Confidential Witnesses in Securities Litigation

Gideon Mark*

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 such information is accompanied by sufficient indicia of reliability; and (2) in general, the identities of confidential witnesses should not be discoverable unless the witnesses will testify at trial.

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I. 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 or Act) in an effort to curb perceived abuses by plaintiffs' lawyers in securities litigation. 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.

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. When plaintiff's claim is based on alleged misrepresentations or omissions of a material fact, the complaint must specify each allegedly misleading statement, the reason(s) why the statement is 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 constitute a securities violation, "state with particularity facts giving rise to a strong inference that the defendant acted with the required 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 pending,

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4. § 78u-4(b)(2).
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." § 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
or even contemplated,\textsuperscript{7} discovery (expedited or otherwise) is stayed for the entire case—even if there are multiple defendants, some of whom have had both their motions to dismiss denied and have answered.\textsuperscript{8} Because the stay includes motions to dismiss amended complaints\textsuperscript{9} and motions for reconsideration of orders on motions to dismiss,\textsuperscript{10} it is of great practical significance. Given the frequency with which original complaints are amended in securities litigation, the net result can be that many months or even years pass before discovery begins in earnest.\textsuperscript{11} This is the typical pattern, because plaintiffs have generally failed in their efforts to have the PSLRA’s mandatory discovery stay lifted, under either the first\textsuperscript{12} or second\textsuperscript{13} statutory exceptions.

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\textsuperscript{7} undue prejudice to the party seeking relief. § 78u-4(b)(3)(B).
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\textsuperscript{8} 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) (concluding that the PSLRA’s discovery provision applies when the Court is aware of defendant’s intent to file a motion to dismiss, but the motion has not yet been filed); Sedona Corp. v. Ladenburg Thalmann, No. 03 Civ. 3120 LSTHK, 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.”).
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\textsuperscript{9} 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, 6:08-3183-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 & Hauqenie Sec. Litig., 214 F. Supp. 2d 100, 106 (D. Mass. 2002) (same).
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\textsuperscript{10} 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, 6:08-3183-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 & Hauqenie Sec. Litig., 214 F. Supp. 2d 100, 106 (D. Mass. 2002) (same).
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\textsuperscript{11} despite the PSLRA’s language (expedited or otherwise) is stayed for the entire case—even if there are multiple defendants, some of whom have had both their motions to dismiss denied and have answered.\textsuperscript{8} Because the stay includes motions to dismiss amended complaints\textsuperscript{9} and motions for reconsideration of orders on motions to dismiss,\textsuperscript{10} it is of great practical significance. Given the frequency with which original complaints are amended in securities litigation, the net result can be that many months or even years pass before discovery begins in earnest.\textsuperscript{11} This is the typical pattern, because plaintiffs have generally failed in their efforts to have the PSLRA’s mandatory discovery stay lifted, under either the first\textsuperscript{12} or second\textsuperscript{13} statutory exceptions.
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\textsuperscript{13} 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, 6:08-3183-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 & Hauqenie Sec. Litig., 214 F. Supp. 2d 100, 106 (D. Mass. 2002) (same).
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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. Allegations based on such information often are the only specific allegations in a complaint supporting a claim of securities fraud.

