Confidential Witnesses in Securities Litigation

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This Article examines the two primary issues associated with the almost universal use by plaintiffs of confidential witnesses in class action securities litigation. The first issue is whether the information provided by such witnesses should be steeply discounted in light of a 2007 decision by the United States Supreme Court concerning the pleading of scienter in securities cases. The second issue is whether the identities of confidential witnesses should be discoverable in advance of trial. This Article concludes that: (1) courts should not discount information provided by confidential witnesses for use in securities fraud complaints if the witnesses are described with sufficient particularity to support the probability that persons in the positions occupied by the witnesses would possess the information alleged; and (2) in general, the identities of confidential witnesses should not be discoverable unless the witnesses will testify at trial.
D. The Informant’s Privilege Justifies Non-Disclosure of Confidential Witnesses

E. The Reporter’s Privilege Justifies Non-Disclosure of Confidential Witnesses

F. Whistleblower Statutes Fail to Adequately Protect Confidential Witnesses

Conclusion

Introduction

The use of confidential witnesses in class action securities litigation has become ubiquitous in the years since Congress enacted the Private Securities Litigation Reform Act of 1995 (PSLRA, Act)\(^1\) in an effort to curb perceived abuses by plaintiffs’ lawyers in securities litigation.\(^2\) Two specific aspects of the PSLRA have driven this trend to use anonymous sources for facts alleged in securities fraud complaints. First, Congress raised the bar for pleading securities fraud. Second, Congress mandated a stay of discovery in all private securities litigation during the pendency of a motion to dismiss, subject to two limited exceptions.

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In particular, the PSLRA imposed two distinct pleading requirements, both of which must be met in order for a complaint to survive a motion to dismiss. The complaint must specify each allegedly misleading statement, why the statement was misleading, and, if an allegation is made on information and belief, “all facts” supporting that belief with particularity. In addition, the complaint must, with respect to each act or omission alleged to violate the securities laws, state with particularity facts giving rise to a “strong inference” that the particular defendant acted with the requisite state of mind.

Congress coupled the PSLRA’s strict pleading standard with a mandatory stay of discovery during the pendency of a motion to dismiss, absent application of one of two statutory exceptions. Thus, so long as a motion to dismiss by any defendant is

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5 Prior to the enactment of the PSLRA in 1995, defendants in federal securities cases were required to participate in discovery during the pendency of motions to dismiss. Defendants could avoid discovery only by moving for a protective order, requesting a stay, and showing good cause under Rule 26(c) of the Federal Rules of Civil Procedure (“Federal Rules”). Such motions were typically denied. Brian Philip Murray, Lifting the PSLRA “Automatic Stay” of Discovery, 80 N.D. L. Rev. 405, 407 & n.19 (2004). The PSLRA changed the rules of the game. It provides: “In any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.” 15 U.S.C. § 78u-4(b)(3)(B). The PSLRA’s stay provision was enacted for two reasons: (1) to prevent plaintiffs from commencing class action securities litigation with the intent to use the discovery process to coerce settlements; and (2) to prevent plaintiffs from filing securities suits as a vehicle to conduct discovery in the hope of finding a sustainable claim. In re Thornburg Mortg., Inc. Sec. Litig., No. CIV 07-0815 JB/WDS, 2010 WL 2977620, at *6 (D.N.M. July 1, 2010).
6 The two exceptions are when particularized discovery is necessary to preserve evidence or to prevent undue prejudice to the party seeking relief. 15 U.S.C. § 78u-4(b)(3)(B).
pending, or even contemplated, discovery (expedited or otherwise) is stayed for the entire case, even if there are multiple defendants, some of whom have had their motions to dismiss denied and/or have answered. Because the stay includes motions to dismiss amended complaints and motions for reconsideration of orders on motions to dismiss, it is of great practical significance. Given the frequency with which original complaints are amended in securities litigation, the net result can be that months or years pass before discovery begins in earnest. This is the typical pattern, because

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7 Discovery has been stayed in PSLRA cases where motions to dismiss were merely contemplated. See, e.g., Friedman v. Quest Energy Partners LP, Nos. CIV-08-936-M, CIV-08-968-M, 2009 WL 5065690, at *2 n.2 (W.D. Okla. Dec. 15, 2009); Sedona Corp. v. Ladenburg Thalmann, No. 03 Civ. 3120 LTSTHK, 2005 WL 2647945, at *2 n.1 (S.D.N.Y. Oct. 14, 2005) (“There is no dispute that the PSLRA stay applies when an initial motion to dismiss is contemplated, but has not yet been filed.”).

8 See Lane v. Page, No. CIV 06-1071 JB/ACT, 2009 WL 1312896, at *1 (D.N.M. Feb. 9, 2009) (“The result may be harsh, but Congress has clearly expressed a desire that discovery not proceed in any securities litigation the PSLRA covers until all pending motions to dismiss have been resolved.”); Fazio v. Lehman Bros., Inc., No. 1:02CV157, 1:02CV370, 1:02CV382, 2002 WL 32121836, at *2 (N.D. Ohio May 16, 2002) (holding that stay applies even as to discovery against co-defendants who have not filed motions to dismiss). But see Latham v. Stein, Civ. Action Nos. 6:08-2995-RBH., ^;08-3183-RBH, 2010 WL 3294722, at *3 (D.S.C. Aug. 20, 2010) (lifting stay as to certain defendants whose motions to dismiss had been denied); In re Lernout & Hauspie Sec. Litig., 214 F. Supp. 2d 100, 106 (D. Mass. 2002) (same).


plaintiffs have generally failed in their efforts to have the PSLRA’s mandatory discovery stay lifted, under either the first or second statutory exceptions.

The combination of the PSLRA’s strict pleading requirements and discovery stay explains why the use of confidential witnesses has become so common. Plaintiffs must plead their cases with particularity, but they are generally barred from obtaining discovery to bolster their allegations until after all motions to dismiss have been decided. The result has been almost universal reliance by plaintiffs in class action securities complaints on information provided by confidential witnesses.


13 The most commonly asserted basis for a claim of undue prejudice is the existence of parallel litigation, or parallel criminal or regulatory investigations, which required class action defendants to produce documents to other plaintiffs, the government, or an investigating body. Courts usually reject this argument. See, e.g., Kuriakose v. Federal Home Loan Mort. Co., No. 08-cv-7281, 2009 WL 4609591 (S.D.N.Y. Dec. 7, 2009) (refusing to lift stay where about 400,000 documents had been produced by lead defendant during active investigations conducted by the SEC, the U.S. Attorney’s Office, and a House committee); In re Schering-Plough Corp./Enhance Sec. Litig., Civ. Action No. 08-397, 2009 WL 1470453 (D.N.J. May 22, 2009). But see Waldman v. Wachovia Corp., No. 08 Civ. 2913(SAS), 2007 WL 86763, at *2 (S.D.N.Y. Jan. 12, 2009) (lifting stay with regard to documents already produced to state and federal authorities); Sarah S. Gold & Richard L. Spinogatti, Are the PSLRA Discovery Stay Exceptions Swallowing the Rule?, N.Y.L.J., Dec. 9, 2009, at 3.


15 See, e.g., Hon. T.S. Ellis, II, et al., Shifting the Securities Law Paradigm: The Brave New World of Litigating a Federal Securities Fraud Action 3 (Apr. 16-18, 2008), ABA Section of Litigation Annual Conference (http://www.abanet.org/litigation/prog_materials/2008_sectionannual/030.pdf (“Confidential sources are a commonplace, if not omnipresent, feature of today’s securities fraud class action complaint.”)); Barry G. Sher & Israel David, The Confidential Source in Securities Fraud Lawsuits, N.Y.L.J., Apr. 25, 2005, at 2 (“Seemingly every securities fraud lawsuit has one these days—a ‘confidential source’ who supposedly can corroborate the key allegations in the
The use of such witnesses, who typically are current or former employees, customers or suppliers\textsuperscript{16} fearful of retaliation if their identities are disclosed,\textsuperscript{17} has raised significant issues concerning pleading and discovery in securities cases. The primary pleading issue is whether and to what extent the information provided by confidential witness must be discounted in the aftermath of the 2007 decision by the United States Supreme Court in \textit{Tellabs, Inc. v. Makor Issues & Rights, Ltd.} (\textit{Tellabs}).\textsuperscript{18} In that case the Court resolved a circuit split concerning interpretation of the “strong inference” standard. The Court did not address the use of confidential witnesses, but nevertheless numerous federal courts have applied \textit{Tellabs} to assess the use of such witnesses. Many courts, following the lead of the Seventh Circuit in \textit{Higginbotham v. Baxter,}\textsuperscript{3}
International, Inc. (Higginbotham), have concluded that the information supplied by confidential witnesses in securities fraud complaints must be steeply discounted when deciding motions to dismiss. Other courts have rejected Higginbotham and eschewed automatic discounting.

The key discovery issue is whether the identities of confidential witnesses must be disclosed by plaintiffs in advance of trial. Federal district courts which have considered this latter issue are split into two camps. Post-PSLRA, a majority has held that the identities of confidential witnesses who provide information set forth in a securities fraud complaint are generally discoverable, and a minority has held that the identities are protected from disclosure as attorney work product and/or on public policy grounds. No federal appellate court had resolved the issue by mid-2010.

This Article provides a framework for analyzing and resolving both the pleading and discovery issues. Part I sets forth background information concerning the use of confidential witnesses in connection with specific claims under the securities laws. Part II considers the use of confidential witnesses prior to Tellabs. Part III examines Tellabs and its application by the lower federal courts. Part IV critiques those decisions which have applied Tellabs to automatically discount information provided by confidential witnesses. Each reason given by Higginbotham and similar decisions to support automatic discounting is reviewed and rejected. Particular attention is paid to Higginbotham’s erroneous conclusion that discounting is justified because discovery of the identities of confidential witnesses is inevitable.

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19 495 F.3d 753 (7th Cir. 2007). See also Jared L. Kopel, Key Securities Law Litigation: Supreme Court, SEC, and FCPA Cases, ASPATORE, 2010 WL 2832729, at *8 (July 2010) (noting the circuit split on whether to accept information provided by CWs as a basis for finding a strong inference of scienter).
The Article concludes that (1) courts should not discount information provided by confidential witnesses for use in securities fraud complaints if the witnesses are described with sufficient particularity to support the probability that persons in the positions occupied by the witnesses would possess the information alleged; and (2) in general, the identities of confidential witnesses should not be discoverable unless the witnesses will testify at trial. A central theme is that imposing a general requirement of disclosure of confidential sources is likely to invite retaliation against them, or have a significant chilling effect that deters informants from providing critical information to plaintiffs’ investigators in meritorious cases, thereby undermining the federal securities laws and the public policy rationale for such laws.

I. Class Action Securities Litigation Background

The volume of class action securities litigation, while subject to annual fluctuations, has remained elevated since the enactment of the PSLRA. During the period January 1, 1996 to June 30, 2010, approximately 3,120 securities class actions were filed in federal court. Of this total, 71 federal securities class actions were filed in the first half of 2010 and 168 were filed in 2009, compared with 223 filings in 2008 and an annual average of 197 filings between 1997 and 2008. Confidential witnesses are

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commonly used to bolster claims asserted under the securities law provisions most frequently utilized in class action securities litigation, which are Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and companion Rule 10b-5. In 2009, 66 percent of filed securities class actions alleged 10b-5 claims (down from 91 percent in 2005).

21 See 15 U.S.C. §78j. Section 10(b) prohibits the “use or employ[ment], in connection with the purchase or sale of any security . . ., (of) any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange Commission (SEC)] may prescribe. . . .” Id.

22 17 C.F.R. §240.10b-5 (2006). Rule 10b-5, promulgated by the SEC under the authority of the Exchange Act, is the “catch-all” anti-fraud provision -- it proscribes fraudulent conduct in connection with the purchase or sale of any security. In order to state a claim for a violation of Rule 10b-5, which encompasses only conduct already prohibited by Section 10(b), plaintiffs must allege six elements: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation (i.e., the economic loss must be proximately caused by the misrepresentation or omission). Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 157 (2008). When Congress enacted the PSLRA it addressed only the misrepresentation and scienter elements of a claim for securities fraud. Consequently, the other elements continue to be analyzed under the pleading standards of the Federal Rules. In re Mut. Funds Inv. Litig., 566 F.3d 111, 120-11 (4th Cir. 2009); Latham v. Mathews, 662 F. Supp.2d 441, 462 (D.S.C. 2009).

23 2009: A Year in Review, supra note 20, at 27. In each year from 2005 to 2009, the percentage of filings with 10b-5 claims decreased relative to the prior year. Id. at 26.
Class action securities litigation also arises with increasing frequency under Section 11 of the Securities Act of 1933 (Securities Act),\textsuperscript{24} which creates a private remedy for purchasers of a security if any part of the registration statement contained an untrue statement of a material fact or omitted to state a material fact required to be stated or necessary to make the statements not misleading.\textsuperscript{25} In 2009, 26 percent of filed securities class actions alleged Section 11 claims (up from 9 percent in 2005).\textsuperscript{26} The PSLRA’s strict pleading requirement concerning state of mind does not apply to a

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\item 15 U.S.C. §77k(a) (2006). Section 11 was designed to assure compliance with the disclosure provisions of the Securities Act by imposing liability on those parties who play a direct role in a registered offering, including issuers and underwriters. Herman and McLean v. Huddleston, 459 U.S. 375, 381-82 (1983). See generally David I. Michaels, No Fraud? No Problem: Outside Director Liability for Shelf Offerings Under Section 11 of the Securities Act of 1933, 26 ANN. REV. BANKING & FIN. L. 345, 363 (2007); Allan Horwich, Section 11 of the Securities Act: The Cornerstone Needs Some Tuckpointing, 58 BUS. LAW. 1 (2002). To state a claim under Section 11, plaintiff must allege that (1) she purchased a registered security, either directly from the issuer or in the aftermarket following the offering; (2) defendant is an individual specified by the statute; and (3) the registration statement for the offering contained an untrue statement of a material fact or omitted to state a material fact necessary to make the statements therein not misleading. In re Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347, 358 (2d Cir. 2010).
\item 2009: A Year in Review, supra note 20, at 27. Section 22(a) of the Securities Act creates concurrent jurisdiction in state and federal courts over claims brought under that statute. It also provides that, subject to certain enumerated exceptions, no claims arising under it and brought in state court may be removed to federal court. 15 U.S.C. §77v(a). In 2009 a circuit split emerged as to whether this so-called removal bar was superseded by the Class Action Fairness Act of 2005 (CAFA), Pub. L. No. 109-2, §§ 4(a) & 5(a), 119 Stat. 4, 9-13 (codified at 28 U.S.C. §§1332(d) and 1453(b)), a statute which generally permits removal to federal court of class actions that exceed $5 million and involve at least partial diversity between plaintiffs and defendants. In Luther v. Countrywide Home Loans Servicing L.P., 533 F.3d 1031 (9th Cir. 2008), the Ninth Circuit held that Section 22’s removal bar effectively trumps CAFA. The Seventh Circuit squarely rejected Luther in Katz v. Girardi, 552 F.3d 558 (7th Cir. 2009). See also Passarella v. Ginn Co., 637 F. Supp.2d 352 (D.S.C. 2009) (finding Katz more persuasive than Luther); New Jersey Carpenters Vacation Fund v. Harborview Mort. Loan Trust, 581 F. Supp. 2d 581, 587-88 (S.D.N.Y. 2008) (holding that CAFA overrides anti-removal provision in Securities Act). The judicial split is discussed in Denise Mazzeo, Note, Securities Class Actions, CAFA, and a Countrywide Crisis: A Call for Clarity and Consistency, 78 FORDHAM L. REV. 1433 (2009) (concluding that Seventh Circuit approach in Katz is superior); Matthew O’Brien, Choice of Forum in Securities Class Actions: Confronting “Reform” of the Securities Act of 1933, 28 REV. LITIG. 845 (2009); and Kenneth I. Schachter & Mary Gail Gearns, Removing ‘33 Act Class Actions Under SLUSA and CAFA, N.Y.L.J., Dec. 1, 2008, at S7.
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Section 11 claim,\(^{27}\) because scienter is not an affirmative element of the claim.\(^{28}\) Rather, defendants in Section 11 cases bear an affirmative burden of disproving scienter, by establishing that they did not act recklessly or wrongfully.\(^{29}\) Nevertheless, confidential witnesses are used by plaintiffs’ lawyers in an effort to establish omissions or misstatements in Section 11 cases,\(^{30}\) just as they are widely used in Section 10(b) cases to establish scienter, omissions, and misrepresentations.

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\(^{27}\) See, e.g., Schultz v. Tomotherapy Inc., Nos. 08-cv-314-slc, 08-cv-342-slc, 2009 WL 2032372, at *9 (W.D. Wis. July 9, 2009) (holding that PSLRA does not apply to Section 11 claims). According to some courts, if the Section 11 claim sounds in fraud, then Rule 9(b) of the Federal Rules, which provides that allegations of fraud or mistake must be stated with particularity, must be satisfied. To comply with Rule 9(b), a complaint must (1) specify the statements that plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent. Lerner v. Fleet Bank, N.A., 459 F.3d 273, 290 (2d Cir. 2006). Other courts have held that because Section 11 claims do not require proof of fraud, they are subject to standard notice pleading under Rule 8(a). See Schultz, supra, 2009 WL 2032372, at *9 (citing cases).

\(^{28}\) Plaintiffs asserting Section 11 claims need not allege scienter, reliance (unless they purchased the stock more than 12 months after the effective date of the registration), or loss causation. In re Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347, 359 (2d Cir. 2010); In re Constar Int’l Inc. Sec. Litig., 585 F.3d 774, 783 (3d Cir. 2009).


\(^{30}\) See, e.g., In re Thornburg Mort., Inc. Sec. Litig., No. Civ 07-0815 JB/WDS, 2010 WL 445047, at *3 n.7 (D.N.M. Jan. 27, 2010); In re Superior Offshore Int’l, Inc. Sec. Litig., Civil Action No. H-08-0687, 2009 WL 82064 (S.D. Tex. Jan. 12, 2009). Confidential witnesses also have been used to assert claims under Section 14(a) of the Exchange Act, 15 U.S.C. §78n(a), and its implementing SEC Rule 14a-9, 17 C.F.R. §240.14a-9. Section 14(a) and the companion rule, which contain an implied private right of action, collectively prohibit the use of false statements in proxy solicitations associated with registered securities. Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc., 594 F.3d 783, 796 (11th Cir. 2010). To state a claim under Section 14(a), plaintiff must allege that: (1) the proxy statement contained a material misstatement or omission; which (2) caused plaintiff’s injury; and (3) the proxy solicitation itself, rather than a particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction. New York City Employees’ Ret. Sys. v. Jobs, 593 F.3d 1018, 1022 (9th Cir. 2010). Scienter is not an element of a Section 14(a) claim. In re Maxim Integrated Prod. Inc. Deriv. Litig., 574 F. Supp. 2d 1046, 1072 (N.D. Cal. 2008). According to the Seventh Circuit, there is no required state of mind, because the statute requires proof only that the proxy solicitation was misleading, “implying at worst negligence by the issuer . . . (a)nd negligence is not a state of mind. . . .” Beck v. Dobrowski, 559 F.3d 680, 682 (7th Cir. 2009). Other courts disagree. See Little Gem Life Sciences Life Sciences, LLC v. Orphan Medical, Inc. 537 F.3d 913, 916 (8th Cir. 2008) (rejecting argument that negligent misrepresentation actions do not involve a state of mind); In re JPMorgan Chase & Co. Sec. Litig., MDL No. 1783, C.A. No. 06 C 4674, 2007 WL 4531794, at *7 (N.D. Ill. Dec. 18, 2007) (“The
II. Confidential Witnesses in Securities Fraud Litigation Prior to Tellabs

The use of confidential witnesses in class action securities litigation is of greatest significance in connection with the motion to dismiss, which is the single most important procedural step in virtually all such litigation. The motion to dismiss acquired its importance in securities litigation primarily by virtue of the PSLRA’s strict pleading requirements. The Act requires, inter alia, that a securities complaint specify each allegedly misleading statement, why the statement was misleading, and, if an allegation is made on information and belief, “all facts” supporting that belief with particularity. During the period 1997 to 2001, several federal district courts interpreted the phrase “all facts” literally, to require plaintiffs to specifically name their confidential

circuit courts have not definitively addressed the issue of whether negligence constitutes a ‘state of mind’ under the PSLRA.”). In any event, Section 14(a) actions are subject to the PSLRA’s provision regarding pleading misrepresentation with particularity. Jobs, supra, 593 F.3d at 1022. Plaintiffs using confidential witnesses in an effort to satisfy the PSLRA in such actions often fail. See, e.g., Berlin Fin. Ltd. v. MPW Indus. Serv. Group, Inc., No. 2:07-cv-442, 2008 WL 161309 (S.D. Ohio Jan. 15, 2008); In re Textainer P’ship Sec. Litig., No. C-05-0969, 2006 WL 1328851, at **3-6 (N.D. Cal. May 15, 2006).

31 Stephen J. Choi & Adam C. Pritchard, The Supreme Court’s Impact on Securities Class Actions: An Empirical Assessment of Tellabs 1-2, University of Michigan Law School Law & Economics Research Paper Series Paper No. 09-016 and New York University Law School Law & Economics Research Paper Series Paper No. 09-34, Dec. 4, 2009, Jhttp://papers.ssrn.com/sol3/papers.cfm?abstract_id=1457085 ("The PSLRA makes the motion to dismiss the main event in securities fraud class actions, effectively using district courts as gatekeepers charged with screening out meritless class actions at an early stage, while allowing meritorious actions to proceed."); Jeffrey A. Barrack, A Primer on Taking A Securities Fraud Class Action to Trial, 31 AM. J. TRIAL ADVOC. 471, 483 (2008) ("The motion to dismiss is thereby the most significant threshold event in a securities fraud case, beyond which the parties must face the trier of fact."). Dismissal statistics confirm this point. For the period 1996 to 2009, among resolved securities class actions, 41 percent were dismissed and 59 percent settled, and 72 percent of these dismissals occurred prior to a ruling on a motion for summary judgment. 2009: A Year in Review, supra note 20, at 21.

sources. This was the conclusion of at least one district court each in California (in In re Silicon Graphics, Inc. Sec. Litig. (Silicon Graphics)), New Jersey, and Florida.

