limited liability company is liable for a civil penalty not exceeding ten thousand dollars ($10,000) for each violation of this section.

(g) This section does not apply to rules, regulations, or policies which implement, or to actions by employers against employees who violate, the confidentiality of the lawyer-client privilege of Article 3 (commencing with Section 950), the physician-patient privilege of Article 6 (commencing with Section 990) of Chapter 4 of Division 8 of the Evidence Code, or trade secret information.

SEC. 3. Section 1102.6 is added to the Labor Code, to read:

1102.6. In a civil action or administrative proceeding brought pursuant to Section 1102.5, once it has been demonstrated by a preponderance of the evidence that an activity proscribed by Section 1102.5 was a contributing factor in the alleged prohibited action against the employee, the employer shall have the burden of proof to demonstrate by clear and convincing evidence that the alleged action would have occurred for legitimate, independent reasons even if the employee had not engaged in activities protected by Section 1102.5.

SEC. 4. Section 1102.7 is added to the Labor Code, to read:

1102.7. (a) The office of the Attorney General shall maintain a whistleblower hotline to receive calls from persons who have information regarding possible violations of state or federal statutes, rules, or regulations, or violations of fiduciary responsibility by a corporation or limited liability company to its shareholders, investors, or employees.

(b) The Attorney General shall refer calls received on the whistleblower hotline to the appropriate government authority for review and possible investigation.

(c) During the initial review of a call received pursuant to subdivision (a), the Attorney General or appropriate government agency shall hold in confidence information disclosed through the whistleblower hotline, including the identity of the caller disclosing the information and the employer identified by the caller.

(d) A call made to the whistleblower hotline pursuant to subdivision (a) or its referral to an appropriate agency under subdivision (b) may not be the sole basis for a time period under a statute of limitation to commence. This section does not change existing law relating to statutes of limitation.

SEC. 5. Section 1102.8 is added to the Labor Code, to read:

1102.8. (a) An employer shall prominently display in lettering larger than size 14 pica type a list of employees' rights and responsibilities under the whistleblower laws, including the telephone number of the whistleblower hotline described in Section 1102.7.

(b) Any state agency required to post a notice pursuant to Section 8548.2 of the Government Code or subdivision (b) of Section 6128 of the Penal Code shall be deemed in compliance with the posting requirement set forth in subdivision (a) if the notice posted pursuant to Section 8548.2 of the Government Code or subdivision (b) of Section 6128 of the Penal Code also contains the whistleblower hotline number described in Section 1102.7.

SEC. 7. Section 1106 of the Labor Code is amended to read:

1106. For purposes of Sections 1102.5, 1102.6, 1102.7, 1102.8, 1104, and 1105, "employee" includes, but is not limited to, any individual employed by the state or any subdivision thereof, any county, city, city and county, including any charter city or county, and any school district, community college district, municipal or public corporation, political subdivision, or the University of California.

SEC. 8. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

O

STATE OF CALIFORNIA
Supreme Court of California

PROOF OF SERVICE

STATE OF CALIFORNIA
Supreme Court of California

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Case Number: **S266001**
Lower Court Case Number:

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

7/1/2021

Date

/s/MaryAnn Galapon

Signature

Seitz, Nicholas (287568)

Last Name, First Name (PNum)

DLSE Legal

Law Firm