The use of confidential witnesses, who typically are current or former employees, by the SEC, the U.S. Attorney’s Office, and a U.S. House of Representatives committee; In re Schering-Plough Corp./Enhance Sec. Litig., Civ. Action No. 08-397 DMC, 2009 WL 1470453 (D.N.J. May 22, 2009) (denying motion to partially modify the PSLRA discovery stay because “the nature of Plaintiffs’ request . . . does not rise to the level of ‘undue prejudice’ contemplated by Congress in creating the very narrow exception to the PSLRA’s mandatory stay of discovery provision”). 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, available at http://www.docstoc.com/docs/37686639/Shifting-the-Securities-Law-Paradigm-The-Brave-New-World ("Confidential sources are a commonplace, if not omnipresent, feature of today’s securities fraud class action complaint."). Indeed, plaintiffs’ lawyers believe that confidential witnesses (hereafter sometimes referred to as CWs) are often essential to avoid dismissal at the pleading stage of securities litigation. See Christopher Keller & Michael Stocker, Balancing the Scales: The Use of Confidential Witnesses in Securities Class Actions, 41 SEC. REG. & L. REP. (BNA) 87 (2009) ("[I]n the absence of publicly available information from SEC or Department of Justice investigations, allegations based on information provided by confidential witnesses offer the ‘best hope’ of plaintiffs surviving the PSLRA pleading standards."); ASS’N OF THE BAR OF THE CITY OF N.Y. SEC. LITIG. COMMA., SUBCOMM. ON USE OF CONFIDENTIAL SOURCES, DIALOGUE ON THE CURRENT LAW AND PROPOSALS FOR REFORM ON THE USE OF INFORMATION FROM AND THE DISCLOSURE OF THE IDENTITY OF INFORMANTS, 3 (Aug. 2009), http://www.nychar.org/pdf/report/uploads/20071798-UseofConfidentialSources.pdf ("Given the restrictions of the PSLRA, informants are virtually the only means of obtaining non-public evidence of wrongdoing at a company and are often essential for avoiding early dismissal of a meritorious action."). The foregoing report includes separate sections written by plaintiffs’ counsel and defense counsel. The foregoing quotation is taken from the plaintiffs’ section. Hereafter, the report is referred to alternatively as NYC Bar Report/Plaintiffs and NYC Bar Report/Defendants. While the use of CWs in securities litigation is quite common, it is not universal. See, e.g., Clark v. Comcast Corp., 582 F. Supp. 2d 692, 704 (E.D. Pa. 2008) ("Plaintiffs appear to be relying exclusively on documentary evidence as the source of their allegations of fraud, as they make no mention of any confidential or other personal sources."); In re PainCare Holdings Sec. Litig., No. 6:06-cv-362-Otl-28DAB, 2008 WL 348781, at *8 (M.D. Fla. Feb. 7, 2008) (defendant argues that absence of scienter is shown by lack of traditional red flags such as confidential witnesses).

customers, or suppliers\textsuperscript{17} fearful of retaliation if their identities are disclosed,\textsuperscript{18} 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 \emph{Tellabs, Inc. v. Makor Issues & Rights, Ltd.}\textsuperscript{19} 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 \emph{Tellabs} to assess the use of such witnesses. Many courts, following the lead of the Seventh Circuit in \emph{Higginbotham v. Baxter Int’l, Inc.}\textsuperscript{20} 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 \emph{Higginbotham} and eschewed automatic discounting.

The key discovery issue is whether plaintiffs must disclose the identities of confidential witnesses in advance of trial. Federal district courts that 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 or on public policy grounds. No federal appellate court had resolved the issue by early 2011.

This Article provides a framework for analyzing and resolving both the pleading and discovery issues. Part I considers the use of confidential witnesses prior to \emph{Tellabs}. Part II examines \emph{Tellabs} and its application by the lower federal courts. Part III critiques those decisions that have applied \emph{Tellabs} to automatically discount information provided by confidential witnesses. Each reason given by \emph{Higginbotham} and similar decisions to support automatic discounting is reviewed and rejected. Particular attention is paid to \emph{Higginbotham}’s erroneous conclusion that discounting is justified because discovery of the identities of confidential witnesses is inevitable.

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.