All federal appellate courts to consider the issue by 2010 rejected the foregoing approach. Beginning in 2000, the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and Eleventh Circuits all rejected the notion that

33 See In re Silicon Graphics, Inc. Sec. Litig., 970 F. Supp. 746, 763-64 (N.D. Cal. 1997), aff'd, 183 F.3d 970 (9th Cir. 1999). On appeal, the Ninth Circuit did not directly address the issue of whether confidential witnesses must be named in a complaint alleging securities fraud. Nevertheless, it affirmed the district court decision, which required witness names. It was unclear from the Ninth Circuit opinion whether this specific aspect of the district court opinion was endorsed. The ambiguity has been noted by other courts. See, e.g., Cal. Public Employees' Ret. Sys. v. Chubb Corp., 394 F.3d 126, 146 n.11 (3d Cir. 2004) (“While not entirely clear, the Ninth Circuit’s interpretation of the statutory command . . . can be read as stopping short of endorsing the district court’s per se rule.”). See also Higginbotham, 495 F.3d at 757 (stating that Ninth Circuit decision in Silicon Graphics requires the naming of all sources); D.E. & J Ltd. P'ship v. Conway, 284 F. Supp.2d 719, 739 (E.D. Mich. 2003) (stating that Ninth Circuit decision in Silicon Graphics “does not require the identification of confidential sources.”); Kathryn B. McKenna, Note, Pleading Securities Fraud Using Confidential Sources Under the Private Securities Litigation Reform Act of 1995: It’s All in the Details, 55 Rutgers L. Rev. 205, 213 (2002) (noting that some courts have read the Ninth Circuit’s opinion uphold ing the dismissal of the complaint in Silicon Graphics as supporting the lower court’s view on confidential witnesses).

34 See In re Party City Sec. Litig., 147 F. Supp.2d 282, 304 (D.N.J. 2001) (“Facts’ also include the names of confidential informants, employees, competitors and others who provide information which leads to the filing of a complaint under the Exchange Act.”); In re: Nice Systems, Ltd. Sec. Litig., 135 F. Supp. 2d 551, 572 n.15 (D.N.J. 2001) (“Unnamed employees simply cannot . . . establish a strong inference of scienter with respect to management.”). This issue was considered in connection with a failed amendment to the PSLRA in the U.S. House of Representatives, when the PSLRA was debated in 1995. McKenna, supra note 23, at 208.

35 In re Republic Servs., Inc. Sec. Litig., 134 F. Supp. 2d 1355, 1362 (S.D. Fla. 2001); In re Tech. Chem. Sec. Litig., No. 98-7334-DIMITROULEAS, 2001 WL543769, at *6 (S.D. Fla. Mar. 21, 2001) (“(T)his court, as it has before, follows the other courts that have not sustained complaints under the PSLRA based on anonymous sources.”).

36 See In re Cabletron Sys., Inc., 311 F.3d 11, 28-30 (1st Cir. 2002).


40 ABC Arbitrage Plaintiffs Group v. Tchuruk, 291 F.3d 336, 351-52 (5th Cir. 2002).


42 Makor Issues & Rights, Ltd v. Tellabs, Inc., 513 F.3d 702, 712 (7th Cir. 2008).


44 In re Daou Sys., Inc. Sec. Litig., 411 F.3d 1006, 1015 (9th Cir. 2005).


confidential witnesses who provide information used in securities fraud complaints must be identified by name in the complaint, as a general rule.\textsuperscript{47} However, the appellate courts have disagreed about how such witnesses should be identified.

The first circuit to specifically consider the subject of confidential witnesses in class action securities litigation was the Second, in 2000. In \textit{Novak v. Kasaks (Novak)}, the Second Circuit concluded that reading “all” literally would produce illogical results that Congress cannot have intended, because it would have allowed complaints to survive dismissal where “all” the facts supporting plaintiff’s information and belief were pled, but those facts were insufficient to support the belief.\textsuperscript{48} The Second Circuit rejected the notion that confidential sources must be named as a general matter,\textsuperscript{49} and then set forth a two-step analysis. First, where plaintiffs rely on both confidential sources and other facts, they need not name their sources as long as the latter facts provide an adequate basis for believing that defendants’ statements or omissions were false or misleading. Second, if the other facts (i.e., documentary evidence) fail to provide an adequate basis for believing defendants’ statements or omissions were false, and confidential witnesses must be identified, such witnesses need not be named so long as they are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged.\textsuperscript{50}

\textsuperscript{47} The D.C. Circuit had not expressly considered the issue by mid-2010.
\textsuperscript{48} 216 F.3d at 313 n.1.
\textsuperscript{49} 216 F.3d at 313.
\textsuperscript{50} 216 F.3d at 314. The Second Circuit remanded the case to the district court for a determination of whether the complaint satisfied these requirements. \textit{Novak} ultimately settled without any further published decisions discussing the issue of confidential witnesses.
The Fifth\textsuperscript{51} and Eighth\textsuperscript{52} Circuits subsequently adopted Novak’s analysis. While all three circuits agreed that confidential witnesses need not be named in a securities fraud complaint as a general matter, none of those courts identified what information about confidential witnesses was required to be set forth in a complaint. That issue was addressed by the First Circuit in 2002. In \textit{In re Cabletron Systems, Inc. (Cabletron)},\textsuperscript{53} the First Circuit agreed with Novak that confidential witnesses need not be named in a securities fraud complaint, so long as the facts alleged provide an adequate basis for believing that defendants’ statements were false. According to the First Circuit, this involves an evaluation, \textit{inter alia}, of the level of detail provided by the confidential sources, the corroborative nature of the other facts alleged (including from other sources), the coherence and plausibility of the allegations, the number of sources, the reliability of the sources, and similar indicia.\textsuperscript{54} \textit{Cabletron} thus requires a review of the totality of the circumstances alleged about information from confidential sources to determine what, if any, weight such information should be given in the scienter

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  \item \textsuperscript{51} In ABC Arbitrage Plaintiffs Group v. Tchuruk, 291 F.3d 336, 351-52 (5th Cir. 2002), the Fifth Circuit adopted both the reasoning and holding of Novak, but when it paraphrased the Second Circuit’s analysis it added a third step--if the other facts relied upon by plaintiffs (i.e., documentary evidence) do not provide an adequate basis for believing that defendants’ statements were false and the descriptions of the sources are not sufficiently particular to support the probability that a person in the position occupied by the source would possess the information, then the complaint must name the confidential witnesses. 291 F.3d at 353. Accord Barrie v. Intervoice-Brite, Inc., 397 F.3d 249 (5th Cir. 2005) (confirming the Fifth Circuit’s three-step approach).
  \item \textsuperscript{52} In Fla. St. Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 667-68 (8th Cir. 2001), the Eighth Circuit agreed with Novak that confidential witnesses generally need not be named in a securities fraud complaint, at least with regard to allegations of scienter. But the court drew a distinction between allegations made on information and belief concerning the statement or omission alleged to be false or misleading, on the one hand, and allegations concerning scienter, on the other hand. \textit{Green Tree} addressed only the latter. See John H. Henn, Brandon F. White & Matthew C. Baltay, \textit{Anonymous Sources in Class Action Complaints}, 38 REV. SEC. & COMMODITIES REG. 131 (2005).
  \item \textsuperscript{53} 311 F.3d 11 (1st Cir. 2002).
  \item \textsuperscript{54} 311 F.3d at 29-30.
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analysis. Subsequently, the Third, Fourth, Ninth, and Tenth Circuits also adopted Novak’s analysis, and some of those circuits expressly supplemented Novak with the Cabletron factors. In summary, prior to Tellabs, the consensus of those federal

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55 311 F.3d at 30.
56 In California Public Employees’ Ret. System v. Chubb Corp., 394 F.3d 126 (3d Cir. 2004) (Chubb), the court expressly adopted Novak’s view that reading literally the PSLRA’s requirement that a securities complaint specify, if an allegation is made on information and belief, “all facts” supporting that belief with particularity, would produce illogical results that Congress cannot have intended. The Third Circuit then concluded that Novak’s approach to assessing the adequacy of allegations on information and belief necessarily entails an examination of various factors that were previously enumerated by the First Circuit in Cabletron, plus the additional factor of the confidential sources’ basis for their knowledge. Id. at 146-47.
58 In In re Daou Sys., Inc. Sec. Litig., 411 F.3d 1006 (9th Cir. 2005), the Ninth Circuit effectively overruled its earlier decision in Silicon Graphics, insofar as it may have been read to require per se disclosure of the names of all anonymous sources. Daou confirmed that the Ninth Circuit adopted Novak’s requirement that confidential witnesses be described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the sources would possess the information alleged, augmented by Cabletron’s suggested criteria for assessing the reliability of CWs. 411 F.3d at 1015. Daou concluded that naming sources in a securities complaint is unnecessary so long as the Novak test is met and the complaint contains adequate corroborating details. 411 F.3d at 1015. Daou’s two-pronged test differs from the standard applied by the other federal circuits, insofar as it expressly requires that information provided by a confidential source be corroborated, even if the basic Novak requirement has been met. See John H. Henn, Brandon F. White & Matthew C. Baltay, Anonymous Sources in Class Action Complaints, 38 REV. SEC. & COMMODITIES REG. 131 (2005) (suggesting that Daou’s addition of a corroboration requirement was unintended). Post-Daou, numerous federal district courts in the Ninth Circuit have applied the two-part test and required corroboration. See, e.g., In re Dura Pharm, Inc. Sec. Litig., No. 99CV0151 JLS (WMC), 2008 WL 483613, at *3 (S.D. Cal. Feb. 20, 2008); In re SeraCare Life Sciences, Inc. Sec. Litig., No. 05-CV-2335-H (CAB), 2007 WL 935583, at *7 (S.D. Cal. March 19, 2007); and In re Portal Software, Inc. Sec. Litig., No. C-03-5138 VRW, 2006 WL 238520, at *6 (N.D. Cal. Aug. 17, 2006). Some district courts elsewhere also have required corroboration. See, e.g., Campo v. Sears Holdings Corp., 635 F. Supp.2d 323, 330 (S.D.N.Y. 2009), aff’d, No. 09-3589-cv, 2010 WL 1292329 (2d Cir. Apr. 6, 2010) (“With respect to allegations derived from confidential witnesses, the Court considers only those allegations that later were corroborated by those witnesses in depositions.”); Druskin v. Answerthink, Inc., 299 F. Supp. 2d 1307, 1333 (S.D. Fla. 2004); and In re Theragenics Corp. Sec. Litig., 137 F. Supp. 2d 1339, 1345 (N.D. Ga. 2001).
59 In Adams v. Kinder-Morgan, Inc., 340 F.3d 1083 (10th Cir. 2003), the Tenth Circuit accepted most, but not all, of the analysis in Novak and ABC Arbitrage. Adams disagreed with those cases insofar as they, in the view of the Tenth Circuit, required plaintiffs to disclose “either personal or documentary sources” for key allegations set forth in a complaint for securities fraud based on information and belief, but agreed with Novak’s general sentiment that by disclosing such sources plaintiffs can significantly strengthen their pleading. Id. at 1102. Adams also identified various factors that courts should use when deciding whether the factual allegations support a reasonable belief that fraud occurred. Id. at 1102-03. These factors are similar (but not identical) to factors previously identified by the First Circuit in Cabletron. The Adams approach is probably the most flexible of the standards adopted by the Circuits prior to Tellabs.
appellate courts considering the issue\textsuperscript{60} was that a Novak-type test should be applied to assess information supplied by confidential witnesses in securities fraud complaints. Subject to some modification by some of the circuits, which has had an impact on the level of protection provided to confidential witnesses,\textsuperscript{61} this test generally requires that the allegations by such a witness be made with sufficient descriptive particularity to support the probability that a person in the position occupied by the witness would possess the information alleged.

This is not a bright-line test. As a result, the analysis by federal courts of the use of confidential witnesses in securities litigation has tended to be both fact-specific\textsuperscript{62} and inconsistent.\textsuperscript{63} As one prime example of inconsistency, courts have blurred and confused the distinction between determining whether (1) a confidential witness is reliable and (2) the witness’s information is probative of scienter. Numerous courts have skipped the first step and moved directly to the second step, with no explanation for their omission.\textsuperscript{64} Other courts have mashed the analysis together,\textsuperscript{65} or commenced an

\textsuperscript{60} The Sixth, Seventh, and Eleventh Circuits failed to address the issue of confidential witnesses in securities litigation in published decisions until after Tellabs, but prior to Tellabs some district courts within those circuits followed Novak. See, e.g., In re Hayes Lemmerz Int’l, Inc. Sec. Litig., 271 F. Supp. 2d 1007, 1016 n.8 (E.D. Mich. 2003).

\textsuperscript{61} Ethan D. Wohl, Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure, 12 FORDHAM J. CORP. & FIN. L. 551, 554 (2007) (“Slight differences in courts’ formulation of what information must be disclosed, however, significantly affect the protection that informants receive.”).

\textsuperscript{62} South Ferry LP #2 v. Killinger, 399 F.Supp.2d 1121, 1140 (W.D. Wash. 2005), vacated in part, 542 F.3d 776 (9th Cir. 2008) (“The fact-specific nature of the analysis means that ‘(t)he precise amount of detail required in describing confidential witness varies based on the circumstances of the case.’”).


analysis of reliability that abruptly veers off-track by concluding that the information provided by the witness is not indicative of defendants’ scienter.\(^{66}\) Other more rigorous courts have evaluated the issues separately, holding that the complaint’s allegations are adequate as to both reliability and scienter,\(^{67}\) inadequate as to both,\(^{68}\) or adequate as to reliability but inadequate as to scienter.\(^{69}\)

Courts have been more consistent when they specifically focus on the witnesses’ reliability. Courts generally refuse to recognize as reliable information from confidential witnesses that is not based on personal knowledge.\(^{70}\) Purported information provided by such witnesses that is hearsay,\(^{71}\) double hearsay,\(^{72}\) second-hand,\(^{73}\) rumor,\(^{74}\) possible

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\(^{67}\) In re Cadence Design Sys., Inc. Sec. Litig., No. 08-4966 SC, 2010 WL 726515 (N.D. Cal. March 2, 2010); In re Par Pharm. Sec. Litig., Civ. Action No. 06-cv-3226 (PGS), 2009 WL 3234273 (D.N.J. Sept. 30, 2009) (finding allegations sufficient as to three of four defendants).


\(^{72}\) Zucco Partners, LLC v. Digimarc Corp., 552 F.3d 981, 997 n.4 (9th Cir. 2009) (“(A) hearsay statement, while not automatically precluded from consideration to support allegations of scienter, may indicate that a confidential witness’s report is not sufficiently reliable, plausible, or coherent to warrant further consideration under Daou.”); Limantour v. Cray Inc., 432 F. Supp.2d 1129, 1155 (W.D. Wash. 2006) (“To the extent the statements of these CWs are hearsay, they cannot support any inference of scienter, much less a strong inference.”).
rumor,\textsuperscript{75} conjecture,\textsuperscript{76} or gossip,\textsuperscript{77} fails to identify the witness’s job title or position with defendant,\textsuperscript{78} fails to describe or adequately describe the witness’s job duties with defendant,\textsuperscript{79} fails to identify the time frame during which the witness was employed by defendant,\textsuperscript{80} and/or has been provided by a witness whose employment with defendant terminated before the class period began\textsuperscript{81} or began after the class period ended\textsuperscript{82} has been routinely determined by courts to lack sufficient indicia of reliability.

\textbf{III. Tellabs and Higginbotham}


\textsuperscript{75} In re Possis Medical, Inc. Sec. Litig., No. 05-CV-1084(JMR/FLN), 2007 WL335051, at *5 (D. Minn. Feb. 1, 2007).


\textsuperscript{78} In re BISYS Sec. Litig., 397 F. Supp.2d 430 (S.D.N.Y. 2005); In re Syncor Int’l Corp. Sec. Litig., 327 F. Supp.2d 1149, 1158 (C.D. Cal. 2004) (“Specific details such as the informant’s job description, job title, dates of employment, and job responsibilities would help support that the informant has a basis of knowledge.”).


\textsuperscript{82} In re Bally Total Fitness Sec. Litig., Nos. 04 C 3530, etc., 2007 WL 551574, at *11 (N.D. Ill. Feb. 20, 2007).
A. The Supreme Court Decision in *Tellabs*

In *Tellabs*, the United States Supreme Court resolved a three-way circuit split concerning whether and to what extent courts must consider and weigh competing culpable and non-culpable inferences in deciding whether a complaint has satisfied the PSLRA’s requirement that plaintiffs state with particularity facts giving rise to a strong inference that defendants acted with the requisite state of mind.\(^{83}\) The Supreme Court did not address the use of confidential witnesses, but lower federal courts have subsequently addressed such use by reference to *Tellabs*. The next section of this Article considers *Tellabs* and its influence on federal courts considering the proper role of confidential witnesses in securities litigation.

Prior to *Tellabs*, the First,\(^ {84}\) Fourth,\(^ {85}\) Sixth,\(^ {86}\) and Ninth\(^ {87}\) Circuits required that the inference that defendants had the requisite scienter be the most plausible when compared with competing inferences, the Second,\(^ {88}\) Fifth,\(^ {89}\) Eighth,\(^ {90}\) Tenth,\(^ {91}\) and Eleventh\(^ {92}\) Circuits required that the inference that defendants acted with the requisite scienter must be at least as equally plausible as competing inferences, and the Third\(^ {93}\)

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\(^{83}\) When Congress enacted the PSLRA it left the key term “strong inference” undefined and otherwise failed to provide guidance as to what facts and circumstances alleged in a complaint might give rise to a strong inference of scienter.

\(^{84}\) In re Credit Suisse First Boston Corp., 431 F.3d 36, 49 (1st Cir. 2005).

\(^{85}\) Ottman v. Hanger orthopedic Group, Inc., 353 F.3d 338 (4th Cir. 2003).


\(^{87}\) Gompper v. VISX, Inc., 298 F.3d 893 (9th Cir. 2002).

\(^{88}\) Acito v. IMCERA Group, Inc., 47 F.3d 47 92d Cir. 1995).

\(^{89}\) Rosenzweig v. Azurix Corp., 332 F.3d 854 (5th Cir. 2003).

\(^{90}\) Fla. State Bd. of Admin. V. Green Tree Fin. Corp., 270 F.3d 645 (8th Cir. 2001).

\(^{91}\) Pirraglia v. Novell, Inc., 339 F.3d 1182 (10th Cir. 2003).

\(^{92}\) Garfield v. NDC Health Corp., 466 F.3d 1255 (11th Cir. 2006).

\(^{93}\) In re Suprema Specialties, Inc. Sec. Litig., 438 F.3d 256 (3d Cir. 2006).
and Seventh\textsuperscript{94} Circuits did not require any assessment of competing inferences, instead looking only at the plausibility of plaintiffs’ allegations.

In \textit{Tellabs}, the Court held, in an 8-1 decision, that to qualify as “strong” an inference of scienter must be more than merely plausible or reasonable. Rather, a complaint will survive a motion to dismiss “only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.”\textsuperscript{95} Because the applicable perspective is that of a reasonable person, “the trial court’s inferences should be based on ordinary assumptions about the world rather than on implausible, biased or unusual ones.”\textsuperscript{96}

Lower federal courts have generally interpreted \textit{Tellabs’} holding to give the tie to plaintiffs. If plaintiff demonstrates only that an inference of scienter is at least as compelling as any non-culpable explanation for defendants’ conduct, plaintiff wins and the motion to dismiss will be denied.\textsuperscript{97} In \textit{Tellabs} the Supreme Court also made

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\textsuperscript{94} Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588, 602 (7th Cir. 2006).
\textsuperscript{95} 551 U.S. at 324. The Court expressly rejected the notion that the inference of scienter must be irrefutable. \textit{Id.} The majority opinion was written by Justice Ruth Bader Ginsburg. Justices Antonin Scalia and Samuel Alito wrote separate opinions concurring in the result only, and expressing concern about the Court’s new standard. Justice Scalia argued in his concurrence that the new standard should require that the inference of scienter be more plausible than the inference of innocence. \textit{Id.} at 329. In other words, Scalia endorsed the First Circuit’s approach that the tie goes to the defendant. Justice Alito suggested that the appropriate test is the same as that used at the summary judgment and judgment as a matter of law stages. \textit{Id.} at 335. \textit{See also} Devona L. Wells, Case Note, \textit{Why Plaintiffs Should Learn to Love the Strong-Inference Standard for Pleading a Securities Fraud Claim—Tellabs v. Makor Issues & Rights, Ltd.}, 36 W. MICH L. REV. 1364, 1376-78 (2010) (discussing concurring opinions).
\textsuperscript{97} \textit{See}, e.g., Frank v. Dana Corp., 547 F.3d 564, 571 (6th Cir. 2008) (“Thus, where two equally compelling inferences can be drawn, one demonstrating scienter and the other supporting a nonculpable inference, Tellabs instructs that the complaint should be permitted to move forward.”); ACA Financial Guaranty Corp. v. Advest, Inc., 512 F.3d 46, 59 (1st Cir. 2008) (“Where there are equally strong inferences for and against scienter, Tellabs now awards the draw to the plaintiff.”). \textit{See also} John P. Stigi III & Martin White, \textit{Courts Interpret Tellabs, NAT’L L.J.}, March 17, 2008, at S1 (stating that in the First, Sixth, and Ninth Circuits, the \textit{Tellabs} “tie goes to the plaintiff” rule lowered the bar for plaintiffs, but this result is of no practical significance); Caryn Jacobs, et al., \textit{Pleading Scienter After Tellabs in Section 10(b) Cases Generally and in the “Subprime”}
clear that in considering whether an inference is strong, the lower court must determine whether “all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.”

The Supreme Court observed but made no further comment on the fact that plaintiffs relied on 27 confidential sources in their amended complaint, and it did not suggest any view as to the validity of that practice under the new standard it announced. The Supreme Court also did not directly address the merits of the case. Instead, after clarifying the standard for pleading a strong inference of scienter, the Supreme Court remanded Tellabs to the Seventh Circuit to determine whether the complaint properly pleaded such an inference. On remand the Seventh Circuit found in 2008 (Tellabs II) that the complaint satisfied the new “cogent and compelling” standard, and again reversed the district court’s dismissal of the case.

B. Application of Tellabs by the Federal Courts

1. Higginbotham and Tellabs II

Context, 9 J. INVESTMENT COMPLIANCE 47, 61 (2008) (noting the likely scarcity of cases in which the inferences for and against scienter are equally strong).