\textsuperscript{17} Id. at *7.
\textsuperscript{18} See \textit{Novak v. Kasaks}, 216 F.3d 300, 314 (2d Cir. 2000) (“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{19} \textit{Tellabs, Inc. v. Makor Issues & Rights, Ltd.}, 551 U.S. 308 (2007).
\textsuperscript{20} \textit{Higginbotham v. Baxter Int’l, Inc.}, 495 F.3d 753 (7th Cir. 2007).
II. CONFIDENTIAL WITNESSES IN SECURITIES FRAUD LITIGATION PRIOR TO TELLABS

More than 2800 securities class actions were filed in federal court from 1996 to 2010\textsuperscript{21} and confidential witnesses were used in many, if not most, of them.\textsuperscript{22} Such witnesses have been 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)\textsuperscript{23} and companion Rule 10b-5.\textsuperscript{24} In 2010, 66\% of the 176 securities class actions filed in federal court included 10b-5 claims.\textsuperscript{25} Confidential witnesses also have been used to support claims asserted under section 11 of the Securities Act of 1933 (Securities Act),\textsuperscript{26} 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{27}

\textsuperscript{21} See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2010 YEAR IN REVIEW 3 (Jan. 2011),
\textsuperscript{22} See 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 complaint.”); Justin Scheck, Securities Lawyers Spar Over Use of Confidential Witnesses, THE RECORDER, Apr. 11, 2005 (“Confidential witnesses have become a staple of securities litigation.”).
\textsuperscript{23} See 15 U.S.C. § 78j (2006). 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.
\textsuperscript{24} 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 § 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, 119 (4th Cir. 2009); Latham v. Mathews, 662 F. Supp. 2d 441, 462 (D.S.C. 2009).
\textsuperscript{25} 2010 YEAR IN REVIEW, supra note 21, at 31. Another study reported 219 securities class action filings for the period January to November 2010, with a projected total of 239 for the full year 2010. This study reported a higher total because it used a counting methodology that differs from other approaches. See NERA ECONOMIC CONSULTING, TRENDS 2010 YEAR-END UPDATE: SECURITIES CLASS ACTION FILINGS ACCELERATE IN SECOND HALF OF 2010; MEDIAN SETTLEMENT VALUE AT AN ALL-TIME HIGH, 2 & n.3 (Dec. 14, 2010), http://www.nera.com/nera-files/PUB_Year_End_Trends_1210.pdf.
\textsuperscript{27} Id. 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 & MacLean v. Huddleston, 459 U.S. 375, 381–82 (1983). To state a claim under § 11, a plaintiff must allege that (1) she purchased a registered security, either directly from the issuer or in the aftermarket following the offering; (2) the 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
The use of confidential witnesses in class action securities litigation has been 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 sources. This was the conclusion of at least one district court each in California, New Jersey, and Florida.

28. See § 78u-4(b)(1) (setting forth the pleading requirement).

30. 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) (requiring plaintiffs to specifically name their confidential sources). On appeal, the Ninth Circuit did not directly address the issue of whether CWs 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 v. Baxter Int’l, Inc., 495 F.3d 753, 757 (7th Cir. 2007) (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 upholding the dismissal of the complaint in *Silicon Graphics* as supporting the lower court’s view on confidential witnesses).

31. 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 30, at 208.

32. 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 WL 543769, at *6 (S.D. Fla. Mar. 20, 2001) (“This court, as it has before, follows the other courts that have not sustained complaints under the PSLRA based on
All federal appellate courts to consider the issue by 2011 rejected the foregoing approach. Beginning in 2000, the First,\(^{33}\) Second,\(^{34}\) Third,\(^{35}\) Fourth,\(^{36}\) Fifth,\(^{37}\) Sixth,\(^{38}\) Seventh,\(^{39}\) Eighth,\(^{40}\) Ninth,\(^{41}\) Tenth,\(^{42}\) and Eleventh\(^{43}\) Circuits all rejected the notion that confidential witnesses who provide information used in securities fraud complaints must be identified by name in the complaint, as a general rule.\(^{44}\) 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 *Novak v. Kasaks*, the Second Circuit concluded that reading “all” literally would tend to produce illogical results that Congress could not have intended, because it would allow complaints to avoid dismissal where all the facts supporting plaintiff’s information and belief had been pled, but such facts were insufficient to support the belief.\(^{45}\) The Second Circuit rejected the notion that confidential sources must be named as a general rule,\(^{46}\) 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.”\(^{47}\)

The Fifth\(^{48}\) and Eighth\(^{49}\) 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 In re Cabletron Systems, Inc., 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 the defendants’ statements were false.’” According to the First Circuit, “[t]his involves an evaluation, 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.” 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 analysis. Subsequently, the Third, Fourth, Ninth, and Tenth Circuits also adopted Novak’s analysis, and some

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. Id. Green Tree addressed only the latter. Id. See John H. Henn, et al., Anonymous Sources in Class Action Complaints, 38 REV. SEC. & COMMODITIES REG. 131 (2005) (analyzing Novak and other federal decisions that adopted its reasoning).

50. In re Cabletron Sys., Inc., 311 F.3d 11 (1st Cir. 2002).
51. Id. at 29 (quoting Novak, 216 F.3d at 314).
52. Id. at 29-30.
53. Id. at 30.
54. In Cal. Pub. Employees’ Ret. Sys. v. Chubb Corp., 394 F.3d 126 (3d Cir. 2004), 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. Id. at 146. 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 147.
56. 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. Id. at 1015. Daou confirmed that the Ninth Circuit adopted the Novak test, augmented by Cabletron’s suggested criteria for assessing the reliability of CWs. Id. 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. Id. 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, et al., supra note 49, at 136 (suggesting that Daou’s addition of a corroboratory 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., 548 F. Supp. 2d 1126, 1132 (S.D. Cal. 2008); In re SeraCare Life Sciences, Inc. Sec. Litig., No. 05-CV-2335-H (CAB), 2007 WL 935583, at *7 (S.D. Cal. Mar. 19, 2007); and In re Portal Software, Inc. Sec. Litig., No. C-03-5138 VRW, 2006 WL 2385250, 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, 371 F. App’x 212 (2d Cir. 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) ("[S]tatements from confidential witnesses need to be bolstered by other facts ‘that provide an adequate basis for believing that the defendants’ statements were false.’") (quoting In re Theragenics Corp. Sec. Litig., 137 F. Supp. 2d 1339, 1345 (N.D. Ga. 2001)).

57. In Adams v. Kinder-Morgan, Inc., 340 F.3d 1083 (10th Cir. 2003), the Tenth Circuit accepted most,
of those circuits expressly supplemented Novak with the Cabletron factors. In summary, prior to Tellabs, the consensus of those federal appellate courts considering the issue 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, this test generally requires that the witness make allegations 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 and inconsistent. 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. Other courts have mashed the analysis together, or commenced an analysis of reliability that veers off-track by concluding that information provided by the witness is not indicative of defendants’ scienter. Other more rigorous courts have evaluated the issues separately, holding that the complaint’s allegations are adequate as to both reliability and scienter, inadequate as to both, or adequate as to reliability, but inadequate as to

but not all, of the analysis in Novak and ABC Arbitrage. 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. See Cabletron, 311 F.3d at 29–30 (identifying factors). The Adams approach is probably the most flexible of the standards adopted by the Circuits prior to Tellabs.


59. 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.”).

60. South Ferry LP v Killinger, 399 F. Supp. 2d 1121, 1140 (W.D. Wash. 2005), vacated in part, 542 F.3d 776 (9th Cir. 2008) (“[T]he 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.’ ”).


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Courts have been more consistent when they specifically focus on the witnesses’ reliability. Courts have generally refused to recognize as reliable information from confidential witnesses that is not based on personal knowledge.68 Courts have generally determined that the following purported information provided by CWs lacked sufficient indicia of reliability: hearsay,69 double hearsay,70 second-hand,71 rumor,72 possible rumor;73 conjecture;74 gossip;75 and information that fails to identify the witness’s job title or position with defendant,76 fails to describe or adequately describe the witness’s job duties with defendant,77 fails to identify the time frame during which the witness was employed by defendant,78 or has been provided by a witness whose employment with defendant terminated before the class period began79 or began after the class period.