551 U.S. at 323 (emphasis in original). It has been suggested that by declining to adopt any of three competing tests used by the circuits, and instead announcing a new, highly malleable test, the Supreme Court failed to resolve the conflict. See James D. Cox, Randall S. Thomas & Lynn Bai, Do Differences in Pleading Standards Cause Forum Shopping in Securities Class Actions? Doctrinal and Empirical Analysis, 2009 Wisc. L. Rev. 421, 438-39 (2009) (“[W]e are not at all persuaded that, post-Tellabs, all three of the earlier purportedly different approaches will not persist. . . . Tellabs leaves us in a world where different circuits will apply different standards to resolve federal securities law cases.”).

551 U.S. at 316. Likewise, the concurring opinions by Justices Antonin Scalia and Samuel Alito failed to address the propriety of plaintiffs’ reliance on confidential witnesses. Justice John Paul Stevens wrote a dissent in which he indicated that he approved of the reliance on confidential witnesses. 551 U.S. at 337.

Makor Issues & Rights Ltd. v. Tellabs, Inc., 513 F.3d 702 (7th Cir. 2008).
In *Higginbotham*, decided in 2007 just four weeks after the *Tellabs* opinion was issued by the Supreme Court, the Seventh Circuit made a sweeping condemnation of the use of confidential witnesses in securities litigation. In this case plaintiffs proffered information provided by five confidential witnesses to show that defendant Baxter International, the corporate parent of a Brazilian subsidiary, was aware that the subsidiary had engaged in accounting fraud. The five witnesses were identified in the complaint an ex-employee of the subsidiary, two ex-employees of Baxter’s headquarters, and two consultants.101 A panel consisting of Judges Easterbrook, Posner and Ripple affirmed the lower court’s dismissal of the complaint. In so doing, the Seventh Circuit unanimously applied *Tellabs* to generally require automatic, deep discounting of allegations in securities fraud complaints based on information provided by confidential sources. The court stated that following the Supreme Court decision, “(i)t is hard to see how information from confidential sources could be deemed ‘compelling’ or how we could take account of plausible opposing inferences. Perhaps these confidential sources have axes to grind. Perhaps they are lying. Perhaps they don’t even exist.”102 The Seventh Circuit concluded that the information provided by confidential witnesses must be discounted under *Tellabs*, and “(u)sually that discount will be steep.”103

In reaching this conclusion, the Seventh Circuit noted that there is no “informers’ privilege” in civil litigation, and defendants are entitled under Rule 26(a)(1)(A) of the Federal Rules to obtain the identities of all persons likely to have discoverable

101 495 F.3d at 756-57.
102 495 F.3d at 757.
103 495 F.3d at 757.
information that plaintiffs may use to support their claims or defenses. According to
the Seventh Circuit, “(c)oncealing names at the complaint stage thus does not protect
informers from disclosure (and the risk of retaliation); it does nothing but obstruct the
judiciary’s ability to implement the PSLRA.” Indeed, Judge Posner’s comments during
oral argument in Higginbotham expressed his surprise that confidential witnesses were
ever used in securities litigation, even though the use of such witnesses had been
commonplace for years. As indicated supra, in the seven years prior to Higginbotham,
most of the federal circuit courts had issued opinions addressing the circumstances
under which confidential witnesses could be used in securities litigation. Moreover, 27
c confidential witnesses had provided information that had been used in the amended
complaint in Tellabs, without drawing any negative reaction from the United States
Supreme Court.

The Seventh Circuit revisited the use of confidential witnesses approximately six
months later, in January 2008, when it considered Tellabs on remand from the Supreme
Court. The decisions in Tellabs and Higginbotham reflected the divided opinion among
circuit courts regarding the usefulness of confidential informants in securities securities
litigation. The Supreme Court’s decision in Tellabs provided some clarity, but many
judges continued to express concern over the use of confidential witnesses.

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104 495 F.3d at 757.
105 495 F.3d at 757.
106 Judge Posner asked: “What are they? Are they like police informants? . . . Are these people
going to testify behind a screen with a voice alternation?” Judge Posner also stated that he was
“baffled” by the use of confidential witnesses. His comments are recounted in J. Robert Brown,
Jr., The “Tellabs Excuse” and Confidential Witnesses, The Harvard Law School Forum on
Corporate Governance and Financial Regulation, Sept. 28, 2007,
worines.html.
107 See text accompanying notes 36-60, supra. This situation led Professor J. Robert Brown, Jr. to
conclude: “Judge Posner’s surprised reaction to the use of confidential informants is, well, itself
surprising.” See J. Robert Brown, Jr., The “Tellabs Excuse” and Confidential Witnesses, The
Harvard Law School Forum on Corporate Governance and Financial Regulation, Sept. 28, 2007,
 witnesses.html. Maybe Judge Posner’s reaction was not surprising. According to two critics, the
Seventh Circuit had a history of hostility to the use of confidential witnesses. See Christopher
Keller & Michael Stocker, Balancing the Scales: The Use of Confidential Witnesses in Securities
Class Actions, 41 SEC. REG. & LAW REPORT 87 (2009) (“Higginbotham was consistent with the
Seventh Circuit’s already entrenched rejection of the use of anonymous sources in complaints. . . ”).
Court (Tellabs II). In that case, the Seventh Circuit, with Judge Posner writing for the three-judge panel, purported to distinguish Higginbotham and its steep discounting of allegations by confidential witnesses. Whereas Higginbotham’s confidential sources included three ex-employees of defendant and two consultants for defendant, none of whose positions were described with particularity, Tellabs II involved confidential witnesses whom the Seventh Circuit described as numerous and consisting of persons who from their job descriptions were in a position to know first-hand the facts to which they were prepared to testify.108 In Tellabs II, the Seventh Circuit concluded that the complaint satisfied the new standard announced by the Supreme Court and thus it reversed and remanded the district court’s dismissal of the complaint.109

While Tellabs II can be and has been read to represent a retreat from Higginbotham,110 the earlier case is alive and well. Nothing in Higginbotham suggests that the Seventh Circuit’s holding concerning the discounting of allegations by confidential witnesses was limited to the specific facts of that case. Moreover, various courts that have cited Higginbotham for the proposition that the Supreme Court’s decision in Tellabs requires steep discounting of information provided by confidential

108 513 F.3d at 711.
109 495 F.3d at 712.
110 See, e.g., Christopher Keller & Michael Stocker, Balancing the Scales: The Use of Confidential Witnesses in Securities Class Actions, 41 SEC. REG. & LAW REPORT 87 (2009) (“Notably, the Seventh Circuit itself quickly backpedaled from its position in Higginbotham in considering the Tellabs v. Makor case on remand from the Supreme Court.”); Sherrie R. Savett, Plaintiffs’ Vision of Securities Litigation: Current Trends and Strategies, Practicing Law Institute, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 145, 195, PLI Order No. 14673 (Sept.-Oct. 2008) (“Tellabs II represents a strong affirmation that plaintiffs can fulfill the pleading requirements by relying on confidential sources, at least where enough detailed support is provided.”).
witnesses have done so even after *Tellabs II* was decided.\textsuperscript{111} As stated succinctly by one review: “*Higginbotham* survives the *Tellabs* remand.” \textsuperscript{112}

2. *Higginbotham’s Influence*

*Higginbotham* has been persuasive for other courts, no doubt in large part because it was unanimously decided by a distinguished panel.\textsuperscript{113} Since the case was decided in 2007 a number of federal courts have implicitly or expressly endorsed its conclusions regarding the automatic discounting of information provided by confidential witnesses.\textsuperscript{114} Such courts include the Second,\textsuperscript{115} Fifth,\textsuperscript{116} and Sixth Circuits.\textsuperscript{117}

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\textsuperscript{112} Gregory A. Markel, et al., *The Dangers of Relying on Anonymous Sources in Securities Complaints* 917, 926 (Nov. 12-14, 2008), Practicing Law Institute, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, PLI Order No. 14864. See also Gregory Markel, Ronit Setton & Abby Meiselman, *Sometimes, The Witness is a Cipher*, NAT’L L.J., Apr. 21, 2008, at S1 (suggesting that *Higginbotham* can be viewed as stating applicable rule when there is less than compelling support for credibility of confidential witnesses, while *Tellabs II* establishes proper approach when complaint contains allegations that tend to strongly support credibility of such witnesses); and Samuel H. Rudman, *Back to ‘Novak’: Confidential Witnesses in Fraud Actions*, N.Y.L.J., Oct. 20, 2008, at 3 (noting that “(c)ase law concerning the use of confidential witnesses has been anything but uniform.”).\textsuperscript{113}

\textsuperscript{113} See Michael J. Kaufman & John M. Wunderlich, *Resolving the Continuing Controversy Regarding Confidential Informants in Private Securities Fraud Litigation*, 19 CORNELL J.L. & PUB. POL’Y 637, 655 (2010) (noting that *Higginbotham* “has been gaining ground among the circuit courts”); Paul V. Konovalov, “Plausible Opposing Inferences”: The Disappearing Role of Confidential Witnesses in Securities Fraud Class Actions, FEDERAL BAR ASSOCIATION/ORANGE COUNTY (Winter 2008), [http://www.lw.com/upload/pubContent/_pdf/pub2614_1.pdf](http://www.lw.com/upload/pubContent/_pdf/pub2614_1.pdf) (“(W)hile *Higginbotham* currently is controlling in the Seventh Circuit only, it was authored by a well-respected jurist and comes from a panel also including Judge Posner, and hence might be viewed favorably by other courts considering similar issues.”); and Jonathan R. Tuttle & Anupama C. Connor, *Pleading Scienter in a Securities Class Action Lawsuit in the First Year After the Supreme Court’s Tellabs Ruling* 481, 493 (Sept.-Oct. 2008), Practicing Law Institute Corp., LAW AND PRACTICE COURSE HANDBOOK SERIES, PLI Order No. 14673 (“(T)he unanimous opinion of the Seventh Circuit already seems to be viewed as persuasive precedent and has been cited by courts outside the Seventh Circuit in granting motions to dismiss.”).

\textsuperscript{114} See Michael J. Kaufman & John M. Wunderlich, *The Unjustified Judicial Creation of Class Certification Merits Trials in Securities Fraud Actions*, 43 U. MICH. J.L. REFORM 323, 348 n.150 (2010) (noting that since *Tellabs*, ability of plaintiffs to obtain access to internal company information has been “severely undercut” by circuit courts’ recent steep discounting of information.
and district courts in the Northern District of Illinois,\textsuperscript{118} Southern District of Indiana,\textsuperscript{119} Eastern District of Kentucky,\textsuperscript{120} Eastern District of Michigan,\textsuperscript{121} Western District of Missouri,\textsuperscript{122} Northern District of Ohio,\textsuperscript{123} and Western District of Texas.\textsuperscript{124} Some of these courts have been quite emphatic. For example, citing \textit{Higginbotham}, the Fifth Circuit held in 2008: "Following \textit{Tellabs}, courts must discount allegations from confidential

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\textsuperscript{115} See Campo v. Sears Holdings Corp., No. 09-3589-cv, 2010 WL 1292329, at *3 n.4 (2d Cir. Apr. 6, 2010) (citing \textit{Higginbotham}, and concluding that plaintiffs’ use of CWs frustrates \textit{Tellabs’} requirement that courts weigh competing inferences when determining whether complaint adequately pleads scienter). In \textit{Campo}, the Second Circuit found no error with the district court’s order that confidential witnesses referenced in the complaint be deposed, to assist it in resolving defendants’ motion to dismiss. No error was found because the district court relied upon the deposition testimony for the limited purpose of determining whether the CWs acknowledged the statements attributed to them in the complaint. \textit{Id. Cf.} Jordan Eth & Timothy Blakely, \textit{The Use and Abuse of Confidential Witnesses: The Battle Continues After Tellabs}, Practicing Law Institute, \textit{Corporate Law and Practice Course Handbook Series}, PLI Order No. 18078, 1762 PLI/Corp 606 (Sept.-Oct. 2009) (arguing that if a complaint relying on CW allegations survives a motion to dismiss, defendants should be permitted to immediately deposing CWs, to determine if they support allegations attributed to them).

\textsuperscript{116} Indiana Elec. Workers’ Pension Trust Fund IBEW v. Shaw Group, Inc., 537 F.3d 527, 535 (5th Cir. 2008).

\textsuperscript{117} Konkol v. Diebold, Inc., No. 08-4572, 2009 WL 4909110 (6th Cir. Oct. 14, 2009) (citing \textit{Higginbotham} favorably in concluding that confidential witness allegations were insufficient to establish an inference of scienter); Ley v. Visteon Corp., 543 F.3d 801, 811 (6th Cir. 2008) (same).

\textsuperscript{118} Last Atlantis Capital LLC v. AGS Specialists Partners, No. 04 C 397, 2008 WL 341371, at *3 (N.D. Ill. Feb. 7, 2008).


\textsuperscript{121} In re ProQuest Sec. Litig., 527 F. Supp. 2d 728, 739-40 (E.D. Mich. 2007).

\textsuperscript{122} In re H & R Block Sec. Litig., No. 06-0236-CV-W-ODS, 2008 WL 482403, at *2 (W.D. Mo. Feb. 19, 2008).

\textsuperscript{123} In re Diebold Sec. Litig., No. 5:05CV2873, 2008 WL 3927467, at *7 (N.D. Ohio Aug. 22, 2008); Frank v. Dana Corp., 525 F. Supp. 2d 922, 931 (N.D. Ohio 2007), vacated and remanded on other grounds, 547 F.3d 564 (6th Cir. 2008).

sources. . . . Such sources afford no basis for drawing the plausible competing inferences required by *Tellabs*.  

A number of other courts have either expressly rejected Higginbotham's reasoning, disregarded it, or acknowledged it without expressing an opinion on its validity. These courts include the First,\(^\text{126}\) Third,\(^\text{127}\) Eighth,\(^\text{128}\) Ninth,\(^\text{129}\) and Eleventh\(^\text{130}\)

\(^{125}\) Indiana Electrical Workers' Pension Trust Fund IBEW v. Shaw Group, 537 F.3d 527, 535 (5th Cir. 2008).  *See also Significant 2008 Caselaw Developments*, 64 Bus. Law. 871, 901 n.305 (2009) (“The Fifth Circuit endorsed a Seventh Circuit interpretation of *Tellabs* that discounts confidential source pleading in securities cases.”).  Just one year earlier, a different panel of the Fifth Circuit concluded that “(c)onfidential source statements are a permissible basis on which to make an inference of scienter.”  *Central Laborers’ Pension Fund v. Integrated Elec. Serv. Inc.*, 497 F.3d 546, 552 (5th Cir. 2007). The *Central Laborers*’ decision did not discuss *Higginbotham* or *Tellabs* in its discussion of confidential sources, although it did discuss *Tellabs* in other contexts. *Id.* at 551, 553.

\(^{126}\) In *New Jersey Carpenters Pension & Annuity Fund v. Biogen IDEC Inc.*, 537 F.3d 35, 51-52 (1st Cir. 2008), the First Circuit considered the impact of *Tellabs* and *Higginbotham* and concluded that its 2002 decision in *Cabletron* remained good law. The court noted that *Tellabs* requires that all information in plaintiffs’ complaint be evaluated, and this includes confidential source information. The court stated: “(W)e see no reason to exclude consideration of such information from the evaluation of whether plaintiffs’ strong inferences of scienter are at least as plausible as defendants’ inferences.” 537 F.3d at 52.


\(^{128}\) In a series of three cases decided in 2008, the Eighth Circuit addressed allegations by confidential witnesses in light of *Tellabs*, but neither mentioned *Higginbotham* nor followed its analysis.  *See* In re Ceridian Corp. Sec. Litig., 542 F.3d 240, 246-47 (8th Cir. 2008); In re Hutchinson Tech., Inc. Sec. Litig., 536 F.3d 952, 962 (8th Cir. 2008); and Cornelia I. Crowell GST Trust v. Possis Med., Inc., 519 F.3d 778 (8th Cir. 2008).

\(^{129}\) In *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981 (9th Cir. 2009), the Ninth Circuit reserved judgment on whether, as *Higginbotham* concluded, *Tellabs* requires automatic discounting of allegations based on information provided by confidential witnesses, but gave no indication that it endorsed *Higginbotham*. 552 F.2d at 995 n.2. The Ninth Circuit, reaffirming *Daou*, also underscored a key point concerning the use of confidential witnesses in securities litigation to establish scienter that is rarely made explicit by federal courts—a complaint relying on statements from such witnesses must pass two distinct hurdles to satisfy the PSLRA’s pleading requirements. First, the CWs must be described with sufficient particularity to support the probability that persons in the positions occupied by the witnesses would possess the information
Circuits, and district courts in the Northern District of California,131 District of Maryland,132 Southern District of New York,133 Western District of New York,134 and Southern District of Ohio.135

IV.  Higginbotham Is Indefensible

A.  Tellabs Provides No Support for Higginbotham’s Conclusion That Information From Confidential Sources Cannot Be Deemed Compelling

alleged. Second, the information provided by CWs must itself be indicative of scienter. 552 F.3d at 995. Accord Karpov v. Insight Enterprises, Inc., No. CV 09-856-PHX-SRB, 2010 WL 2105448, at *6 (D. Ariz. Apr. 30, 2010). In Avaya, the Third Circuit also underscored Zucco’s key point concerning the distinction between substance and form. The court stated: “(F)or analytical purposes it is important to distinguish deficiencies relating to the content of allegations from those relating to their form.” 564 F.3d 263 n.33.

130 In Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1239-40 (11th Cir. 2008), the Eleventh Circuit did not mention Higginbotham when it joined all other circuits to consider the issue and rejected the notion that confidential sources must be named in securities fraud complaints. The Eleventh Circuit, rejecting defendants’ argument that statements by confidential witnesses should be heavily discounted, analogized such witnesses in securities cases to confidential sources in criminal cases who furnish information used to justify issuance of a search warrant, but noted that the analogy was imperfect. Id. at 1240. Accordingly, Mizzaro, after adopting the Novak-Cabletron analysis, concluded that the weight given to allegations based on statements proffered by CWs in securities cases could be reduced by virtue of their confidentiality. 544 F.3d at 1240. Accord Edward J. Goodman Life Income Trust, Case No. 8:06-cv-01716-T-23EAJ, 2009 WL 179669, at *9 (M.D. Fla. Jan. 26, 2009). See also In re HomeBanc Corp. Sec. Litig., Civ. Action No. 1:08-cv-1461-TCB, 2010 WL 1524836, at **8-9 (N.D. Ga. Apr. 13, 2010) (citing Mizzaro for proposition that statements and observations of CWs cannot be wholly disregarded).


132 In re Bausch & Lomb, Inc. Sec. Litig., Master File No. 06-CV-6294, 2008 WL 49111796, at *13 (W.D.N.Y. Nov. 13, 2008) (citing Higginbotham and then noting cases which have considered allegations based on confidential sources post-Tellabs without discounting them).

133 In re Huntington Bancshares Inc. Sec. Litig., No. 2:07-cv-1276, 2009 WL 4666455, at *7 (S.D. Ohio Dec. 4, 2009) (“For analysis purposes, the Court accepts the confidential witnesses’ statements in full and without discount.”).
The Seventh Circuit’s decision in *Higginbotham* is indefensible on numerous grounds and those courts which have endorsed its reasoning are incorrect. The remainder of this Article examines the faulty reasoning of *Higginbotham* and other federal courts which have been persuaded by the Seventh Circuit. As will be seen, no sound reasons support the automatic deep discounting of information provided by confidential witnesses for use in securities fraud complaints.

First, neither the reasoning nor the holding in *Tellabs* compels *Higginbotham*’s analysis. The Seventh Circuit concluded that information from confidential sources could rarely if ever be deemed compelling, and the use of such sources precluded the type of comparative analysis required by *Tellabs*. But this is incorrect, because the use of confidential witnesses can form the predicate for relevant inferences. As noted by Professor Geoffrey P. Miller, “(i)t is a non sequitur to say that, because *Tellabs* mandates a rigorous analysis, confidential sources should be excluded entirely. Rather, a statement in the complaint that a confidential source has provided certain information is a predicate allegation like any other that, evaluated in light of general information, can be used to draw forensically relevant inferences.” Indeed, insofar as *Tellabs* mandates that a complaint be considered in its entirety before determining whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter (and not whether any individual allegation, scrutinized in isolation, meets the standard), singling out information provided by confidential witnesses “is the antithesis”

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136 See 495 F.3d at 757 (“It is hard to see how information from anonymous sources could be deemed ‘compelling’ or how we could take account of plausible opposing inferences.”).
of the *Tellabs* approach. The Seventh Circuit specifically acknowledged this command of *Tellabs*.

Higginbotham’s assertion that the use of confidential witnesses precludes the weighing of inferences under *Tellabs* assumes that naming the witnesses will help the court weigh inferences of scienter when deciding a motion to dismiss in a securities action. This assumption is unwarranted because names, in the absence of additional information, provide no assistance to the court in the weighing process. What is useful in the process is a description of the witnesses with sufficient particularity to support the probability that persons in the positions occupied by them would possess the information set forth in the complaint. Those descriptions should be required, and if

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139 495 F.3d at 757 (“*Tellabs* instructs courts to evaluate the allegations in their entirety.”).

they are sufficiently detailed no discounting should take place.\footnote{Post-Tellabs, some plaintiffs in securities fraud cases have attempted to circumvent the requirement that witnesses be identified with sufficient particularity by failing to identify any source for non-public facts alleged in their complaints. This end-run should fail. If the facts set forth in a complaint are not based on personal information or public records, they must have come from confidential witnesses, and such witnesses should be identified with sufficient particularity. See Rubke v. Capital Bancorp Ltd., 551 F.3d 1156, 1166 (9th Cir. 2009) (holding that plaintiff’s allegations regarding defendants’ statements made at meetings of board of directors and on other occasions were insufficient due to failure to reveal sources of information); Susan E. Hurd & Elizabeth P. Skola, Closer Scrutiny of ‘Confidential Informants,’ Law360, Apr. 15, 2009, http://securities.law360.com/print_article/95750.} Moreover, even if the names of witnesses provided some minimal assistance to the court in weighing inferences of scienter, that incremental aid is significantly outweighed by the policy considerations described infra\footnote{See text accompanying notes 224-44, infra.} that militate against requiring disclosure of confidential witnesses in advance of trial.

Higginbotham’s reasoning is the antithesis of the Tellabs approach in other respects as well. As indicated, the Seventh Circuit asserted that perhaps confidential witnesses (1) have axes to grind, (2) are lying, or (3) don’t exist.\footnote{495 F.3d at 757.} Of course, all three points could be equally true with regard to named witnesses.\footnote{See In re Thornburg Mort., Inc. Sec. Litig., No. CIV 07-0815 JB/WDS, 2010 WL 378300, at *5 n.11 (D.N.M. Jan. 27, 2010) (“When a complaint is filed, a court has no way of knowing whether even named witnesses have axes to grind, are lying, and/or exist; indeed, the Court has to assume what named witnesses say is true when ruling on a motion to dismiss.”).} Moreover, the first assertion complete discounts the realistic possibility that confidential witnesses have axes to grind precisely because they are disturbed by the fraud they discovered, and thus it ignores the command of Tellabs that courts must determine if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.
The second contingency ignores the fact that confidential witnesses in private securities litigation (unlike government whistleblowers)\textsuperscript{145} have no financial incentive to lie, because they receive no compensation for their information. The absence of remuneration significantly enhances the credibility of confidential witnesses in class action securities litigation. Moreover, the Seventh Circuit’s suggestion that the information provided by confidential witnesses should be steeply discounted because such witnesses may be lying irreconcilably conflicts with the fundamental rule, expressed by the Supreme Court’s statements in both \textit{Tellabs}\textsuperscript{146} and the 2007 case of \textit{Bell Atlantic Corp. v. Twombly},\textsuperscript{147} that at the pleading stage of litigation courts cannot

\textsuperscript{145} The SEC has had a limited program in place since the 1990s to reward whistleblowers in insider trading cases. By July 2010 the program had paid only five rewards totaling $159,537. Sarah Johnson, \textit{Paid to Whistle}, CFO.com, July 23, 2010, \url{http://www.cfo.com/printable/article.cfm/14512666}. The Internal Revenue Service (IRS) has had a program in place since 2007 that provides tax whistleblowers a reward up to 30 percent of any tax, interest, penalties, or additional amounts collected based on information provided to the IRS. By August 2009 at least 1,263 tax whistleblowers had submitted claims under the new program. No rewards had been paid by that date, but this is partly because claims resolution can take several years. See Internal Revenue Service Whistleblower Office, \textit{Annual Report to Congress on the Use of Section 7623} at 3 (2009), \url{http://www.irs.gov/pub/whistleblower/annual_report_to_congress_september_2009.pdf}. Finally, section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010, adds a new § 21F to the Exchange Act which provides that the SEC shall pay awards to whistleblowers who voluntarily provide information to the SEC that leads to successful enforcement actions in an amount equal to 10-30% of money collected by the SEC in such actions where the sanctions exceed $1 million. This is a major expansion of the SEC’s existing whistleblower program. See John C. Coffee, Jr., \textit{Hidden Impacts of the Dodd-Frank Act}, N.Y.L.J., July 15, 2010, at 5. Section 748 of the Dodd-Frank Act creates an analogous program with regard to the Commodity Futures Trading Commission. See Marcia Coyle, \textit{Corporate Sector Sounds the Alarm over Financial Reform’s ‘Bounty’ System}, Law.com, July 20, 2010, \url{http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1202463690243}.

\textsuperscript{146} 551 U.S. at 328 ("[T]he case will fall within the jury’s authority to assess the credibility of witnesses. . . .").

\textsuperscript{147} 550 U.S. 544, 556 (2007) ("Rule 12(b)(6) does not countenance . . . a judge’s disbelief of a complaint’s factual allegations."). In \textit{Twombly}, an antitrust case, the Supreme Court held that, in order to survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim that is plausible on its face. Subsequently, in \textit{Ashcroft v. Iqbal}, --U.S.--, 129 S. Ct. 1973, 1949 (2009), the Supreme Court held 5-4 that the “facial plausibility” pleading sufficiency test applies to all federal civil actions. The \textit{Twombly} and \textit{Iqbal} decisions have generated a blizzard of academic commentary, some of which includes Edward A. Harnett, \textit{Taming Twombly}, \textit{Even After Iqbal}, 158 U. PENN. L. REV. 473 (2010); Robin J. Effron, The
decide whether witnesses are truthful. The Supreme Court expressly stated in *Tellabs* that it is “within the jury’s authority to assess the credibility of witnesses, resolve genuine issues of fact, and make the ultimate determination whether (defendants) acted with scienter.”

By steeply discounting information provided by confidential witnesses on the assumption that they may be lying, the Seventh Circuit, in clear contradiction of the Supreme Court’s command, is removing from the jury its function of assessing the credibility of witnesses.

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*Plaintiff Neutrality Principle: Pleading Complex Litigation in the Era of Twombly and Iqbal*, 51 WILLIAM & MARY L. REV. 1997 (2010); Patricia A. Hatamayr, *The Tao of Pleading: Do Twombly and Iqbal Matter Empirically?*, 59 AM. U. L. REV. 553 (2010); and Rakesh N. Kilaru, Comment, *The New Rule 12(B)(6): Twombly, Iqbal, and the Paradox of Pleading*, 62 STAN. L. REV. 905 (2010). The decisions also have resulted in Congressional action. In July 2009, Sen. Arlen Specter introduced S. 1504, the Notice Pleading Restoration Act of 2009, which provides that federal courts shall not grant motions to dismiss except under the notice pleading standards applicable under Supreme Court precedent prior to Twombly. That precedent was established in Conley v. Gibson, 355 U.S. 41 (1957), which held that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief. *Id.* at 45-46. In December 2009, the Senate Judiciary Committee conducted a hearing on whether the recent Supreme Court decisions have limited Americans’ access to federal court. Prof. Stephen B. Burbank testified that “(p)erhaps the most troublesome possible consequence of *Twombly* and *Iqbal* is that they will deny access to court to plaintiffs and prospective plaintiffs with meritorious claims who cannot satisfy those decisions’ requirements either because they lack the resources to engage in extensive pre-filing investigation or because of informational asymmetries.” Prepared Statement of Stephen B. Burbank, Hearing on Whether the Supreme Court has Limited Americans’ Access to Court before the Sen. Comm. on the Judiciary, 111th Cong., 1st Sess., Dec. 2, 2009, [http://judiciary.senate.gov/pdf/12-02-09%20Burbank%20testimony.pdf](http://judiciary.senate.gov/pdf/12-02-09%20Burbank%20testimony.pdf). Notwithstanding the foregoing, it is unclear what impact *Twombly* and *Iqbal* will have on securities cases. Compare Durham v. Whitney Info. Network, No. 06-CV-00687, 2009 WL 3783375, at n.5 (M.D. Fla. Nov. 10, 2009) (“The interplay between Twombly, Iqbal, and the PSLRA in terms of pleading requirements is not clear.”) with West Virginia Inv. Mgt. Bd. v. Doral Fin. Corp., 344 Fed. Appx. 717, 721 (2d Cir. 2009) (holding that even if plaintiffs’ allegations were plausible under *Twombly* and *Iqbal*, they still failed to satisfy PSLRA’s standards); Kevin LaCroix, *The D&O Diary*, *The Iqbal Case and Damages Actions under the Federal Securities Laws*, Oct. 26, 2009, [http://www.dandoiary.com/2009/10/articles/securities-litigation/the-iqbal-case-and-damages-actions-under-the-federal-securities-laws](http://www.dandoiary.com/2009/10/articles/securities-litigation/the-iqbal-case-and-damages-actions-under-the-federal-securities-laws) (“Iqbal appears to represent yet another factor raising the hurdle that plaintiffs’ initial (pleadings) must overcome in order to survive a motion to dismiss in a securities class action lawsuit.”); and *Panelists Weigh in on Foreign-Cubed Case; Discuss Trends in Securities Class Actions, 42 SEC. REG. & LAW REPORT 452* (March 15, 2010) (quoting plaintiffs’ attorney Daniel Sommers for proposition that *Twombly* and *Iqbal* “in practice have not changed much of anything” in class action securities litigation).

148 551 U.S. at 311.
The third contingency (that confidential witnesses don’t exist) basically assumes widespread misconduct by plaintiffs and their counsel in class action securities litigation. Insofar as complaints in securities litigation typically rely on numerous confidential witnesses and such witnesses must be described with particularity in order to be deemed credible, pursuant to prevailing law in almost every federal circuit, the suggestion that witnesses do not exist assumes that the identifying detail also has been fabricated, with respect to numerous witnesses. (If the witnesses are not identified, they almost certainly will be discounted by the district court.) This suggestion is contrary to *Tellabs*, because it considers irrational, rather than plausible, inferences.  

The suggestion also is contrary to *Tellabs* insofar as ties go to the plaintiff. *Higginbotham* balances the inference that confidential witnesses do not exist against the allegation that they do, and improperly resolves the balance in favor of defendants.

**B. *Higginbotham* is Undercut By Rule 11 and the PSLRA’s Sanctions Provision**

The suggestion by the Seventh Circuit that information provided by confidential witnesses is inherently unreliable because such witnesses may be lying also is directly undercut by both Rule 11(b) of the Federal Rules and the PSLRA. Rule 11(b) provides in relevant part that by presenting to the court a pleading, written motion, or other paper, an attorney or unrepresented party certifies that, to the best of the person’s knowledge, information and belief, formed after reasonable inquiry, the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery. Rule 11(b) thus

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150 Rule 11(b), Fed. R. Civ. P.
requires that plaintiffs’ counsel conduct reasonable factual inquiry before filing suit.\textsuperscript{151} Both a represented party and his attorney may be sanctioned under Rule 11(b)(3) for the factual insufficiency of a complaint.\textsuperscript{152} Where the party knows that the filing and signing are wrongful, and the attorney reasonably should know, then sanctions against both are appropriate.\textsuperscript{153}

The PSLRA requires district courts overseeing securities fraud suits to make specific findings, upon final adjudication of the action, as to whether all parties and all attorneys have complied with each requirement of Rule 11(b) with respect to the complaint, responsive pleading, and dispositive motion.\textsuperscript{154} If the court determines that a violation of Rule 11(b) has occurred in a securities case, the imposition of sanctions is mandatory, whereas it is discretionary in other types of cases.\textsuperscript{155} The PSLRA also adopts a rebuttable presumption that the appropriate sanction for a complaint that substantially fails to comply with Rule 11(b) is an award to the opposing party of the reasonable attorneys’

\textsuperscript{151} Rule 11(b), Fed. R. Civ. P.
\textsuperscript{152} Oliveri v. Thompson, 803 F.2d 1265, 1274 (2d Cir. 1986).
\textsuperscript{153} Chien v. Skystar Bio Pharm. Co., 256 F.R.D. 67, 75 (D. Conn. 2009). Prior to imposing sanctions for a violation of Rule 11 the court must provide the potential violator with notice and an opportunity to respond. Rule 11, Federal Rules; Glonti v. Stevenson, No. 08 cv 8960(CM), 2009 WL 311293, at *12 (S.D.N.Y. Feb. 6, 2009) (setting show cause hearing prior to imposing sanctions under Rule 11 and PSLRA). Given Rule 11’s due process requirement, in general it is an abuse of discretion for district courts to impose sanctions \textit{sua sponte}. Brunig v. Clark, 560 F.3d 292, 297 (5th Cir. 2009). But sanctions can never be \textit{sua sponte} under the PSLRA, because Congress has mandated Rule 11 findings. \textit{ATSI Communications, Inc. v. The Shaar Fund, Ltd.}, 579 F.3d 143, at *6 (2d Cir. 2009).
\textsuperscript{154} 15 U.S.C. § 78u-4(c)(1); Vladimir v. Bioenvision Inc., No. 07 Civ. 6416(SHS), 2009 WL 857552, at *19 (S.D.N.Y. March 31, 2009). At least one court has held that the Rule 11 inquiry is mandatory even if some of the claims in this action do not arise under federal securities laws. See Morris v. Wachovia Sec., Inc., 448 F.3d 268, 276 (4th Cir. 2006). See also Citibank Global Markets, Inc. v. Rodriguez Santana, 573 F.3d 17, 31-32 (2d Cir. 2009) (“The statute requiring such findings does not appear to brook any exceptions. . .”).
fees and other expenses incurred in the action. The presumption may be rebutted upon a showing of either a *de minimis* violation or that the full sanction award unjustly creates an unreasonable burden on the sanctioned party and that a partial award would not impose a greater burden on the party in whose favor sanctions are to be imposed. If the presumption is rebutted the court shall award the sanction that it deems appropriate pursuant to Rule 11. A district court’s imposition of sanctions under the PSLRA and Rule 11 is reviewed on appeal for abuse of discretion.

The express Congressional purpose of the PSLRA’s sanctions provision was to increase the frequency of Rule 11 sanctions in securities litigation and thus tilt the balance toward greater deterrence of frivolous securities fraud claims. Some empirical evidence indicates that this ultimate goal of deterrence has been achieved, in part. Post-PSLRA, fewer frivolous suits have been filed, and the risk of Rule 11 sanctions has likely motivated plaintiffs’ counsel in class action securities litigation to avoid reliance on witnesses whose information has been fabricated. Indeed,

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156 15 U.S.C. § 78u-4(c)(3)(A)(ii); Simon DeBartolo Group, LP v. Richard E. Jacobs Group, Inc., 186 F.3d 157, 167 (2d Cir. 1999). If the abuse being punished is a Rule 11(b) violation in any responsive pleading or dispositive motion, the rebuttable presumption is that the appropriate sanction is an award to the opposing party of the reasonable attorneys’ fees and other expenses incurred as a direct result of the violation. 15 U.S.C. § 78u-4(c)(3)(A)(i).

157 Gurary v. Nu-Tech Bio-Med, Inc., 303 F.3d 212, 221, 223 (2d Cir. 2002). The *de minimis* exception is not defined by the PSLRA and federal courts have not explained its scope. In re Australia and New Zealand Banking Group Ltd. Sec. Litig., No. 08 Civ. 11278(DLC), 2010 WL 187528, at *10 (S.D.N.Y. May 11, 2010).


159 ATSI Communics., Inc. v. Shaar Fund, Ltd., 579 F.3d 143, 150 (2d Cir. 2009) (affirming award of sanctions under PSLRA, but vacating amount awarded for assessment of its reasonableness); Morris v. Wachovia Sec., Inc., 448 F.3d 268, 277 (4th Cir. 2006). Indeed, the Second Circuit has held that the review is even more exacting than under the ordinary abuse of discretion standard. ATSI Communics., supra, 579 F.3d at 150; Perez v. Danbury Hosp., 347 F.3d 419, 423 (2d Cir. 2003).

160 ATSI Communics., Inc. v. Shaar Fund, Ltd., 579 F.3d 143, 152 (2d Cir. 2009).

161 See Stephen J. Choi, *Do the Merits Matter Less After the Private Securities Litigation Reform Act?*, 23 J. LAW, ECON. & ORGAN. 598, 623 (2007) (concluding that PSLRA has operated to reduce incidence of both nuisance litigation and meritorious litigation).
defendants have not hesitated to seek sanctions in such litigation where they have found discrepancies between allegations in complaints based on information provided by confidential witnesses and the subsequent sworn testimony or interviews of the witnesses. While those efforts generally have failed, whether made at the pleading stage or at the conclusion of a case, defendants’ aggressive posture directly undercuts the Seventh Circuit’s conclusion that the information provided by confidential witnesses for use in securities complaints should be steeply discounted because such witnesses may be lying. Rule 11 and the PSLRA’s sanctions provision combine to provide a powerful deterrent to the use by plaintiffs’ counsel of fabricated information from confidential witnesses.

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162 See, e.g., In re Par Pharm. Sec. Litig., Civ. Action No. 06-cv-3226 (PGS), 2009 WL 3234273, at **11-12 (D.N.J. Sept. 30, 2009) (denying sanctions where confidential witness subsequently claimed she was misquoted, but did not deny making any of the statements attributed to her in plaintiffs’ Second Amended Complaint); In re JDS Uniphase Corp. Sec. Litig., No. C 02-1486 CW, 2008 WL 753758, at *3 (N.D. Cal. March 19, 2008) (denying sanctions where plaintiffs asserted that over 95 percent of the statements included in their second amended consolidated complaint were corroborated); In re Proquest Sec. Litig., 527 F. Supp.2d 728 (E.D. Mich. 2007) (denying sanctions, but discounting allegations by confidential witness); Wu Group v. Synopsys, Inc., No. C 04-3580 MJJ, 2005 WL 1926626, at *13 (N.D. Cal. Aug. 10, 2005) (denying sanctions where plaintiffs contended that information provided by confidential witnesses was accurately set forth in complaint); and In re Exodus Communics., Inc. Sec. Litig., No. C-01-2661, slip. op. at 2-4 (N.D. Cal. Dec. 17, 2004) (denying sanctions and refusing to strike allegations by confidential witnesses). But see ATI Communics., Inc. v. Shaar Fund, Ltd., 579 F.3d 143, 150 (2d Cir. 2009) (affirming award of sanctions under PSLRA and Rule 11, but vacating amount awarded for assessment of its reasonableness); In re Australia and New Zealand Banking Group Ltd. Sec. Litig., No. 08 Civ. 11278(DLC), 2010 WL 187528, at *10 (S.D.N.Y. May 11, 2010) (imposing sanctions under PSLRA and Rule 11). If defendants move to strike the allegations of a confidential witness, does that motion justify lifting the PSLRA’s stay to permit particularized discovery? Most courts to have considered the issue have sensibly concluded that lifting the stay is not justified, and the submission by the CW of a declaration that backtracks from the allegations attributed to him in a complaint does not constitute a violation of the automatic stay. See In re Par Pharm. Sec. Litig., supra, at **11-12; In re Proquest Sec. Litig., supra, 527 F. Supp.2d at 740. But cf. Campo v. Sears Holdings Corp., No. 09-3589-cv, 2010 WL 1292329, at *3 n.4 (2d Cir. Apr. 6, 2010) (finding no error with district court’s decision to permit depositions of CWS for limited purpose of determining whether they made statements attributed to them in complaint, to assist court in resolving defendants’ motions to dismiss).

163 See In re MTI Tech. Corp., No. SACV 00-0745 DOC, 2002 WL 32344347, at *5 (C.D. Cal. June 13, 2002) (Rule 11 serves to “keep a plaintiff’s allegations in all case(s), including PSLRA cases, in
C. Disclosure of Confidential Witnesses is Not Inevitable Under Rule 26

1. Initial Disclosures Under Rule 26(a)(1)

In both Higginbotham\(^\text{164}\) and again on remand in Tellabs II,\(^\text{165}\) the Seventh Circuit asserted that an identification of confidential witnesses must inevitably be made under Rule 26 of the Federal Rules, and because identification is inevitable, no purpose is served by delaying it. The Eighth Circuit has expressed a similar view,\(^\text{166}\) and so have several district courts.\(^\text{167}\) In fact, identification is not inevitable under Rule 26, because disclosure is not mandated by the Rule’s initial disclosure scheme and discovery is, or should be, precluded by the work product protection provided by the Rule, or on public policy grounds. The three issues are considered separately below, beginning with initial disclosures.

Rule 26 provides in part that the identity and location of persons having knowledge of any discoverable matter are discoverable.\(^\text{168}\) Parties are not required to check.”\(^\text{169}\). A 2006 study found only four examples of sanctions in a securities class action case in the decade since the enactment of the PSLRA, but the authors acknowledged that “the mere possibility of judicially imposed sanctions may have deterred plaintiffs from filing frivolous lawsuits to such an extent that sanctions are only rarely applied.”\(^\text{170}\) Stephen J. Choi & Robert B. Thompson, Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA, 106 COLUM. L. REV. 1489, 1511 (2006). An alternative explanation for the extremely low incidence of sanctions is that virtually all securities class actions which are not dismissed are resolved by settlement, and the settlement agreements typically include a provision pursuant to which the parties agree that the action was instituted and prosecuted in good faith and the parties and their counsel fully complied with Rule 11. See Jordan Eth & Timothy Blakely, The Use and Abuse of Confidential Witnesses: The Battle Continues After Tellabs, Practicing Law Institute, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, PLI Order No. 18078, 1762 PLI/Corp 606 (Sept.-Oct. 2009).

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\(^{164}\) 495 F.3d at 757 (noting that “anonymity is (not) possible in the long run.”).
\(^{165}\) 513 F.3d at 711.
\(^{167}\) See, e.g., In re Marsh & McLennan Sec. Litig., MDL No. 1744, No. 04 Cv. 8144(SWK), 2008 WL 2941215, at *4 (S.D.N.Y. July 30, 2008) (“With regard to these CWs, the issue of disclosure is really a matter of when, not whether.”).
wait for formal discovery to learn the identity of witnesses with knowledge of relevant information. Rather, each party must voluntarily disclose the name (and, if known, address and telephone number) of each individual “likely to have discoverable information . . . that the disclosing party may use to support its claims.” The parties also must disclose the subject of the information known by the witnesses. Initial disclosures are required to be made at the Rule 26(f) conference (or within 14 days thereof), and that conference must take place “as soon as practicable” and at least 21 days before the scheduling conference required under Rule 16(b). A party’s failure to comply with Rule 26’s initial disclosure requirement may result in exclusion of the evidence at trial. Rule 37 provides that a party who fails to make the required initial disclosure is barred from using that information or witness to supply evidence on a

169 Fed. R. Civ. P. 26(a)(1)(A)(i). A limited number of actions are exempt from the initial disclosure requirement. Exempt actions include (i) actions for review on an administrative record, (ii) civil forfeiture actions under federal statutes, (iii) petitions for habeas corpus or any other proceeding to challenge a criminal conviction or sentence, (iv) actions by state or federal prisoners pro se, (v) actions to enforce or quash an administrative summons or subpoena, (vi) actions by the United States to recover benefit payments; (vii) actions by the United States to collect on a student loan guaranteed by the United States, (viii) proceedings ancillary to proceedings in other courts, and (ix) actions to enforce an arbitration award. Fed. R. Civ. P. 26(a)(1)(B); Alvarez v. Robinson, No. CIV S-06-0414 FCD EFB PS, 2007 WL 2972886, at *1 (E.D. Cal. Oct. 10, 2007).