70. 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.”).


76. In re BISYS Sec. Litig., 397 F. Supp. 2d 430, 442 (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.”).


III. TELLABS AND HIGINBOTHAM

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. 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, Fourth, Sixth, and Ninth Circuits required that the inference that defendants had the requisite scienter be the most plausible when compared with competing inferences. The Second, Fifth, Eighth, Tenth, and Eleventh Circuits required that the inference that defendants acted with the requisite scienter must be at least as equally plausible as competing inferences. The Third and Seventh Circuits did not require any assessment of competing inferences, instead looking only at the plausibility of plaintiffs’ allegations.

In *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.”

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.”

Lower federal courts have generally interpreted Tellabs’ holding to give the tie to plaintiffs. If a plaintiff demonstrates only that an inference of scienter is at least as compelling as any nonculpable explanation for defendants’ conduct, that plaintiff wins and the motion to dismiss will be denied.

In Tellabs the Supreme Court also made 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

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93. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 324 (2007). The Court expressly rejected the notion that the inference of scienter must be irrefutable. 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. Id. at 329–33. 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. Id. at 335. See also Devona L. Wells, Case Note, Why Plaintiffs Should Learn to Love the Strong-Inference Standard for Pleading a Securities Fraud Claim—Tellabs v. Makor Issues & Rights, Ltd., 36 WM. MITCHELL L. REV. 1364, 1376–78 (2010) (discussing concurring opinions).


95. See, e.g., Frank v. Dana Corp., 547 F.3d 364, 371 (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) (“[W]here there are equally strong inferences for and against scienter, Tellabs now awards the draw to the plaintiff.”). See also John P. Stigi III & Martin White, Courts Interpret Tellabs, NAT’L J., March 17, 2008, at S1 (stating that in the First, Sixth, and Ninth Circuits, the Tellabs “tie goes to the plaintiff” rule lowered the bar for plaintiffs, but this result is of no practical significance); Caryn Jacobs et al., Pleading Scienter After Tellabs in Section 10(b) Cases Generally and in the “Subprime” Context, 9 (No. 4) J. INVESTMENT COMPLIANCE 47, 61 (2008) (noting the likely scarcity of cases in which the inferences for and against scienter are equally strong).

96. Tellabs, 551 U.S. at 323 (emphasis in original). The Supreme Court reaffirmed this holistic approach in 2011. See Matrixx Initiatives, Inc. v. Siracusano, No. 09-1156, 2011 WL 977060, at *13 (U.S. March 22, 2011) (“In making this determination, the court must review ‘all the allegations holistically.’”) (quoting Tellabs, 551 U.S. at 326). 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 in Tellabs, 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 WIS. 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.”).

97. Tellabs, 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. Id. at 337.
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.98

B. Application of *Tellabs* by the Federal Courts

1. *Higginbotham* and *Tellabs II*

   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 the 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 as an ex-employee of the subsidiary, two ex-employees of Baxter’s headquarters, and two consultants.99 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.”100 The Seventh Circuit concluded that the information provided by confidential witnesses must be discounted under *Tellabs*, and “[u]sually that discount will be steep.”101

   In reaching this conclusion, the Seventh Circuit noted that there is no “informer’s privilege” in civil litigation, and defendants are entitled under Rule 26(a)(1)(A) of the Federal Rules of Civil Procedure to obtain the identities of all persons likely to have discoverable information that plaintiffs may use to support their claims or defenses.102 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.”103 Indeed, Judge Posner’s comments during oral argument in *Higginbotham* expressed his surprise that confidential witnesses were ever used in securities litigation,104 even though the use of such witnesses