171 Fed. R. Civ. P. 26(f)(1). The Rule 16(b) scheduling order, which ensues from the scheduling conference, is required in all cases, except as otherwise provided by local rules. The scheduling order must set time limits for joinder of other parties, amending the pleadings, completion of discovery, and filing of motions, and may include certain additional items. Fed. R. Civ. P. 16(b)(3)(A). It must issue no later than 90 days after the first defendant’s appearance in the action, whether by answer or motion, or within 120 days after any defendant is served, if earlier. Fed. R. Civ. P. 16(b)(2).
motion, at a hearing, or at trial,\textsuperscript{172} except where the failure to comply with disclosure requirements was substantially justified or harmless.\textsuperscript{173} Courts have considerable discretion in determining whether to excuse a failure to comply as substantially justified or harmless, and they use a variety of multifactor tests.\textsuperscript{174}

Initial disclosures do not encompass trial witnesses. Instead, Rule 26 requires parties to disclose the witnesses they intend to call at trial (other than for impeachment) in their pretrial disclosures due 30 days before trial.\textsuperscript{175} This is the first point at which parties are compelled to identify the fact witnesses they intend to call at trial. Before then, their identities are typically protected (sometimes as attorney work product),

\begin{itemize}
  \item \textsuperscript{172}Fed. R. Civ. P. 37(c)(1). See Hoffman v. Constr. Protective Servs., Inc., 541 F.3d 1175, 1179 (9th Cir. 2008).
  \item \textsuperscript{173}Fed. R. Civ. P. 37(c)(1). The party facing the sanction has the burden to demonstrate that the failure to comply with Rule 26(a) was substantially justified or harmless. See Torres v. City of Los Angeles, 548 F.3d 1197, 1213 (9th Cir. 2008). Failure to disclose a witness may be harmless if there is significant relevant evidence apart from the witness’s testimony, the witness’ identity is already known to the opposing party, or the witness’s identity has been disclosed by other parties. See Worldwide Network Serv., LLC v. Dyncorp Int’l, LLC, Nos. 08-2108, 08-2166, 2010 WL 489477, at *10 (4th Cir. Feb. 12, 2010) (“[t]he record contains abundant evidence of racial animus apart from Mack’s testimony.”); SEC v. Koenig, 557 F.3d 736, 744 (7th Cir. 2009) (failure by plaintiff to list witness was harmless where he was listed by defendant); El Ranchito, Inc. v. City of Harvey, 207 F. Supp. 2d 814, 818 (N.D. Ill. 2002) (failure to disclose witnesses known to opposing party was harmless).
  \item \textsuperscript{174}See, e.g., Worldwide Network Serv., LLC v. Dyncorp Int’l, LLC, Nos. 08-2108, 08-2166, 2010 WL 489477, at *10 (4th Cir. Feb. 12, 2010) (describing five-factor test); Esposito v. Home Depot, Inc. U.S.A., Inc., 590 F.3d 72, 78 (1st Cir. 2009) (describing different but similar five-factor test). Courts sometimes hold that the failure to identify a witness may be remedied by permitting the taking of his deposition. See, e.g., Valentin v. County of Suffolk, 342 Fed. Appx. 661, at *1 (2d Cir. 2009); Wertz v. Target Corp., No. 08-CV-78 GSA, 2009 WL 651129, at *2 (E.D. Cal. March 12, 2009).
  \item \textsuperscript{175}Fed. R. Civ. P. 26(a)(3)(A). Rule 26 also requires disclosure of the identities of experts who have been retained or specially employed to provide expert testimony in the case and their opinions and certain other information, and permits the parties to take their depositions. Fed. R. Civ. P. 26(a)(2), (b)(4)(A). But expert disclosures are due at least 90 days before the trial date or the date the case is to be ready for trial, unless the parties have stipulated or the court has ordered otherwise. Fed. R. Civ. P. 26(a)(2). See Strauss v. Credit Lyonnais, S.A., 242 F.R.D. 199, 233 (E.D.N.Y. 2007) (declining to compel expert disclosures, because no date for such disclosures had yet been set by the court).
\end{itemize}
discoverable only upon a showing of particular need.\textsuperscript{176} Because the court will order a scheduling conference no later than 120 days after any defendant is served, and the parties must make their initial disclosures (and prepare a discovery plan) at least 21 days before the scheduling conference is held, the parties’ Rule 26(f) conference is required to be held at least 21 days before the 120-day mark.\textsuperscript{177} Accordingly, initial disclosures (including an identification of persons with discoverable information) will be due no later than approximately three months after the first defendant is served, but an identification of trial witnesses is not due until 30 days before trial.\textsuperscript{178}

Contrary to the conclusion of the Seventh Circuit, the foregoing scheme does not render inevitable the disclosure of confidential witnesses in securities litigation. If a party simply discloses at the Rule 26(f) conference its list of knowledgeable witnesses, includes its confidential witnesses on the list, but does not specify which, if any, of them were the witnesses who provided information used in the complaint, then identification is not certain to occur. Identification may occur if the witnesses are subsequently...


\textsuperscript{178} However, Rule 26 provides for disclosure of witnesses likely to have discoverable information that the disclosing party \textit{may use} to support its claims or defenses (unless solely for impeachment). “May use” includes any use at a pretrial conference, or to support a pretrial motion, as well as use at trial, and witnesses intended to be used only if the need arises. Fed. R. Civ. P. 26(a)(1), Adv. Comm. Notes to 2000 Amendment.
interviewed or deposed, but it is not inevitable, and if it does occur it will not happen until much later in the litigation process. There is no inevitability in part because a protective order prohibiting defendants from inquiring into the deponents’ status as confidential witnesses could issue. Such orders have been issued in cases arising under the Fair Labor Standards Act (FLSA).

Moreover, delayed identification will rarely prejudice defendants, because trials in class action securities litigation are so uncommon, and when they do occur confidential witnesses rarely are called by plaintiffs as witnesses. By June 2010, only 27 class action securities cases had gone to trial since the PSLRA was enacted in 1995. Only nine of those 27 cases were tried to a verdict and involved post-PSLRA conduct.

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179 See, e.g., In re Harmonic, Inc. Sec. Litig., No. C-00-2287 PJH (EMC), 2007 WL 2701123, at *3 (N.D. Cal. Sept. 13, 2007) (“Plaintiffs) concede that by deposing or otherwise investigating all of the 77 witnesses, Defendants will eventually be able to discern who the five CWs are. Thus, . . . it is a matter of when, not if, the CW’s identities will be discovered.”). See also Ethan D. Wohl, Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure, 12 FORDHAM J. CORP. & FIN. L. 551, 569 (2007) (“Requiring plaintiffs to name confidential informants, but conceal them among a long list of other persons with knowledge, results in an unhappy compromise that forces defendants to deposing third parties who may be only tangentially involved.”).


181 Adam T. Savett, Claims Compensation Bureau, LLC, Securities Class Action Trials in the Post-PSLRA Era (June 2010), http://www.box.net/shared/xxav75dzpf. Seven cases involving post-PSLRA conduct were tried by June 2010, but not to a verdict. Either a settlement occurred during trial, or a default judgment was entered. Eleven cases involving pre-PSLRA conduct were tried to a verdict. Savett, supra. At least three explanations have been proffered as to why so few securities class actions go to trial. First, theoretical damages are potentially ruinous, exceeding both the amount of available insurance and defendants’ ability to pay. Second, the typical directors’ and officers’ insurance policy excludes coverage in the event of an adjudication of fraud, which naturally makes defendants extremely wary of a jury verdict. Third, given the tremendous burden and expense associated with trying a securities case, plaintiffs’ lawyers have little economic incentive to risk an unfavorable verdict. See Kevin LaCroix, The D&O Diary, A Securities Lawsuit Goes to Trial, Oct. 24, 2007, http://www.dandodiary.com/2007/10/articles/securities-litigation/a-securities-lawsuit-goes-to-trial/. The significance of the first two factors was increased by declining share prices during the recession of 2007-10, which raised the level of potential damages in securities cases. See Bruce D. Angiolillo, Aligning Legal Strategy with Trends in Securities Litigation, ASPIRE at *1 (Apr. 2009), 2009 WL 1615207. See also James C. Dugan, A Primer on Securities Litigation and Enforcement in
Confidential witnesses rarely are called to testify in the few class action securities trials which do occur, because typically the outcome of such a trial is determined by the documents, rather than by the witnesses.\footnote{An Economic Crisis, ASPATORE at *1 (Apr. 2009 WL 1615203 (concluding in 2009 that given the negative public perception of business generally, “there has probably never been a worse time to be a securities fraud defendant facing a jury trial.”); John C. Coffee, Jr., Accountability and Competition in Securities Class Actions: Why “Exit” Works Better Than “Voice,” 30 CARDOZO L. REV. 407, 413-14 (2008) (explaining how risk averse nature of plaintiffs’ lawyers in securities class actions is exploited by defendants to avoid trials); and Jeffrey A. Barrack, A Primer on Taking A Securities Fraud Class Action to Trial, 31 AM. J. TRIAL ADVOC. 471, 476-77 (2008) (identifying various factors pointing to a future increase in securities fraud cases that will proceed to trial).} A good example of this proposition is the 2007 securities fraud trial involving defendant JDS Uniphase Corporation, which was probably the largest securities class action to go to trial by that date.\footnote{Jordan Eth & Timothy Blakely, The Use and Abuse of Confidential Witnesses: The Battle Continues After Tellabs, Practicing Law Institute, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, PLI Order No. 18078, 1762 PLI/Corp 606 (Sept.-Oct. 2009) (“Confidential witnesses often are like the space shuttle’s rocket boosters: after they blast the shuttle into orbit, they fall away into the sea, discarded and forgotten.”).} Plaintiffs’ initial complaint was dismissed for failure to meet the PSLRA’s strict pleading requirements. Following dismissal, plaintiffs filed an amended complaint containing allegations attributed to 50 confidential witnesses. On the basis of these allegations (and other information), the court denied a renewed motion to dismiss.\footnote{In re JDS Uniphase Corp. Sec. Litig., No. C 02-1486 CW, 2005 WL 43463, at **6-7 (N.D. Cal. Jan. 6, 2005).} Subsequently, most of the 50 confidential witnesses either were deposed or interviewed during discovery, but none testified during the course of the five-week trial that resulted in a defense verdict following less than two days of jury deliberations.\footnote{Jordan Eth & Timothy Blakely, Lessons for Securities Litigators from the JDS Uniphase Corporation Securities Litigation Trial, Practicing Law Institute, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES 363, 367, PLI Order No. 14673 (Sept.-Oct. 2008).}
Similarly, in In re St. Paul Travelers Sec. Litig. II, the court denied a motion to compel the identification of confidential witnesses after plaintiffs advised that they did not intend to have such witnesses testify at trial. The court ordered that disclosure must occur if plaintiffs changed course, and this is the correct approach. Where plaintiffs intend to use or rely on their confidential witnesses at trial, identification must be made under Rule 26. Where plaintiffs do not intend to use or rely on the witnesses at trial, compelled identification is inappropriate because it undermines the attorney work product doctrine and is contrary to public policy, as is described, infra. In short, mandating disclosure of confidential sources would deter such individuals from providing critical information to investigators in meritorious cases and/or invite retaliation against them, thus thwarting the filing of such cases. Precluding disclosure is consistent with the approach used by many courts with regard to the informant’s

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188 See, e.g., Mazur v. Lampert, No. 04-61159-CIV, 2007 WL 917271 (S.D. Fla. March 25, 2007) (“[I]f Plaintiffs intend to treat those witnesses merely as confidential sources, and not truly as ‘witnesses’ whose identities will be revealed at trial, then Plaintiffs are justified in their refusal to disclose those persons in discovery.”). Several courts have rejected this approach. See, e.g., Hubbard v. BankAtlantic Bancorp, Inc., No. 07-61542-CIV, 2009 WL 3856458, at *4 (S.D. Fla. Nov. 17, 2009) (court orders discovery of confidential witnesses, even after plaintiffs state their intention not to call such individuals as trial witnesses); In re Marsh & McLennan Cos. Sec. Litig., No. 04 Cv. 8144(SWK), 2008 WL 2941215, at *2 (S.D.N.Y. July 30, 2008) (same); and Brody v. Zix Corp., No. 3-04-CV-1931-K, 2007 WL 1544638, at *2 (N.D. Tex. May 25, 2007) (declining to find work product protection even where plaintiffs argued that they did not intend to use their confidential witnesses beyond the pleading stage).
189 See text accompanying notes 224-44, infra.
190 See, e.g., In re Cabletron Sys., Inc., 311 F.3d 11, 30 (1st Cir. 2002) (requiring plaintiffs to name their confidential internal corporate sources would “have a chilling effect on employees who provide information about corporate malfeasance.”); Richard M. Heimann, Joy A. Kruse and Sharon M. Lee, Post-Tellabs Treatment of Confidential Witnesses in Federal Securities Litigation, 2 J. SEC. LAW, REG. & COMPLIANCE 205, 212 (2009) (“Whether confidential witnesses will continue to come forward with information exposing corporate wrongdoing is likely to depend on the ability to preserve their anonymity, at least prior to discovery. Without such an assurance, whistleblowers fearing retaliation will be likely to be deterred and, as a consequence, otherwise meritorious cases may not be filed.”).
privilege, discussed infra, under which the privilege is generally upheld prior to trial and then yields to protect defendant’s right to a fair trial.

2. Work Product Protection

The conclusion of the Seventh Circuit and other courts that disclosure of confidential witnesses is inevitable also is undermined by the work product doctrine, which creates a qualified immunity from discovery for materials prepared by an attorney in anticipation of litigation and is included in Rule 26. Post-PSLRA, federal district courts have split regarding the discoverability of the identities of confidential witnesses. A number of courts have held that the identities of confidential witnesses who provide information set forth in a securities fraud complaint are generally discoverable, but the remaining, better-reasoned opinions have concluded that the

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191 See text accompanying notes 245-83, infra.
identities are protected from disclosure as attorney work product and/or on public policy grounds.\textsuperscript{196}

No federal appellate court had considered the discoverability issue by mid-2010. Appellate resolution of the issue seems unlikely to occur any time soon, in light of the very limited appellate review of discovery orders that is available to federal litigants. Generally, federal discovery orders are not final orders of the district court because they do not end the litigation on the merits, and therefore they are not immediately appealable.\textsuperscript{197} Moreover, the circuit courts are split on the question of whether, and to what extent, interlocutory review is available.\textsuperscript{198} The result of the conflicting

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\textsuperscript{197} Hernandez v. Tanninen, No. 09-35085, 2010 WL 1882304, at *4 (9th Cir. May 12, 2010).

\textsuperscript{198} In Carpenter v. Mohawk Indus., Inc., 130 S. Ct. 599 (2009), the Supreme Court resolved a circuit split by holding that discovery orders adverse to the attorney-client privilege do not qualify for immediate appeal under the collateral order doctrine. Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 546-47 (1949), permits review of interlocutory orders that finally determine claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review, and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated. Mohawk abrogated the decisions of three circuits (the Third, Ninth, and D.C.) that permitted appeals under Cohen of orders concerning attorney-client privilege. See 130 S.Ct. at 604 n.1. Cf. Hernandez v. Tanninen, No. 09-35085, 2010 WL 1882304, at *1 (9th Cir. May 12, 2010) (holding that reasoning of Mohawk “applies likewise to appeals of disclosure orders adverse to the attorney work product privilege.”); Perry v. Schwarzenegger, 591 F.3d 1126, 1136 (9th Cir. 2010) (assuming without deciding that reasoning of Mohawk applies to appeals of disclosure orders adverse to First
approaches is that “some litigants have access to interlocutory review and relief that others do not, based only on geographic location.” Finally, in general, discovery-related orders are rarely overturned on appeal.

Courts finding no work product protection for the identities of confidential witnesses in securities litigation have rested their decisions on one or more of the following points, each of which can be effectively rebutted. First, to the extent that plaintiffs’ complaint provides sufficient detail to satisfy the Novak test for use of information provided by confidential witnesses, that information may be so detailed

Amendment privilege). In Mohawk, the Supreme Court noted that three avenues of review are available to litigants seeking interlocutory review of a discovery order, apart from collateral order appeal. 130 S.Ct. at 607-08; Thomas R. Newman & Steven J. Ahmuty, Jr., ‘Mohawk’ and the Federal Collateral Order Doctrine, N.Y.L.J., Feb. 8, 2010, at 3. The first avenue is for a party to disobey the discovery order, stand in contempt of court and, if the court issues a criminal contempt order, challenge the discovery order on appeal of the contempt order, which of course is risky business. See United States v. Myers, 593 F.3d 338, 344 (4th Cir. 2010) (holding that civil contempt orders, unlike criminal contempt orders, are not immediately appealable); Aaron S. Bayer, The Collateral Order Doctrine After ‘Mohawk,’ N.A.L.J., Feb. 8, 2010, at 14 (“(C)ontempt not only poses obvious risks, but it also may not yield an appealable order, because only criminal contempt is immediately appealable. It would be difficult to know whether a court would hold a party in criminal, or civil, contempt for disobeying a discovery order.”). A second avenue is to seek review under 28 U.S.C. § 1292(b), which permits immediate appellate review by certification only when (1) the challenged order involves a controlling question of law and (2) an immediate appeal from the order may materially advance the ultimate termination of the litigation. Certification of discovery orders is rare, as indicated by the district court’s refusal to certify in Mohawk. See also Solis v. Washington, No. C08-5479BHS, 2010 WL 1186184, at *3 (W.D. Wash. March 23, 2010) (refusing to certify order because plaintiff “has not established that the informant’s privilege is a controlling question of law.”). A third avenue is to seek review of a discovery order by writ of mandamus. But mandamus is an extraordinary remedy that is usually reserved for questions of unusual importance, or important issues of first impression, and thus writs involving discovery are generally difficult to obtain. Compare Peck v. United States, 397 F.3d 274, 283 (5th Cir. 2005) (“(T)his court, in accord with other circuits, has considered and issued writs of mandamus over discovery orders implicating privilege claims.”) with In re County of Erie, 473 F.3d 413, 416 (2d Cir. 2007) (“Ordinarily, pretrial discovery orders involving a claim of privilege are unreviewable on interlocutory appeal, and we have expressed reluctance to circumvent this salutary rule by mandamus.”) and Chase Manhattan Bank, N.A. v. Turner & Newall, PLC, 964 F.2d 159, 163 (2d Cir. 1992) (“Unlike other circuits, we have rarely used the extraordinary writ of mandamus to overturn a discovery order involving a claim of privilege.”). See also Erwin Chemerinsky, Court Keeps Tight Limits on Interlocutory Review, 46 TRIAL 52, 54 (2010) (“Certification by district courts is relatively rare and mandamus even rarer.”). 199 Cassandra Burke Robertson, Appellate Review of Discovery Orders in Federal Court: A Suggested Approach for Handling Privilege Claims, 81 WASH. L. REV. 733, 759 (2006).

200 Awuah v. Coverall North America, Inc., 585 F.3d 479, 481 (1st Cir. 2009).
that it is possible for defendants to identify the witnesses, particularly by comparing the
descriptions in the complaint with the list of witnesses disclosed under Rule 26(a)(1). If
defendants are able to discern the identities of these individuals, “there is actually little
confidentiality at stake.”

Second, the identities of confidential witnesses are matters of underlying fact,
and their disclosure will not reveal the mental impressions, conclusions, opinions, or legal
theories of plaintiffs’ counsel, as is required in order to invoke the protection of the
doctrine. Moreover, even if work product protection does exist, that protection is
merely qualified, rather than absolute, and may be overcome by a showing of
hardship. Rule 26(b)(3) provides that documents and tangible things prepared in
anticipation of litigation or for trial by or for another party or its representatives may be
discovered if the party shows that (1) they are otherwise discoverable, and (2) it has
substantial need for the materials to prepare its case and cannot, without undue
hardship, obtain their substantial equivalent by other means. Several courts have
concluded that where plaintiffs disclosed extensive lists of individuals with knowledge of
matters alleged in plaintiffs’ complaints, defendants’ burden of interviewing or
deposing all such witnesses constituted undue hardship sufficient to overcome qualified
work product protection. Undue hardship was found where plaintiffs’ list consisted of

201 In re Marsh & McLennan Sec. Litig., MDL No. 1744, No. 04 Civ. 8144(SWK), 2008 WL 2941215, at
WL 2701123, at *4 (N.D. Cal. Sept. 13, 2007) (declining to find work product protection in part
because “(p)laintiffs have already provided substantial indicators as to who the CWs are.”); and
(“(T)o the extent that the complaint enables identification, there is no confidentiality to
preserve.”).

202 See, e.g., In re Aetna Inc. Sec. Litig., No. CIV. A. MDL 1219, 1999 WL 354527 (E.D. Pa. May 26,
1999); In re Harmonic, Inc. Sec. Litig., No. C-00-2287 PJH (EMC), 2007 WL 2701123 (N.D. Cal. Sept.
13, 2007). See also Stephen M. Sinaiko & Matan A. Koch, Using Confidential Informants to Meet
the PSLRA’s Standards, N.Y.L.J., July 7, 2008, at 11.

750 knowledgeable individuals (and that list was expected to expand), and where plaintiffs produced a list of 362 individuals who possessed information that plaintiffs intended to use to support their case (and the parties were limited to 125 depositions per side).

A third point is waiver. Numerous courts have held that by attributing allegations in the complaint to confidential witnesses, plaintiffs have made at least a partial disclosure of protected information, and thereby have waived protection for the remainder, including the identities of the witnesses. Moreover, the partial disclosure operates as a forbidden dual shield and sword. Under the shield and sword doctrine, a party who raises a claim that will require proof by way of privileged information cannot insist that the information is privileged.

The foregoing points, while not without some merit, collectively provide limited justification for courts refusing to find work product protection. First, the argument that

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204. In re Aetna Inc. Sec. Litig., No. CIV. A. MDL 1219, 1999 WL 354527 (E.D. Pa. May 26, 1999) (“Defendants would be forced to engage in a time-consuming and expensive effort to ferret out the veritable needle in the haystack. . . . The Court will not allow the discovery process to be subverted in this way.”).


no work product protection attaches when the descriptions of confidential witnesses are specific is circular. The most likely scenario in which descriptions in the complaint are sufficiently detailed to permit an identification of the witnesses is one in which a court has subverted the Novak test by requiring excessive, non-essential identifying information. For example, some courts demand a laundry list of identifying information that includes the specific dates when a CW was employed by the defendant corporation. Such a demand is unwarranted and serves only to create a situation in which defendants are able to identify the witness, thus permitting the court to conclude that no work product protection exists. Requiring plaintiffs to specify the exact dates of employment significantly erodes the confidentiality of confidential sources, and an allegation that the witness worked for defendant during a range such as late-2010 to late-2011 or during the class period should suffice, with respect to time. Several courts


210 In re Seebydend Tech. Corp. Sec. Litig., 266 F. Supp.2d 1150, 1159 (C.D. Cal. 2003). Accord Osher v. JNI Corp., 308 F. Supp.2d 1168, 1178 (S.D. Cal. March 10, 2004). See also In re Dot Hill Sys. Corp. Sec. Litig., No. 06CV228 JLS (WMc), 2008 WL 4184616, at *10 (S.D. Cal. Sept. 2, 2008) (declining to require plaintiffs to plead the exact dates of each confidential witness’s employment); In re Syncor Int’l Corp. Sec. Litig., 327 F. Supp.2d 1149, 1158 (C.D. Cal. July 6, 2004) (“Plaintiffs are not required to plead details to the extent that they jeopardize the confidentiality of the source.”). A similar problem arises with regard to small firm defendants, where the level of descriptive detail required by some courts may make inevitable the identification of confidential witnesses. An obvious solution is to permit in camera review of details about such witnesses instead of requiring plaintiffs to plead those details in the complaint. But courts have rejected this idea. See, e.g., In re Silicon Graphics, Inc. Sec. Litig., 183 F.3d 970, 983 n.12 (9th Cir. 1999) (affirming district court’s exclusion of in camera filing that described sources with requisite specificity because the filing “was inappropriate and unsupported by authority”); In re Dot Hill Sys. Corp. Sec. Litig., No. 06CV228 JLS (WMc), 2008 WL 4184616, at *10 (S.D. Cal. Sept. 2, 2008) (also rejecting in camera filing); and Plamp v. Mitchell School Dist. No. 17-2, No. CIV. 07-4009, 2008 WL 2277519, at *12 (D.S.D. June 3, 2008) (denying request for in camera inspection of witness interview notes in sexual harassment case).
have so held.\textsuperscript{211} Similarly, requiring job titles is neither sufficient nor necessary—titles may convey little information about actual job duties, and a description of the witnesses’ functional positions and general duties is more likely to establish that the witnesses were in a position to have access to the information alleged.\textsuperscript{212} And that is the critical issue. Information that is not essential to resolving that issue and instead operates to undermine confidentiality should not be required.

Second, discovery of the identities of confidential witnesses tends to accomplish three things that undermine the work product doctrine. The identification by name of witnesses linked to specific factual contentions in securities fraud complaints (1) reveals plaintiffs’ counsel’s opinions of the relative importance of such witnesses, (2) highlights their knowledge, and (3) links future statements by the witnesses with counsel’s legal theories and conclusions as outlined in the complaint.\textsuperscript{213} Courts in cases not involving

\textsuperscript{211} See, e.g., Cornwell v. Credit Suisse Group, No. 08 Civ. 3758(VM), 2010 WL 537593, at *7 (S.D.N.Y. Feb. 11, 2010) (finding sufficient an allegation that CW3 worked for defendant from late 2005 to mid-2007); In re Dot Hill Sys. Corp. Sec. Litig., No. 06CV228 JLS (WMC), 2008 WL 4184616, at *10 (S.D. Cal. Sept. 2, 2008) (declining to require plaintiffs to plead the exact dates of each confidential witness’s employment); In re St. Paul Travelers Sec. Litig., Civ. No. 04-4697 (JRT/FLN), 2006 WL 2735221, at *3 n.2 (D. Minn. Sept. 25, 2006) (finding sufficient an allegation that each of the CWs worked for defendants during the class period); In re VeeCo Instruments, Inc. Sec. Litig., No. 05 MD 1695(CM), 2006 WL 759751, at *7 (S.D.N.Y. March 21, 2006) (same); and In re Syncor Int’l Corp. Sec. Litig., 327 F. Supp.2d 1149, 1158 (C.D. Cal. 2004) (“Plaintiffs are not required to plead details to the extent that they jeopardize the confidentiality of the source.”).

\textsuperscript{212} See, e.g., In re Atlas Air Worldwide Holdings, Inc. Sec. Litig., 324 F. Supp.2d 474, 493 (S.D.N.Y. 2004) (“Plaintiffs are not required to plead exact job titles, describe the sources’ responsibilities and duties in detail or allege access to specific company documents.”); In re Northpoint Communc, Group, Inc. Sec. Litig., 221 F. Supp.2d 1090, 1097 (N.D. Cal. 2002) (noting that job titles may convey little information about actual job duties). Cf. In re Packaged Ice Antitrust Litig., No. 08-MD-01952, 2010 WL 2671306, at *17 (E.D. Mich. July 1, 2010) (holding that class action complaint in antitrust action was not required to plead CWs’ exact job titles or describe job duties in detail); Hinds County, Miss. v. Wachovia Bank, N.A., Civil No. 08 2516, MDL No. 08 1950, 2010 WL 1244765, at *12 n.5 (S.D.N.Y. March 25, 2010) (same).

securities fraud similarly have often concluded that the identities of witnesses interviewed by counsel are protected from disclosure by the work product doctrine.\footnote{See, \textit{e.g.}, \cite{In_re_Hardwood_P-G_Inc._Bankr._No._06-50057-LMC,_2009_WL_1037571}, \cite{In_re_Hardwood_P-G_Inc._Bankr._No._06-50057-LMC,_2009_WL_1037571} (denying defendant’s motion to compel identification of witnesses who were interviewed, because such disclosure would reveal mental impressions and trial strategy of counsel); \cite{Equal_Employment_Opportunity_Comm'n_v._Collegeville_Imagineering_Ent._No._CV-05-3033_PHX-DGC,_2007_WL_1089712} (holding that identities of witnesses interviewed by plaintiff’s counsel are protected by work product doctrine); \cite{Electronic_Data_Sys._Corp._v._Steingraber,No._4:02.CV.225,2003_WL.21653405,at.*2} ("The Court finds that revealing the identity of witnesses interviewed would permit opposing counsel to infer which witnesses counsel considers important, thus revealing mental impressions and trial strategy."); \cite{United_States_v._Urban_Health_Network_Inc._Inc.,No._91-5976,1993_WL.12811,at.*3} ("The names and dates of persons interviewed by the government during its investigation are also covered by the work product rule."); \cite{Laxalt_v._C.K._McClatchy,116_F.R.D._438,443} (refusing to compel disclosure of witnesses who were interviewed by counsel); \cite{Commonwealth_of_Massachusetts_v._First_Nat’l_Supermarkets,_Inc.,122_F.R.D._149} (D. Mass. 1986) (same); and Board of Educ. v. Admiral Heating, 104 F.R.D. 23, 32 (N.D. Ill. 1984) (same). \textit{See also} \cite{Tierno_v._Rite_Aid_Corp.,No._C05-02520_THE,2008_WL.2705089} (finding work product protection for declarations of store manager class members obtained by plaintiffs’ counsel in wage-and-hour employment case). \textit{But see} \cite{In_re_Theragenics_Corp._Sec._Litig.,205_F.R.D._631,634} (N.D. Ga. 2002) ("Numerous courts . . . have recognized that names and addresses of witnesses interviewed by counsel who have knowledge of the facts alleged in the complaint are not protected from disclosure by the work product doctrine."); \cite{In_re_Aetna_Inc._Sec._Litig.,No._CIV._A._MDL_1219,1999_WL.354527,at.*2} (E.D. Pa. May 26, 1999) (holding that names and addresses of individuals interviewed by plaintiffs’ counsel are not protected by attorney work product doctrine). \footnote{In re Veeco Instruments, Inc. Sec. Litig., No. 05MD1695 CMGAY, 2007 WL 274800, at *1 (S.D.N.Y. Jan. 29, 2007); Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys., 2005 WL 1459555, at *4 (N.D. Cal. June 21, 2005). \textit{But see} \cite{In_re_Marsh_&_McLennan_Sec._Litig.,MDL_No._1744,No._04_Cv._8144(SWK),2008_WL._2941215,at.*3} (S.D.N.Y. July 30, 2008) (observing that the relationship between witness identification and an attorney’s case strategies or mental impressions is much more attenuated than in connection with interview notes); \cite{In_re_Harmonic_Inc._Sec._Litig.,No._C-}}

Those cases are germane to this discussion, because compelled disclosure of confidential witnesses providing information used in securities fraud complaints is substantially similar to compelled disclosure of witnesses interviewed by counsel in other contexts, insofar as in both situations discovery permits opposing counsel to infer which witnesses counsel considers important, thus revealing mental impressions and trial strategy.\footnote{In re Veeco Instruments, Inc. Sec. Litig., No. 05MD1695 CMGAY, 2007 WL 274800, at *1 (S.D.N.Y. Jan. 29, 2007); Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys., 2005 WL 1459555, at *4 (N.D. Cal. June 21, 2005). \textit{But see} \cite{In_re_Marsh_&_McLennan_Sec._Litig.,MDL_No._1744,No._04_Cv._8144(SWK),2008_WL._2941215,at.*3} (S.D.N.Y. July 30, 2008) (observing that the relationship between witness identification and an attorney’s case strategies or mental impressions is much more attenuated than in connection with interview notes); \cite{In_re_Harmonic_Inc._Sec._Litig.,No._C-}
The mere fact that confidential witnesses may be included in a long list of potential deponents should not generally constitute undue hardship sufficient to overcome qualified work product protection. In other analogous situations, a long list of potential deponents has failed to constitute undue hardship. For example, in cases involving the use of confidential informants in cases filed under the FLSA, this fact repeatedly has been held to be insufficient to overcome the informer’s privilege.\(^{216}\) Moreover, confidential witnesses used in securities fraud complaints typically are the defendants’ current or former employees.\(^{217}\) In light of this fact, defendants are in the best position to know what information each of these individuals may possess,\(^{218}\) which means defendants usually should be unable to show the substantial need required to overcome the qualified privilege.\(^{219}\) More specifically, insofar as confidential witnesses typically are identified in those securities fraud complaints surviving motions to dismiss by positions they held, their locations at the time of the actions alleged, and similar indicia of reliability, many of the witnesses in Rule 26 disclosures can be eliminated as the source of information referenced in a complaint, without the need to interview or

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\(^{217}\) See, e.g., In re Ashworth, Inc. Sec. Litig., 213 F.R.D. 385, 389 (S.D. Cal. 2002) (“(H)ere there are approximately 100 potential witnesses who are, for the most part, former or current employees of defendant.”).


\(^{219}\) In re Ashworth, Inc. Sec. Litig., 213 F.R.D. 385, 390 (S.D. Cal. 2002)
depose them.\textsuperscript{220} Thus, the conclusions of some courts that a long list of potential deponents constitutes substantial need and/or undue hardship in this context often lacks foundation.

Third, with regard to waiver, two key factors that courts consider in determining whether waiver has occurred are (1) whether the party intended to waive the privilege, and (2) whether a finding of waiver is necessary in the interest of fairness.\textsuperscript{221} The first factor certainly militates against finding waiver in the typical case. It will rarely, if ever, be true that plaintiffs in securities fraud cases intended to waive work product protection by including in their complaints allegations based on information provided by confidential witnesses. The second factor presents a closer question. But insofar as confidential witnesses used in securities fraud complaints rarely become trial witnesses, as discussed supra, it generally is not unfair to defendants to find that no waiver of work product protection has occurred.\textsuperscript{222} This conclusion is reinforced by the fact that courts

\begin{itemize}
\item \textsuperscript{220} See Ross v. Abercrombie & Fitch Co., Nos. 2:05-cv-0819 etc., 2008 WL 821059, at *3 (S.D. Ohio March 24, 2008) (“The mere fact that counsel may have to do some investigative work to determine which witnesses have knowledge of which relevant facts is clearly insufficient to justify an intrusion into the particulars of how opposing counsel structured their interviews and how much credence they gave to the statements of individual witnesses.”). Accord In re Veeco Instruments, Inc. Sec. Litig., No. 05MD1695 CMGAY, 2007 WL 274800, at *1 (S.D.N.Y. Jan. 29, 2007) (denying motion to compel partly because identification of three CWs from list of 55 potential witnesses would not be unmanageable task); In re Ashworth, Inc. Sec. Litig., 213 F.R.D. 385, 389 (S.D. Cal. 2002) (denying motion to compel in part because 100 potential witnesses was manageable number). But see Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys., 2005 WL 1459555, at *5 (N.D. Cal. June 21, 2005) (granting motion to compel after finding 496 current or former employees of defendant to be an unmanageable number); Miller v. Ventro Corp., No. C01-01287 SBA (EDL), 2004 WL 868202 at *2 (N.D. Cal. Apr. 21, 2004) (granting motion to compel identification of CWs where plaintiffs’ initial disclosure listed more than 200 individuals and at least 165 of them fit CW descriptions in complaint).
\item \textsuperscript{221} Pamida, Inc. v. E.S. Originals, Inc., 281 F.3d 726, 732 (8th Cir. 2002); In re St. Paul Travelers Sec. Litig. II, Civil No. 04-4697 (JRT/FLN), 2007 WL 1424673, at *1 (D. Minn. May 10, 2007).
\end{itemize}
in general are quite hesitant to find implied waivers of the attorney work product doctrine.\textsuperscript{223}

3. Public Policy

The basic public policy rationale justifying non-disclosure of the identities of confidential witnesses is that such witnesses may either (1) suffer serious prejudice, in the form of retaliation or other adverse consequence, if their identification results in them being labeled as whistleblowers, or (2) be deterred from providing information, by the chilling effect of a fear of possible retaliation. The proposition was stated in Novak: “Imposing a general requirement of disclosure of confidential sources . . . could deter informants from providing critical information to investigators in meritorious cases or invite retaliation against them.”\textsuperscript{224} Indeed, it is precisely such risks that motivated the enactment of federal whistleblower statutes, such as the federal Whistleblower Protection Act,\textsuperscript{225} which are designed to address the problem of retaliation against employees.\textsuperscript{226} More generally, confidential informants play a vital role in many area of public life, including counter-espionage, law enforcement, and the investigative press.\textsuperscript{227} Informants have been described by former FBI Director William Webster as “the

\textsuperscript{224} 216 F.3d at 314. Accord In re Cabletron Sys., Inc., 311 F.3d 11, 30 (1st Cir. 2002) (requiring plaintiffs to name their confidential internal corporate sources would “have a chilling effect on employees who provide information about corporate malfeasance.”); Selbst v. McDonald’s Corp., No. 04 C 2422, 04 C 3635, 04 C 3661, 2005 WL 2319936, at *6 (N.D. Ill. Sept. 21, 2005) (same); and In re Initial Public Offering Sec. Litig., 220 F.R.D. 30, 37 (S.D.N.Y. 2003) (noting that Novak rule “encourag[es] whistle-blowers to expose corporate wrong-doing by protecting them from retaliation.”).
\textsuperscript{226} New Jersey Carpenters Pension & Annuity Funds, 537 F.3d 35, 52 (1st Cir. 2008).
single most important tool in law enforcement.” An estimated one-third of fraud and other economic crimes against businesses are reported by whistleblowers.

The same policy considerations which militate against requiring identification of confidential witnesses in securities fraud complaints also militate against requiring disclosure during discovery. Specifically, “requiring specific identification of confidential sources from among the universe of individuals with relevant knowledge in a securities fraud case would chill informants from providing critical information. . . .”

Some courts ordering disclosure of the identities of confidential witnesses in securities litigation have recognized the public policy issue, but they have erroneously minimized the significance of the issue in various respects. First, such courts find minimal prejudice if the employers of the witnesses have ceased to exist, or if the confidential witnesses are for any other reason former, rather than current, employees of the defendant. Continued employment by many of the witnesses in the same industry

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232 See, e.g., In re Connectics Corp. Sec. Litig., No. C 07-02940 SL, 2009 WL 1126508, at *2 (N.D. Cal. Apr. 27, 2009) (“These concerns are mitigated in this case, however, by the fact that Connectics Corporation ceased to exist three years ago.”).
has not altered the result.\textsuperscript{234} Second, other courts dismiss the claim of potential retaliation outright, by holding that the right to obtain discovery and avoid surprise at trial takes precedence.\textsuperscript{235} Third, courts ordering disclosure sometimes conclude that the risk of retaliation is less an argument against discovery and more an argument for imposition of a protective order limiting access to the requested information.\textsuperscript{236} Under Rule 26(c)(1), a protective order must be premised on good cause,\textsuperscript{237} and these same courts typically find that general statements regarding a serious risk of retaliation do not satisfy the standard. Rather, plaintiffs are required to make a specific showing that disclosure will cause a clearly defined and serious injury.\textsuperscript{238} Fourth, a number of courts have minimized the public policy issue by noting that confidential witnesses are adequately protected by whistleblower statutes.\textsuperscript{239}

\textsuperscript{236} See, e.g., In re Marsh & McLennan Sec. Litig., MDL No. 1744, No. 04 Cv. 8144(SWK), 2008 WL 2941215, at *5 (S.D.N.Y. July 30, 2008).
\textsuperscript{237} See Fed. R. Civ. P. 26(c)(1).
\textsuperscript{238} See, e.g., In re Marsh & McLennan Sec. Litig., MDL No. 1744, No. 04 Cv. 8144(SWK), 2008 WL 2941215, at *5 (S.D.N.Y. July 30, 2008) (threat of retaliation requires specific factual support); Brody v. Zix Corp., No. 3-04-CV-1931-K, 2007 WL 1544638, at *2 (N.D. Tex. May 25, 2007) (holding that conclusory assertion of consequences to CWs if their identities were revealed “does not come close to establishing a genuine risk of retaliation”); Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys., 2005 WL 1459555, at *7 (N.D. Cal. June 21, 2005) (“Plaintiffs have not provided any evidence indicating that there is a real fear of retaliation from Cisco.”); In re Aetna Inc. Sec. Litig., No. CIV. A. MDL 1219, 1999 WL 354527, at *5 (E.D. Pa. May 26, 1999) (denying protective order because plaintiffs failed to make specific showing that defendant “has attempted to intimidate individuals connected with this case or has a history of such intimidation in other cases.”). See also Norflet v. John Hancock Fin. Servs. Inc., No. 3:04cv1099 (JBA), 2007 WL 433332, at *4 (D. Conn. Feb. 5, 2007) (in case involving alleged racial discrimination, absent specification of form of retaliation feared by CWs, conclusory assertion that witness feared retaliation in the life insurance industry could not support assertion that genuine risk of retaliation existed).
\textsuperscript{239} See, e.g., Mazur v. Lampert, No. 04-61159-CIV, 2007 WL 917271, at *4 (S.D. Fla. March 25, 2007) (“W)istleblower statutes may certainly apply and protect (confidential witnesses) from unlawful
All of the foregoing arguments can be effectively rebutted. First, as discussed infra, in connection with the analogous informant’s privilege, even former employees who are whistleblowers can be subject to a serious risk of retaliation.\textsuperscript{240} Moreover, under the informant’s privilege, the government is entitled to assert the privilege without a threshold showing that reprisal or retaliation is likely, or even a risk.\textsuperscript{241} Accordingly, a specific showing of likely reprisal should be unnecessary where plaintiffs seek to prevent disclosure of the identities of confidential witnesses in securities cases. Second, as discussed supra, confidential witnesses in securities litigation very rarely are trial witnesses, so the issue of surprise and prejudice is of minimal significance. Third, courts demanding a specific showing of likely retaliation ignore the numerous more subtle but still damaging aspects of potential retaliation that do not involve a direct job loss and therefore are very difficult to demonstrate in a motion for protective order.\textsuperscript{242} Those aspects are discussed, infra.\textsuperscript{243} Fourth, confidential witnesses are not adequately protected by whistleblower statutes, again as discussed infra.\textsuperscript{244}

\textsuperscript{240} See text accompanying notes 267-72, infra.
\textsuperscript{242} See, e.g., NYC Bar Report/Plaintiffs, at 15 (“It is important to recognize that the harm to be avoided through the order is the danger that potential witnesses will refuse to come forward – i.e., the chilling effect that results from the fear of possible retaliation or harm to reputation, and not the actual retaliation or injury to reputation itself. Even if a witness’ fear of adverse consequences is unsupported, such fear can nevertheless silence the witness and prevent disclosure of wrongdoing.”).
\textsuperscript{243} See text accompanying notes 305-08, infra.
\textsuperscript{244} See text accompanying notes 302-62, infra.
In summary, contrary to the conclusion of the Seventh Circuit, disclosure under Rule 26 of the identities of confidential witnesses in securities litigation is not inevitable. Disclosure is not mandated by the early disclosure scheme of Rule 26, and in the typical case the identities should be protected from discovery by the attorney work product doctrine or for public policy reasons.

D. The Informant’s Privilege Justifies Non-Disclosure of Confidential Witnesses

The Seventh Circuit justified its sweeping condemnation of the use of confidential witnesses in securities litigation in part on the basis of its observation that “(t)here is no ‘informer’s privilege’ in civil litigation.” This observation is erroneous. Pursuant to Roviaro v. United States, decided by the United States Supreme Court more than 50 years ago, the government has a privilege to withhold from disclosure both an informant’s name and facts tending to reveal the informant’s identity. The purpose of the privilege is the furtherance and protection of the public interest in effective law enforcement and to make retaliation as difficult as possible. Even information

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246 353 U.S. 53, 59 (1957). See also Zathrina Zasell Gutierrez Perez, Piercing the Veil of Informant Confidentiality: The Role of In Camera Hearings in the Roviaro Determination, 46 AM. CRIM. L. REV. 179, 185 (2009) (noting that informant’s privilege existed long before it was recognized in Roviaro, and the term is a misnomer because the privilege is held not by the informant, but by the government).
248 Brock v. On Shore Quality Control Specialists, Inc., 811 F.2d 282, 284 (5th Cir. 1984). Accord United States v. Abuhamra, 389 F.3d 309, 324 (2d Cir. 2004) (”The government’s strong and legitimate interest in protecting confidential sources from premature identification is undeniable. Identification not only compromises the government’s ability to use such sources in other
within the scope of the privilege may be discoverable, under standards established by Roviaro. The privilege must yield whenever disclosure of an informant’s identity is relevant and helpful to the defense of an accused,\textsuperscript{249} disclosure of an informant’s identity is essential to a fair determination of a cause,\textsuperscript{250} or the individual’s right to prepare his defense outweighs the public interest in protecting the flow of information to law enforcement.\textsuperscript{251} Some courts refer to this overall standard as a balancing test, which takes into account the particular circumstances of each case, the crime charged, possible defenses, and the potential significance of the informant’s testimony.\textsuperscript{252} Others courts refer to the privilege as qualified.\textsuperscript{253}

In either case, whether the privilege is qualified or a balancing occurs, federal courts begin with a presumption in favor of protecting the identity of confidential informants.\textsuperscript{254} Once the government asserts the privilege and the information is within the scope of the privilege, the opposing party bears the burden of showing a compelling need for the information requested.\textsuperscript{255} This is because “the informant’s privilege is the rule and Roviaro is the exception.”\textsuperscript{256} Defendant bears a “heavy”

\textsuperscript{249} 353 U.S. at 60-62.
\textsuperscript{250} 353 U.S. at 61.
\textsuperscript{251} 353 U.S. at 62.
\textsuperscript{252} United States v. Vann, 336 Fed. Appx. 944, 949 (11th Cir. 2009).
\textsuperscript{253} See Chao v. Westside Drywall, Inc., 254 F.R.D. 651, 656 (D. Or. 2009); Simmons v. City of Racine, PFC, 37 F.3d 325, 328 (7th Cir. 1994) (“The privilege is qualified, however, not absolute.”).
\textsuperscript{256} Zathrina Zasell Gutierrez Perez, \textit{Piercing the Veil of Informant Confidentiality: The Role of In Camera Hearings in the Roviaro Determination}, 46 AM. CRIM. L. REV. 179, 201 (2009). Accord United States v. Ivory, No. 08-Cr-333, 2009 WL 398122, at *3 (E.D. Wis. Feb. 18, 2009) (“While a defendant can overcome the confidential informant privilege by demonstrating a need for the information, he bears this burden in the face of the assumption that the privilege should apply.”).
To compel the disclosure of the identity of a confidential informant, a defendant must do more than speculate that knowing the identity would be useful in presenting his or her defense. The most common situation in which the privilege is overcome is where the legality of a warrantless search is in issue, and an informant’s communications are claimed to establish probable cause. In these cases the government has been required to disclose the identity of the informant unless there was sufficient evidence apart from the confidential communication. Absent this situation, the privilege generally applies to conceal informants’ identities, unless the informant will be a trial witness. A district court’s refusal to order disclosure of information relating to a confidential informant typically is reviewed only for an abuse of discretion.