100. Id. at 757.
101. Id.
103. *Higginbotham*, 495 F.3d at 757.
104. Judge Posner asked: “What are they? Are they like police informants? . . . Are these people going to testify behind a screen with a voice alteration?” 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, HARVARD L. SCH. FORUM ON CORP. GOVERNANCE AND FIN. REG., Sept. 28, 2007,
had been commonplace for years. As indicated supra, in the seven years prior to Higginbotham, most of the federal court courts had issued opinions addressing the circumstances under which confidential witnesses could be used in securities litigation.105 Moreover, 27 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 (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.106 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.107

While Tellabs II can be and has been read to represent a retreat from Higginbotham,108 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, numerous courts that have cited Higginbotham for the proposition that the Supreme Court’s decision in Tellabs requires steep discounting of information provided by confidential witnesses have done so even after Tellabs II was decided.109 As stated succinctly by one review: “Higginbotham survives the Tellabs remand.”110


105. See supra text accompanying notes 33–57 (delineating various federal courts’ approaches to the use of confidential witnesses). 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 Brown, supra note 104. Maybe Judge Posner’s reaction was not surprising. According to two commentators, 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. & L. REP. (BNA) 87, 89 (2009) (“Higginbotham was consistent with the Seventh Circuit’s already entrenched rejection of the use of anonymous sources in complaints.”).

106. Makor Issues & Rights, Ltd. v. Tellabs, 513 F.3d 702, 711 (7th Cir. 2008).

107. Id. at 712.

108. See, e.g., Keller & Stocker, supra note 105, at 89 (“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.”).


110. Gregory A. Markel et al., The Dangers of Relying on Anonymous Sources in Securities Complaints
2. Higginbotham’s Influence

Higginbotham has been persuasive for other courts, no doubt mainly because the case was unanimously decided by a distinguished panel. 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. Such courts include the Second, Fifth, and Sixth Circuits, and

917, 926 (PLI Corp. Law & Practice, Course Handbook Series No. 14864, 2008). See also Gregory Markel et al., Sometimes, The Witness is a Cipher, NAT’L L.J., Apr. 21, 2008, at S1 (suggesting that Higginbotham can be viewed as stating the applicable rule when there is less than compelling support for credibility of confidential witnesses, while Tellabs II establishes the 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 (“Case law concerning the use of confidential witnesses has been anything but uniform”).

111. 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. Konovafov, “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/pbContent/_pdf/pub2614_1.pdf (“While 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 (PLI Corp. Law & Practice, Course Handbook Series No. 14673, 2008) (“[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.”).

112. 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 provided by confidential witnesses); William R. Maguire, Current Issues in Securities Fraud Litigation, ASPATORE, 2009 WL 2510892, at *4 (Aug. 2009) (“Tellabs may have weakened the impact of confidential witnesses in securities fraud complaints.”). See also Lifschitz v. NextWave Wireless Inc., No. 08CV1697-LAB (WMC), 2011 WL 940918, at *2 (S.D. Cal. Mar. 16, 2011) (noting that courts have “grown to regard [CWs] with a good amount of skepticism.”).

113. See Campo v. Sears Holdings Corp., 371 F. App’x 212, at *3 n.4 (2d Cir. 2010) (citing Higginbotham and concluding that plaintiffs’ use of CWs frustrates Tellabs’s requirement that courts weigh competing inferences when determining whether a complaint adequately pleads scienter). In 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), 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. Id. The Second Circuit’s endorsement in dicta of the practice of permitting depositions under circumstances which arguably violate the PSLRA’s discovery stay had not found support in other courts by late 2010. See In re Cell Therapeutics, Inc. Class Action Litig., No. C10-414MJP, 2010 WL 4791808, at *1–2 (W.D. Wash. Nov. 18, 2010) (rejecting Campo). Cf. Joseph C. Weinstein & Joseph Rodgers, Unmasking Confidential Witnesses?, Law360 (June 23, 2010), http://www.law360.com/web/articles/172877 (suggesting that Campo “is a step in the right direction”); Jordan Eth & Timothy Blakely, The Use and Abuse of Confidential Witnesses: The Battle Continues After Tellabs (PLI Corp. Law & Practice, Course Handbook Series No. 18078, 2009), WL 1762 PLI/Corp 606 (arguing that if a complaint relying on CW allegations survives a motion to dismiss, defendants should be permitted to immediately depose CWs, to determine if they support allegations attributed to them).