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257 United States v. Cartagena, 593 F.3d 104, 113 (1st Cir. 2010); United States v. Lewis, 40 F.3d 1325, 1335 (1st Cir. 1994).
259 353 U.S. at 61.
260 See, e.g., United States v. Abuhamra, 389 F.3d 309, 325 (2d Cir. 2004) (noting that informant’s privilege will generally be upheld in pre-trial proceedings); United States v. Moore, 954 F.2d 379, 381 (6th Cir. 1992) (holding that court may require disclosure only if it finds that informant’s provision of relevant trial testimony is reasonably probable); United States v. Thompson-Bey, No. 3:09-CR-64, 2010 WL 276122, at *2 (E.D. Tenn. Jan. 15, 2010) (concluding that informant must be disclosed only upon showing by defendant that disclosure is essential to a fair trial); and United States v. Bayer, Crim. Action No. 09-cr-120 (JCH), 2010 WL 55292, at *2 (D. Conn. Jan. 4, 2010) (noting that in order to overcome privilege, defendant must show that absent disclosure he will be deprived of a fair trial). But cf. United States v. Ivory, No. 08-Cr-333, 2009 WL 398122, at *4 (E.D. Wis. Feb. 18, 2009) (holding that disclosure may be compelled under Roviaro even if confidential informant will not be a trial witness).
While there is some minor dispute about the issue, the clear majority view—contrary to the Seventh Circuit’s statement in *Higginbotham*262—is that the informant’s privilege is applicable in both civil and criminal cases.263 Indeed, many courts have recognized that in civil cases the privilege is greater, because not all constitutional guarantees enjoyed by criminal defendants are similarly available to civil defendants.264

In the civil context, the informant’s privilege has often been used to conceal the names of claimant-employees who filed complaints that precipitated an action brought under the FLSA by the Secretary of Labor. In FLSA cases, the privilege applies to both current and former employees who have communicated with the Department of Labor

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262 495 F.3d 753 at 757. See also *Hubbard v. BankAtlantic Bancorp, Inc.*, No. 07-61542-CIV, 2009 WL 3856458, at *4 (S.D. Fla. Nov. 17, 2009) (“If Congress wished to create an informer’s privilege for confidential witnesses in a PSLRA case, it knew how to do so and could have done so.”)

263 Compare *Brennan v. Automatic Toll Sys.*, 60 F.R.D. 195, 196 (S.D.N.Y. 1973) (“The government’s claim of ‘informant’s privilege’ in a civil case is without substantial basis in modern jurisprudence.”) with *Chao v. Security Credit Sys.*, Inc., No. 08CV267A, 2009 WL 1748716, at *3 n.1 (W.D.N.Y. June 19, 2009) (“*Brennan* appears to be inconsistent with the vast majority of cases discussing the informant’s privilege.”). See also *Dole v. Local 1942, IBEW*, 870 F.2d 368, 372 (7th Cir. 1994) (“The privilege is applicable in civil as well as criminal cases”); *Suarez v. United States*, 582 F.2d 1007, 1010 n.4 (5th Cir. 1978) (“*Roviaro* was a criminal case, but it is clear that the informant’s privilege exists in civil cases as well. . . .”); and *D’Orazio, III v. Washington T’ship*, Civil No. 07-5097 (RMB), 2008 WL 4307446, at *3 (D.N.J. Sept. 16, 2008) (“Although *Roviaro* involved a criminal prosecution, it is well-established that the informant’s privilege also applies in a civil case.”).

At least six federal circuits have upheld the informant’s privilege in the context of alleged violations of the FLSA, to protect the identity of potential witnesses during discovery proceedings when the witnesses feared a retaliatory loss of employment.

The Fifth Circuit has noted three reasons why the informant’s privilege should be applied with respect to former employees in FLSA cases. First, employers almost always require prospective employees to supply names of prior employers as references when applying for a job. Former employees “could be severely handicapped in their efforts to obtain new jobs if the defendant should brand them as ‘informers’ when references are sought.” Second, it is possible that a former employee could be subjected to retaliation if his new employer discovers that the employee previously cooperated with the government. Third, a former employee may find it desirable or necessary to seek re-employment with the defendant, thus exposing himself to the same risk of retaliation as a current employee. This risk of retaliation is not mere conjecture -- most

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whistleblowers never work in their fields again. Sensibly, the Fourth Circuit and district courts elsewhere have agreed that the informant’s privilege applies with respect to both current and former employees.

Some courts holding that the names of confidential witnesses who supply information used in securities fraud complaints need not be included in the complaint or are not discoverable have reasoned by analogy to the informant’s privilege and, in particular, to the recognition in FLSA cases that the privilege applies with equal measure to current and former employees. The analogy is persuasive. In both situations the court is required to evaluate the reliability of the anonymous source, using the same process. Moreover, the policy considerations are identical. In In re MTI Tech. Corp. Sec. Litig., the court, citing FLSA case law, noted that “there are important public policy concerns implicated by disclosure of former employees acting as informants. Although the whistle-blower privilege is not available in this private suit, that does not lessen the need to consider the practical results of an order requiring disclosure of the employees’ identities.” And those results, as noted by the court, include a serious risk of retaliation.

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271 Draveau v. Detecon, Inc., 515 F.3d 334, 343 (4th Cir. 2008) (noting that FLSA protects both current and former employees from retaliation).
273 See, e.g., Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1240 (11th Cir. 2008); In re Cabletron Sys., Inc., 311 F.3d 11, 30 (1st Cir. 2002) (“(Courts) frequently allow such anonymously-provided information, if properly supported, to justify an otherwise problematic search.”).
275 Id. at *5.
276 Id. at *5.
According to Higginbotham, the analogy between confidential witnesses in securities litigation and informants used by the government in affidavits to obtain search warrants in criminal cases fails because the “compelling inference” standard set forth by the Supreme Court in *Tellabs* is more rigorous than the probable cause standard for warrants.\(^\text{277}\) But it is not clear why the difference in standards should matter, insofar as the policy rationale is the same. Moreover, if anything, the case for non-disclosure in civil cases is stronger than it is in criminal cases. In criminal cases, the accused’s Sixth Amendment right to confront witnesses may outweigh the public’s interest in protecting the informant’s anonymity.\(^\text{278}\) In civil cases there is no such Sixth Amendment right.\(^\text{279}\)

Other courts have rejected the FLSA analogy, by giving lip service to policy issues and then observing that even if the privilege in FLSA cases applies to statements given to federal investigators, it does not apply to statements given to private attorneys.\(^\text{280}\) This observation may be true, but it does not explain why application of the privilege should not be extended, particularly since corporate fraud often leads to parallel criminal prosecutions and private securities litigation.\(^\text{281}\) Finally, it could be argued that

\(^\text{277}\) *495 F.3d at 757.*

\(^\text{278}\) *Chao v. Brumfield Constr., No. C07-821RSL, 2008 WL 1928984, at *1 n.2 (W.D. Wash. Apr. 28, 2008).*

\(^\text{279}\) *Austin v. United States, 509 U.S. 602, 608 (1993) ("The protections provided by the Sixth Amendment are explicitly confined to ‘criminal prosecutions.’"); U.S. Steel, LLC v. Teco, Inc., 261 F.3d 1275, 1287 n.13 (11th Cir. 2001) ("Of course, the Confrontation Clause is not applicable in civil cases. . . . ").*


\(^\text{281}\) The federal government has increasingly used simultaneous or successive civil and criminal proceedings as a strategy to bring criminal indictments against corporations and their officers who engaged in fraud, and almost all public cases have a parallel private class action covering the same fraud allegation. Peter N. Downing, Comment, *Parallel Proceedings in the Post-Enron Era: The Duty to Warn and the Case for Abolishing the Government Misconduct Test*, 58 CATH. U.
confidential witnesses in private securities fraud litigation are less likely than informants in criminal cases to risk serious injury or death.\textsuperscript{282} Again, such an argument may be true, but it is simply a question of degree. Informants in civil cases, or whistleblowers, typically confront non-physical but still major threats to their economic and emotional well-being, as explained \textit{infra}.\textsuperscript{283}

E. The Reporter’s Privilege Justifies Non-Disclosure of Confidential Witnesses

A general rule of non-disclosure of the identities of confidential witnesses in securities litigation finds additional support by analogy to the reporter’s privilege. The protection of confidential sources is the focus of the long-running debate concerning the reporter’s privilege, which is most similar to the informant’s privilege discussed above. Both seek to protect the source of the communication rather than the communication itself. Journalists have been asserting their right to retain the confidentiality of their sources since colonial times,\textsuperscript{284} with mixed results. By 2010, 36 states and the District of Columbia had enacted shield laws to provide journalists with

\textsuperscript{282} See NYC Bar Report/Defendants, at 28 (arguing that reliance by plaintiffs on \textit{Rovario} and its progeny is fundamentally misplaced, because those cases are based on “policy and constitutional considerations applicable to criminal cases but not to civil cases, including the threat of physical harm or death faced by government informants in criminal proceedings.”)

\textsuperscript{283} See text accompanying notes 305-08, \textit{infra}.

\textsuperscript{284} Mary-Rose Papandrea, \textit{Citizen Journalism and the Reporter’s Privilege}, 91 \textit{MINN. L. REV.} 515, 533 (2007) (noting that Benjamin Franklin’s brother was imprisoned in 1732 when he refused to divulge to a legislative commission the name of the author of an article in his newspaper); Michelle C. Gabriel, \textit{Plugging Leaks: The Necessity of Distinguishing Whistleblowers and Wrongdoers in the Free Flow of Information Act}, 40 \textit{LOY. U. CHI. L.J.} 531, 536 (2009) (“From the Federalist Papers to the Pentagon Papers, some of the greatest pieces of journalism have been the product of anonymous sources and authors. For this reason, freedom of the press has long been linked to journalists’ ability to guarantee confidentiality to their sources”).
different degrees of protection for their sources and information.\textsuperscript{285} The scope of protection varies considerably according to the text of each state’s particular law. The vast majority of these laws protect a confidential source’s identity, but many also protect a reporter’s notes or outtakes.\textsuperscript{286} A number of jurisdictions also recognize a reporter’s privilege under their state constitutions or under common law.\textsuperscript{287} Sixteen states have adopted at least a qualified journalist’s privilege by court decision, and Wyoming is the only state without either a statutory or common-law privilege.\textsuperscript{288}

At the federal level, the reporter’s privilege derives from \textit{Branzburg v. Hayes},\textsuperscript{289} in which the Supreme Court addressed the question of whether requiring journalists to appear and testify before state or federal grand juries violated the First Amendment’s guarantees of freedom of speech and press. The Supreme Court held on a 5-4 vote that the Free Press Clause of the First Amendment does not contain even a qualified testimonial privilege for journalists, at least with regard to a grand jury subpoena.\textsuperscript{290} In

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\item \textsuperscript{287} James Thomas Tucker & Stephen Wermiel, \textit{Enacting A Reasonable Federal Shield Law: A Reply to Professors Clymer and Eliason}, 57 AM. U. L. REV. 1291, 1302 (2008) ("All state shield laws provide journalists at least some relief from judicial subpoenas directed at obtaining the identity of confidential sources.").
\item \textsuperscript{288} Henry Cohen & Kathleen Ann Ruane, Cong. Res. Serv., \textit{Journalists’ Privilege: Overview of the Law and Legislation in the 109\textsuperscript{th} and 110\textsuperscript{th} Congress}, CRS-3 (2008), http://www.fas.org/sgp/crs/secrecy/RL34193.pdf.
\item \textsuperscript{289} \textit{Branzburg}, 408 U.S. 665 (1972).
\item \textsuperscript{290} The \textit{Branzburg} majority expressly noted that while it was refusing to recognize a constitutional basis for a reporter’s privilege, Congress remained free to create such a privilege through federal legislation. 408 U.S. at 706. Nevertheless, a federal reporter’s privilege has not been codified. In February 2009 four co-sponsoring Senators introduced the Free Flow of Information Act, S. 448, a bill that would codify a qualified privilege for journalists subject to federal subpoenas who seek to protect the identity of their sources. The House version of the
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the decades since *Branzburg* was decided most federal circuits have recognized a qualified privilege for journalists to resist disclosure of sources’ identities and source materials, generally on the basis of Justice Powell’s ambiguous, tie-breaking, three-paragraph concurring opinion in the case, which made clear that the Court’s decision did not bar all First Amendment protection for journalists seeking to protect their sources.\footnote{Branzburg, 408 U.S. at 709 (Powell, J., concurring) (“The Court does not hold that newsmen . . . are without constitutional rights with respect to the gathering of news or in safeguarding their sources.”); David Abramowicz, Note, Calculating the Public Interest in Protecting Journalists’ Confidential Sources, 108 COLUM. L. REV. 1949, 1950 (2008); and James C. Goodale, et al., Reporter’s Privilege, PRACTICING LAW INSTITUTE, PATENTS, COPYRIGHTS, TRADEMARKS, AND LITERARY PROPERTY COURSE HANDBOOK SERIES 163, 168, PLI ORDER NO. 14142 (Nov. 13-14, 2008).} The qualified privilege is generally expressed as a three-part test that derives from Justice Stewart’s dissent in *Branzburg*. To overcome the privilege, a litigant must make a clear and specific showing that the information sought is (1) highly material and relevant to the underlying claim, (2) necessary or critical to maintenance of the claim, and (3) unavailable from alternative sources. This formulation of the test has been
adopted by numerous federal courts.\textsuperscript{292} If the party seeking discovery fails to satisfy any one of the three factors the privilege generally is upheld and discovery is denied.\textsuperscript{293}

The fundamental argument in favor of a reporter’s privilege is that the ability to promise confidentiality significantly promotes the compelling public interest in newsgathering, as in the case of anonymous sources who blow the whistle on government or corporate corruption.\textsuperscript{294} While there are dozens of federal statutes concerning whistleblowers who fear retaliation, such laws do not necessarily ensure the anonymity of the whistleblower.\textsuperscript{295} Indeed, a 2005 Congressional Research Service report concluded that one major reason federal employees leak information to the press is that federal whistleblower laws fail to provide adequate protection.\textsuperscript{296} But this leakage does not solve the problem, because the reporter’s privilege is uneven. The absence of a federal shield law, in combination with the hodge-podge of conflicting

\textsuperscript{292} James C. Goodale, et al., \textit{Reporter’s Privilege}, Practicing Law Institute, PATENTS, COPYRIGHTS, TRADEMARKS, AND LITERARY PROPERTY COURSE HANDBOOK SERIES 163, 186-87, PLI ORDER NO. 14142 (Nov. 13-14, 2008).
state shield laws,297 likely fuels the use of subpoenas to compel disclosure of confidential sources, including whistleblowers. As recently noted, “(e)ven the most elaborate of the existing reporter’s privileges—whether First Amendment, statutory, or common-law—contain so many variables that it is rarely possible to have complete assurance that the confidence cannot be breached.”298 Thus, in 2006 alone, there were 213 instances in which confidential information was sought in media subpoenas, and 92 of these subpoenas sought the name of a confidential source.299 The issuance of these subpoenas has had a significantly negative impact on the relationship between the media and potential confidential sources. A 2009 study of 761 U.S. daily newspapers and television news stations found that the willingness of confidential sources to speak on condition of confidentiality is waning, and “the atmosphere for this form of newsgathering is being poisoned by the subpoena threat.”300

In summary, the reporter’s privilege, like the informant’s privilege, provides support by analogy for a rule that generally precludes the disclosure of confidential sources in securities litigation, absent reliance by plaintiffs on such witnesses at trial.

While the privilege is not yet codified at the federal level, precisely the same policy argument applies. Specifically, the compelled disclosure of source identities will chill the free flow of information essential to protect the public interest in combating government and corporate fraud.  

F. Whistleblower Statutes Fail to Adequately Protect Confidential Witnesses

In *Tellabs II* the Seventh Circuit observed that even if retaliation against anonymous sources is a genuine risk, federal law protects employees who blow the whistle on securities fraud. Such a conclusion is unjustified. A general rule precluding disclosure of the identities of confidential witnesses at both the pleading and discovery stages of litigation is warranted because existing whistleblower statutes fail to adequately protect these individuals from retaliation.

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301 See, e.g., RonNell Andersen Jones, *Media Subpoenas: Impact, Perception, and Legal Protection in the Changing World of American Journalism*, 84 WASH. L. REV. 317, 350-51, 395 (2009) (“(A) federal shield law that protects at least the traditional press would provide an important foundation for fostering public-serving reportage and would alleviate some of the negative impact that the current increase in media subpoenas had had on newsgathering at the very institutions that pioneered the investigative reporting that supports, nourishes, and sustains our democratic tradition.”). *But cf.* Ethan D. Wohl, *Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure*, 12 FORDHAM J. CORP. & FIN. L. 551, 579 (2007) (“One obvious precedent for protecting the identities of private informants—the reporter’s privilege—in fact provides little guidance because the current status of the privilege is unsettled.”).

302 513 F.3d at 711.

303 A frequently cited definition of a whistleblower is one who (1) acts to prevent harm to others, not him or herself, (b) while possessing evidence that would convince a reasonable person. See Myron P. Glazer & Penina Glazer, *THE WHISTLEBLOWERS* 4 (1989); Anthony Heyes & Sandeep Kapur, *An Economic Model of Whistle-Blower Policy*, 25 J.L. ECON. & Org. 157, 159 (2009). Another common definition of whistleblowing is “(t)he disclosure by organization members (former or current) of illegal, immoral, or illegitimate practices under the control of their employers to persons or organizations that may be able to effect action.” See Marcia P. Miceli & Janet P. Near, *BLOWING THE WHISTLE* 15 (1992). Black’s Law Dictionary more narrowly defines whistleblower: “An employee who reports employer wrongdoing to a governmental or law-enforcement agency.” BLACK’S LAW DICTIONARY 1627 (8th ed. 2004).
The volume of whistleblower activity in the United States has increased significantly in recent years, and some of the most famous accounting scandals of the 1990s and 2000s prominently featured whistleblowers. Retaliation against whistleblowers often follows. One study found that 82 percent of the whistle-blowing population had been fired, quit their job under duress, or had significantly altered responsibilities, as a result of their whistleblowing activities. Other surveys have found that up to two-thirds of whistleblowers lose their jobs and due to blacklisting, most never work in their fields of expertise again. Retaliation can take many different forms, some more subtle than others, including being fired, socially ostracized, intimidated, demoralized, humiliated, demoted, blacklisted, denied a promotion, overtime, or benefits, formally disciplined, reassigned, or given a reduction in wages or hours.