district courts in the Northern District of Illinois, Southern District of Indiana, Eastern District of Kentucky, Eastern District of Michigan, Western District of Missouri, Northern District of Ohio, and Western District of Texas. Some of these courts have been quite emphatic. For example, citing Higginbotham, the Fifth Circuit held in 2008: “Following Tellabs, courts must discount allegations from confidential 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, Third, Eighth, Ninth, and Eleventh Circuits and

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).


123. Indiana Electrical Workers’ Pension Trust Fund IBEW v. Shaw Grp., 537 F.3d 527, 535 (5th Cir. 2008). See also Significant 2008 Case Law Developments, 64 BUS. LAW. 871, 901 n.305 (2009) (“[T]he 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 mention Higginbotham or Tellabs in its discussion of confidential sources, although it did discuss Tellabs in other contexts. Id. at 551, 553.

124. In New Jersey Carpenters Pension & Annuity Funds 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 the 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.” Id. at 52.


126. In a series of three cases decided in 2008, the Eighth Circuit addressed allegations by confidential
district courts in the Northern District of California,\textsuperscript{129} District of Maryland,\textsuperscript{130} Southern District of New York,\textsuperscript{131} Western District of New York,\textsuperscript{132} and Southern District of Ohio.\textsuperscript{133}

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) (applying a Tellabs analysis without mention of Higginbotham); In re Hutchinson Tech., Inc. Sec. Litig., 536 F.3d 952, 962 (8th Cir. 2008); and Cornelia I. Crowell GST Trust v. Posis Med., Inc., 519 F.3d 778 (8th Cir. 2008).

127. In Zucco Partners, LLC v. Diginare 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. Zucco Partners, 552 F.3d at 995 n.2. Zucco also underscored a key point concerning the use of confidential witnesses (CWs) 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.” Id. at 995. 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 alleged. Id. Second, the information provided by CWs must itself be indicative of scienter. Id. Accord Int’l Bhd. of Elec. Workers Local 697 Pension Fund v. Int’l Game Tech., No. 3-09-CV-419-ECR-RAM, 2011 WL 915115, at *6 (D. Nev. Mar. 15, 2011); Karpov v. Insight Enter., 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.” Inst. Investors Grp. v. Avaya, 564 F.3d 242, 263 n.33 (3d Cir. 2009).

128. 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. Mizzaro, 544 F.3d at 1239–40. 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. Id. at 1240. Accord Edward J. Goodman Life Income Trust v. Jabil Circuit, Inc., 595 F. Supp. 2d 1253, 1267–68 (M.D. Fla. 2009) (concluding that weight given to statements made by a confidential source depends on specificity of description). See also In re HomeBanc Corp. Sec. Litig., 706 F. Supp. 2d 1336, 1349–50 (N.D. Ga. 2010) (citing Mizzaro for proposition that statements and observations of CWs cannot be wholly disregarded); Hubbard v. BankAtlantic Bancorp., Inc., 625 F. Supp. 2d 1267, 1284 (S.D. Fla. 2008) (citing Mizzaro for proposition that “courts may be skeptical of confidential sources cited in securities fraud complaints”).


132. In re Bausch & Lomb, Inc. Sec. Litig., 592 F. Supp. 2d 323, 341–42 (W.D.N.Y. 2008) (citing Higginbotham and then noting cases which have considered allegations based on confidential sources post-Tellabs without discounting them).