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305 Short lists of famous whistleblowers of this era often include Sherron Watkins (Enron), Cynthia Cooper (WorldCom), and James Bingham (Xerox). See James Fanto, Whistleblowing and the Public Director: Countering Corporate Inner Circles, 83 OR. L. REV. 435, 438-39 (2004). But neither Watkins (an Enron vice president), nor Cooper (WorldCom’s head of internal auditing), both among “The Whistleblowers” named by Time magazine as Persons of the Year for 2002, were whistleblowers under the Black’s Law Dictionary definition set forth in n.303, supra. Watkins advised Enron chairman of the board Kenneth Lay of accounting improprieties, and Cooper advised the WorldCom board’s audit committee. Neither Watkins nor Cooper alerted governmental or law-enforcement agencies. See Richard Lacayo & Amanda Ripley, Persons of the Year, TIME, Dec. 30, 2002, at 30.
308 See Geoffrey C. Rapp, Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers, 94 B.U.L. REV. 91, 120-21 (2007) (“Although the precise incidence of ostracism of whistleblowers is difficult to determine, researchers universally mention it as a leading consequence of blowing the whistle. . . . (S)ocial ostracism of whistleblowers is a more common retaliatory technique than adverse employment action.”); C. Fred Alford, WHISTLEBLOWERS: BROKEN LIVES AND ORGANIZATIONAL POWER 31-32 (2001) (“The usual practice is to demoralize and humiliate the whistleblower, putting him or her under so much psychological stress that it becomes difficult to do a good job.”); and Gerard Sinzdak,
A patchwork of federal and state statutes, supplemented by common law, has been enacted to protect whistleblowers from retaliation. More than 50 federal whistleblower statutes have been enacted, and nearly all states provide some whistleblower protection, either statutory or pursuant to common law.\textsuperscript{309} These measures vary widely in the scope of protection they provide. For example, only 17 state statutes protect private-sector whistleblowers.\textsuperscript{310} The majority of states fail to protect employees who blow the whistle internally to supervisors, and virtually no states protect whistleblowers who report to the media or other non-governmental actors.\textsuperscript{311}

The primary federal statute providing protection to individuals who blow the whistle on publicly-traded companies which engage in fraud is the Sarbanes-Oxley Act

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\textsuperscript{309} Mary Kreiner Ramirez, \textit{Blowing the Whistle on Whistleblower Protection: A Tale of Reform Versus Power}, 76 U. CIN. L. REV. 183, 191 (2007). Some of the more recent federal whistleblowers measures are found in the American Recovery and Reinvestment Act of 2009 (IRRA) (Pub. L. No. 111-5, 123 Stat. 115 (2009)) and the Consumer Product Safety Improvement Act of 2008 (CPSIA) (15 U.S.C. §§ 2051, et seq.). Section 1553 of the former prohibits any private employer or state or local government that receives funds pursuant to the IRRA from retaliating against an employee who discloses, internally or externally, information that the employee reasonably believes constitutes evidence of one or more of a number of specified improper uses of economic stimulus funds, including gross mismanagement of an agency contract or grant, gross waste of covered funds, or an abuse of authority related to the implementation or use of covered funds. See Ben James, \textit{ARRA Expected to Cause Whistleblower Claims Spike}, Law360, Feb. 27, 2009, http://www.law.360/print_article/87859. The CPSIA creates a federal cause of action for unlawful retaliation against whistleblowing employees in the consumer products industry. 15 U.S.C. § 2051.
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of 2002 (SOX), which has three whistleblower sections. The most important of these is Section 806, which states, in pertinent part, that a covered company cannot “discharge, demote, suspend, threaten, harass, or in any other manner discriminate” against a whistleblower who reports covered information to someone within the organization who “has the authority to investigate, discover, or terminate misconduct.” If the whistleblower suffers retaliation, and she decides to seek a remedy under SOX, she must first file an administrative complaint with the DOL which then refers it to the Occupational Safety and Health Administration (OSHA, an agency within the DOL) for possible investigation. To make a prima facie case of whistleblower retaliation under SOX and avoid dismissal, an employee must show that (1) she engaged in protected activity, (2) the employer knew that she was engaged in the protected activity, (3) she suffered an unfavorable personnel action, and (4) the protected activity was a contributing factor in the unfavorable action. If that showing is made, the burden then shifts to the employer to rebut the employee’s prima facie case by demonstrating by clear and convincing evidence that it would have taken the same personnel action in the absence of the whistleblowing. If the employer fails to rebut the case, OSHA will conduct an investigation and determine if

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313 SOX (1) protects whistleblowers who report fraud at publicly traded companies, (2) provides criminal penalties for retaliation against whistleblowers, and (3) requires publicly-traded companies to adopt procedures for handling internal complaints. 18 U.S.C. §§ 1514A, 1513, and 78j-1.
314 18 U.S.C. § 1514A.
316 Allen v. Admin. Review Bd., 514 F.3d 468, 475-76 (5th Cir. 2008); 29 C.F.R. § 1980.104(b)(1) (2006). 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. Allen, supra, 514 F.3d at 476 n.3.
317 Harp v. Charter Communics., Inc., 558 F.3d 722, 726-27 (7th Cir. 2009); 18 U.S.C. § 1514A; 49 U.S.C. §4212(b)(2)(B). The latter statute is applicable because § 1514A claims are governed by the procedures applicable to whistleblower claims brought under the Wendell H. Ford Aviation Investment and Reform Act for the 21st Century, § 4212(b).
there is reasonable cause to believe that prohibited retaliation occurred. If reasonable cause is found, OSHA shall issue a preliminary order of relief, which effective immediately restores the complainant to her employment status and requires the employer to take affirmative action to abate the violation.\textsuperscript{318}

OSHA preliminary orders become final, and are not subject to judicial review, if no party objects to the order. If an objection is timely filed, the order is reviewable by an administrative law judge (ALJ), who conducts a \textit{de novo} hearing and has broad discretion to limit discovery and the scope of permissible evidence, in order to expedite the proceeding.\textsuperscript{319} Either party may petition for review of an ALJ decision. Such decisions are reviewable on a discretionary basis by the DOL’s Administrative Review Board (ARB). If the complete administrative claims process is not concluded within 180 days, from initial filing to ARB decision (if applicable), and the delay is not the result of the employee’s bad faith, OSHA’s exclusive jurisdiction terminates and the employee (but not the employer) may remove the case to federal district court, which will have jurisdiction regardless of diversity.\textsuperscript{320}

The foregoing SOX scheme is seriously deficient in numerous respects, and therefore fails to protect confidential witnesses, contrary to the conclusion of the

\textsuperscript{319} 29 C.F.R. § 1980.107(b) and (d)(2006).
\textsuperscript{320} See Stone v. Instru. Lab. Co., 591 F.3d 239, 249 (4th Cir. 2009) (“In summary, the plain language of § 1514A(b)(1)(B) unambiguously establishes a Sarbanes-Oxley whistleblower complaint’s right to \textit{de novo} review in federal district court if the DOL has not issued a ‘final decision’ and the statutory 180-day period has expired.”). Appeals from an ARB decision are taken to the appropriate federal court of appeals. 29 C.F.R. § 1980.110(b)-(c)(2006). Findings of law are reviewed \textit{de novo}, and will be set aside if they are arbitrary, capricious, an abuse of discretion, or otherwise not in accord with law. Platone v. United States Dep’t of Labor, 548 F.3d 322, 326 (4th Cir. 2008). Findings of fact are upheld if they are supported by substantial evidence, which is more than a mere scintilla but less than a preponderance. Allen v. Admin. Review Bd., 514 F.3d 468, 476 (5th Cir. 2008). The same standard is used by ARBs when reviewing ALJ findings of fact. 29 C.F.R. § 1980.110(b) (2006).
Seventh Circuit in *Tellabs II* and other courts. Those deficiencies are underscored by the fact that whistleblowers almost always lose cases filed by them under SOX. According to a 2008 study, whistleblowers prevailed just 17 times out of 1,273 complaints (1.3 percent) filed by them under SOX after 2002. 841 complaints (66 percent) were dismissed.\(^{321}\) The success rate for SOX whistleblowers is significantly lower than it is for whistleblowers under other types of federal statutes.\(^{322}\)

SOX’s deficiencies can be categorized according to (1) boundary issues, (2) procedural hurdles, (3) claims investigation, and (4) remedies. Initially, in order to prevail, an employee must demonstrate that his claim falls within SOX boundaries. Boundary issues concern, *inter alia*, the individuals and disclosures that are covered by the statute. Many of the claims filed by SOX whistleblowers have been dismissed because the whistle-blowing employee worked for a corporation’s private subsidiary, and ALJs have generally ruled that SOX does not protect employees of privately-held subsidiaries of publicly-traded companies unless the employee can pierce the corporate veil or show that the publicly-traded company has actively participated in the retaliation.\(^{323}\)

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321 Jennifer Levitz, *Whistleblowers Are Left Dangling*, THE WALL STREET JOURNAL, Sept. 4, 2008, at xx. Another 187 cases settled, and the remaining cases were withdrawn or awaiting resolution. *Id.* See also Stephen Taub & Tim Reason, *Whistle-blowers Never Win*, CFO.com, June 8, 2007, [http://www.cfo.com/printable/article.cfm/9321686](http://www.cfo.com/printable/article.cfm/9321686) (noting that of nearly 1,000 complaints filed under Section 806 between 2002 and 2007, only six survived the first level of review by ALJs and not a single one survived review by ARBs).


A second key boundary issue is that several federal appellate courts, including the First,\textsuperscript{324} Fourth,\textsuperscript{325} and Fifth\textsuperscript{326} Circuits, have significantly narrowed SOX whistleblower protection by requiring the employee’s allegations to definitively and specifically relate, both subjectively and objectively, to one or more of the six offenses enumerated in SOX. Those six offenses are mail fraud, wire fraud, bank fraud, securities fraud, a violation of any rule or regulation of the SEC, and a violation of any provision of federal law relating to fraud against shareholders.\textsuperscript{327} If the allegations do not relate to one of the foregoing offenses, the claim will be dismissed. In other words, an employer’s retaliation or discrimination constitutes a SOX violation only if it was a response to the employee’s reasonable, articulated belief that one of the six offenses occurred.\textsuperscript{328}

\textit{Whistleblowers by Contract}, 79 U. COLO. L. REV. 975, 997 (2008). But see Steven J. Pearlman, \textit{In Defense of DOL’s Interpretation of Section 806}, LAW360, Sept. 15, 2008, \url{http://www.law360.com/print_article/69311} (refuting argument that subsidiaries of covered corporations are automatically covered by Section 806). In 2009, the ARB affirmed an ALJ decision holding that both a publicly-traded company and a privately-held company retaliated against claimant in violation of SOX. See Kalkunte v. DVI Financial Serv., Inc., ARB Case Nos. 05-139 & 05-150, ALJ Case No. 2004-SOX-056 (Feb. 27, 2009). Kalkunte may expand whistleblower liability under SOX to private entities engaged in business with publicly-traded companies. Moreover, under Section 922 of the new Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010, Section 806 of SOX has been expanded to cover private subsidiaries or affiliates of publicly traded companies, but only if their financial information is included in the consolidated financial statements of such companies.

\textsuperscript{324} Day v. Staples, Inc., 555 F.3d 42 (1st Cir. 2009).

\textsuperscript{325} Platone v. United States Dep’t of Labor, 548 F.3d 322, 326 (4th Cir. 2008); Welch v. Chao, 536 F.3d 269 (4th Cir. 2008).

\textsuperscript{326} Allen v. Administrative Review Bd., 514 F.3d 468 (5th Cir. 2008).

\textsuperscript{327} 18 U.S.C. § 1514A(a)(1). There is a split in authority as to whether the sixth offense modifies the preceding five offenses, such that all allegations must relate to fraud against shareholders in order for SOX whistleblower protection to apply. Compare Bishop v. PCS Admin. (USA), Inc., No. 05-Civ-5683, 2006 WL 1460032, at *9 (N.D. Ill. May 23, 2006) ("The phrase ‘relating to fraud against shareholders’ must be read as modifying each item in the series. . . .") with Reyna v. Conagra Foods, Inc., 506 F. Supp.2d 1363 (M.D. Ga. 2007) (holding that under plain language of §1514A, the alleged fraud need not relate to fraud against shareholders to be protected activity).

\textsuperscript{328} See, e.g., Pearl v. SDT Sys., Inc., No. 08-2196, 2010 WL 27066 (8th Cir. Jan. 7, 2010) (affirming summary judgment in favor of employer in Section 806 case, where employee’s belief concerning understated earnings was not objectively reasonable).
To have an objectively reasonable belief there has been shareholder fraud, for example, the employee’s theory must at least approximate the basic elements of securities fraud.” This requirement significantly limits whistleblower protection, because virtually all employees will be unaware of the basic elements of securities fraud when they blow the whistle. Under Rule 10b-5, the elements are a material misrepresentation or omission by the defendant, scienter, a connection between the misrepresentation or omission and the purchase or sale of a security, reliance upon the misrepresentation or omission, economic loss, and loss causation. Few whistleblowing employees will be sufficiently well-versed in securities law to be cognizant of each of these elements.

A third major boundary issue is that SOX only addresses retaliation, in the form of adverse employment action, against employees who blow the whistle against their current employers. It does nothing to protect whistleblowers from social retaliation. And it does nothing to protect whistleblowers who have left their employer and find themselves unable to secure new employment as a result of blacklisting by potential new employers. Moreover, returning to a former job is a very limited option. In cases

331 See Debra S. Katz, Whistleblowing, Sarbanes-Oxley, and Retaliation Claims, American Law Institute—American Bar Association Continuing Legal Education, ALI-ABA Course of Study, SP024 ALI-ABA 23, 37 (Dec. 4-6, 2008) (“Allen . . . constitutes a dramatic departure from the purpose of the whistleblower law by requiring employees to become experts in securities law before making complaints.”).
332 See Justin Tyler Hughes, Note, Equity Compensation and Informant Bounties: How Tying the Latter to the Former May Finally Alleviate the Securities Fraud Predicament in America, 82 S. CAL. L. REV. 1043, 1063-64 (2009) (“SOX . . . is entirely incapable of protecting whistleblowers from social retaliation.”).
333 Geoffrey C. Rapp, Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers, 94 B.U.L. REV. 91, 154 (2007) (“SOX . . . offers little or no hope of assuaging the other severe disincentives to whistleblowing such as fear of social ostracism or
where it finds reasonable cause to believe a violation has occurred, OSHA is authorized by SOX to order job reinstatement with the same seniority status the employee would have had but for the retaliation, but reinstatement may be denied where the company establishes that the former employee is a security risk.\textsuperscript{334} And some courts have held that they do not have the power to enforce preliminary orders of reinstatement, under which OSHA can require the reinstatement of an employee even prior to the \textit{de novo} hearing on the merits before an ALJ.\textsuperscript{335}

A fourth boundary issue is that most courts and ALJs have refused to extend SOX whistleblower protection to employees working outside the United States, generally on the basis that Section 806 fails to reflect the necessary clear expression of congressional intent to extend the statute’s reach beyond the nation’s borders.\textsuperscript{336} This refusal

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\textsuperscript{334} 29 C.F.R. § 1980.105(c).
\textsuperscript{336} See, e.g., Carnero v. Boston Scientific Corp., 433 F.3d 1, 18 (1st Cir. 2006). In Carnero, the First Circuit reasoned that the text of Section 806 was silent as to its extraterritorial application, the legislative history indicated that Congress gave no consideration to the possibility of its application outside of the U.S, and Congress expressly provided in other SOX provisions for extraterritorial application. The First Circuit also noted the potential problems flowing from extraterritorial application, including authorizing United States courts and administrative agencies to “delve into the employment relationship between foreign employers and their foreign employees.” \textit{Id.} at 15. \textit{But cf.} O’Mahony v. Accenture Ltd., 537 F. Supp.2d 506 (S.D.N.Y. 2006) (distinguishing Carnero and denying motion to dismiss SOX whistleblower claim filed by American employee of Bermuda company’s French subsidiary against Bermuda company and its United States subsidiary). \textit{See also} Matt A. Vega, \textit{The Sarbanes-Oxley Act and the Culture of Bribery: Expanding the Scope of Private Whistleblower Suits to Overseas Suits, 46 HARV. J. LEGIS. 425, 488-94 (2009) (criticizing Carnero).
discourages whistleblowing by overseas employees, who are unprotected from retaliation.\textsuperscript{337}

A primary procedural hurdle has been the 90-day statute of limitations for filing SOX claims,\textsuperscript{338} which begins to run when an employee has knowledge of an adverse employment action and has been strictly enforced.\textsuperscript{339} OSHA and ALJs consistently rebuff employees’ claims that the limitations period should be tolled or not enforced for equitable reasons.\textsuperscript{340} Ninety days is very short, given that most SOX claimants allege that they have lost their jobs,\textsuperscript{341} are likely preoccupied with finding new employment, and fail to realize quickly enough how to protect their rights.\textsuperscript{342} The consequences have been harsh. ALJs have dismissed one-third of SOX claims decided in favor of the employer for failure to satisfy the 90-day statute of limitations.\textsuperscript{343}

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\item 18 U.S.C. § 1514A(b)(2)(D).
\item Fred W. Alvarez, et al., \textit{The Sarbanes-Oxley Act: Current Issues in Whistleblower Enforcement}, American Law Institute – American Bar Association Continuing Legal Education, ALI-ABA Course of Study, SP027 ALI-ABA 233, 246-47 (March 5-7, 2009) (“The 90-day filing deadline is strictly enforced. ALJ’s have almost uniformly rejected equitable arguments for extending the limitations period when untimely complaints were filed. . . . ALJ decisions have also rejected equitable estoppels arguments.”).
\item See Terry Morehead Dworkin, \textit{SOX and Whistleblowing}, 105 MICH. L. REV. 1757, 1763 (2007) (“The effectiveness of the protection offered by Section 806 is tempered by the very short statute of limitations of ninety days after a retaliatory action occurs. Most potential claimants don’t realize what their rights are and how to pursue them in such a short period.”). \textit{See also} Richard E. Moberly, \textit{Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win}, 49 WM. & MARY L. REV. 65, 107-08, 133 (2007) (“No compelling rationale for a 90-day limitations period appears in the literature on labor relations, employee rights, or whistleblowing.”).
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whistleblowing statute of limitations was expanded to 180 days, under the new Dodd-
Frank Wall Street Reform and Consumer Protection Act, but even this is too short. Other federal whistleblower statutes have more realistic limitations periods that range up to 300 days. The American Recovery and Reinvestment Act of 2009, designed to provide whistleblowing protection to employees of private companies and state and local government receiving economic stimulus funds under the largest economic stimulus bill since the Great Depression, contains no statute of limitations. Instead, the applicable limitations period is governed by the analogous state or federal law.

A second procedural hurdle is that SOX whistleblower claims may be subject to mandatory arbitration. In 2008, the First Circuit held in Guyden v. Aetna, Inc., in a case of first impression in the federal appellate courts, that such claims are arbitrable. This decision, which followed a line of consistent rulings from ALJs, may have a significant negative impact on the protection available to whistleblowers under SOX: “As mandatory arbitration policies are increasingly a condition of employment at publicly-traded companies, one result from Guyden may be to chill potential SOX whistleblowing claims.”

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344 Dodd-Frank Wall Street Reform and Consumer Protection Act (H.R. 4173), §922.
345 These statutes include the Age Discrimination in Employment Act (29 U.S.C. § 623(d)), Americans with Disabilities Act (42 U.S.C. § 12203(a)), and Civil Rights Act of 1964 (42 U.S.C. § 2003(a)).
348 544 F.3d 376 (2008).
whistleblowers from asserting SOX claims and, consequently, erode the deterrent features of SOX.”

A third procedural hurdle is that whereas SOX’s burdens of proof are employee-friendly (as indicated, if the employee makes a prima facie case, the burden shifts to the employer to demonstrate by clear and convincing evidence that it would have taken the same personnel action in the absence of the whistleblowing), in practice OSHA has failed to implement these burdens. Evidence for this proposition is provided by statistics showing that in almost 70 percent of cases in which SOX whistleblower claims were dismissed by OSHA for failure to show causation, there was a failure to show that the protected activity was a contributing factor in the retaliation. This is a very high percentage, given that the threshold is so low, and it suggests that OSHA has misapplied the SOX burden of proof.

The claims investigation issues stem from placement of SOX under OSHA’s umbrella. Whistleblower claims are highly fact-intensive and tend to require significant resources, time, and expertise to investigate. OSHA, which primarily concerns itself with

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worker health and safety issues, has no expertise regarding securities fraud.\textsuperscript{353} It was given no additional funding by Congress to deal with SOX claims, even though such claims represented 13 percent of its caseload by 2007.\textsuperscript{354} Given these constraints, SOX claimants invariably fail at the OSHA investigative stage.\textsuperscript{355}

With regard to remedies, recovery for successful claimants under SOX is limited to equitable compensatory damages.\textsuperscript{356} Punitive damages are not authorized\textsuperscript{357} and there is a split of authority as to whether SOX provides damages for reputational injury.\textsuperscript{358} Damages for pain and suffering and mental anguish likewise likely are unavailable.\textsuperscript{359} These limitations are likely to deter whistleblowing. Pre-SOX studies of whistleblower statutes demonstrated that if employees were unable to recover damages for punitive damages, the statute failed to spur whistleblowing and failed to


\textsuperscript{355} See Statement of Prof. Richard E. Moberly Before the House Subcomm. on Workforce Protections, Hearing on Private Sector Whistleblowers: Are There Sufficient Legal Protections, May 15, 2007, http://edlabor.house.gov/testimony/051507/RichardMoberlyTestimony.pdf (concluding that during first three years of SOX, only 3.6 percent of SOX whistleblowers won relief through initial OSHA investigative process and only 6.5 percent won on review by ALJs).


\textsuperscript{357} Murray v. TXU Corp., 279 F. Supp.2d 799 (N.D. Tex. 2003).


adequately reward the employee for the risks incurred in reporting alleged misconduct.\textsuperscript{360}

The combined effect of the foregoing factors is that whistleblower statutes fail to protect confidential witnesses whose names are disclosed. Indeed, whistleblower statutes are significantly less effective than anonymity in protecting informants confronted with possible retaliation.\textsuperscript{361} Not surprisingly, then, the majority of corporate employees who observe corporate wrongdoing fail to report it,\textsuperscript{362} and of those who do report, a substantial percentage, in retrospect, would not have done so.\textsuperscript{363} Overall, contrary to the unsupported summary conclusion of the Seventh Circuit and other federal courts, SOX and other whistleblower statutes fail to adequately protect confidential witnesses. Because the protection is inadequate, the existence of whistleblower statutes like SOX provides no basis for courts to conclude that identification of confidential witnesses during the pleading or discovery stages of class action securities litigation is appropriate. That conclusion has no empirical support.

Conclusion

In 2009, a Fifth Circuit panel that included retired Supreme Court Justice Sandra Day O’Connor (sitting by designation) wrote: “To be successful, a securities class-action

\textsuperscript{361} See Does I thru XXIII v. Advanced Textile Corp., 214 F.3d 1058, 1071 (9th Cir. 2000) (observing that informants are better served “by concealing their identities than by relying on the deterrent effect of post hoc remedies under (a statutory) anti-retaliation provision.”).
plaintiff must thread the eye of a needle made smaller and smaller over the years by judicial decree and Congressional action. Those ever higher hurdles are not, however, intended to prevent viable securities actions from being brought.”

Courts which read *Tellabs* to require automatic, steep discounting of information provided by confidential witnesses and included in securities class action complaints may well prevent viable securities actions from proceeding. Likewise for courts which permit discovery of the identities of confidential witnesses in advance of trial. Imposing a general requirement of disclosure of confidential sources is likely to invite retaliation against them, or have a significant chilling effect that deters informants from providing critical information to plaintiffs’ investigators in meritorious cases, thereby thwarting the federal securities laws. To avoid such an outcome, (1) courts should not discount information provided by confidential witnesses for use in securities fraud complaints if the witnesses are described with sufficient particularity to support the probability that persons in the positions occupied by the witnesses would possess the information alleged, and (2) in general, the identities of confidential witnesses should not be discoverable unless the witnesses will testify at trial. Adherence to these two guidelines can help ensure that meritorious securities class actions are not barred.

*Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 235 (5th Cir. 2009) (*per curiam*). It has been reported that Justice O’Connor, appointed by a Republican president and with prior experience as a Republican legislator, wrote the opinion in this case. See Kevin LaCroix, D&O Diary, June 22, 2009, [http://www.danodiary.com/2009/06/articles/securities-litigation/rare-fifth-circuit-securities-case-reversal](http://www.danodiary.com/2009/06/articles/securities-litigation/rare-fifth-circuit-securities-case-reversal).