IV. HIGGINBOTHAM IS INDEFENSIBLE

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

The Seventh Circuit’s decision in Higginbotham is indefensible on numerous grounds and those courts that have endorsed its reasoning are incorrect. The remainder of this Article examines the faulty reasoning of Higginbotham and other federal courts that 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.134 But this is incorrect, because the use of confidential witnesses can form the predicate for relevant inferences. As noted by Professor Geoffrey P. Miller:

It 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.135

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” of the Tellabs approach.136 The Seventh Circuit specifically acknowledged this command of Tellabs.137

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

134. See Higginbotham v. Baxter Int’l, Inc., 495 F.3d 753, 757 (7th Cir. 2007) (“It is hard to see how information from anonymous sources could be deemed ‘compelling’ or how we could take account of plausible opposing inferences.”).

135. Miller, supra note 14, at 523. Accord David F. Rees & Mark A. Friel, Not As Bad As It Looks: A Plaintiff’s View of Tellabs and Bell Atlantic, 24 SEC. REFORM ACT LITIG. REP. 5, 9 (Oct. 2007) (“[T]here is nothing in Tellabs that says that courts should discount allegations from confidential witnesses.”).


137. Higginbotham, 495 F.3d at 757 (“Tellabs instructs courts to evaluate the allegations in their entirety.”).
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 they are sufficiently detailed, no discounting should take place. 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 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. Of course, all three points could be equally true with regard to named witnesses. Moreover, the first assertion completely 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) have no financial incentive to

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139. 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://www.law360.com/web/articles/95750.

140. See infra text accompanying notes 226–246 (describing the public policy rationale justifying the confidentiality of witnesses).

141. Higginbotham, 495 F.3d at 757.

142. See In re Thornburg Mortg., 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.”).

143. The SEC has had a limited program in place since the 1990s to reward whistleblowers in insider trading cases. By mid-2010 the program had paid only five rewards totaling $159,537. Sarah Johnson, Paid to Whistle, CFO.COM (July 23, 2010), 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% of any tax, interest, penalties, or additional amounts collected based on information provided to the IRS. By August 2009 at least 1263 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 Annual Report to Congress on the Use of Section 7623 at 3, INTERNAL REVENUE SERVICE (2009), http://www.irs.gov/pub/whistleblower/annual_report_to_congress_september_2009.pdf (describing the IRS’s procedures for compensating whistleblowers). More recently, section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1841 (2010) (hereafter DFA), signed into law in July 2010, adds a new section 21F to the Exchange Act which provides that the SEC shall pay awards 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 irrefutably conflicts with the fundamental rule, expressed by the Supreme Court’s statements in both Tellabs\textsuperscript{144} and the 2007 case of Bell Atlantic Corp. v. Twombly,\textsuperscript{145} that at the pleading stage of litigation courts cannot 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.”\textsuperscript{146} 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.

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 reliable, 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. This suggestion is contrary to Tellabs, because it considers irrational, rather than plausible, inferences.\textsuperscript{147} The suggestion also is contrary

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., Hidden Impacts of the Dodd-Frank Act, N.Y. L.J., July 15, 2010, at 5 (predicting that the DFA “will bring whistleblowers out of the woodwork to a degree never previously witnessed”). Section 748 of the DFA creates an analogous bounty program with regard to the Commodity Futures Trading Commission. See Marcia Coyle, Corporate Sector Sounds the Alarm over Financial Reform’s ‘Bounty’ System, LAW.COM (July 20, 2010), http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1202463690243 (analyzing the SEC’s new whistleblower program). The DFA’s legislative history states that the purpose of the bounty program is to elicit high-quality tips by motivating persons with insider knowledge “to come forward and assist the Government to identify and prosecute persons who have violated the securities laws.” See S. Rep. No. 111-176, at 110 (2010) (explaining the rationale behind the bounty program). The SEC has estimated that the DFA whistleblower provisions will encourage approximately 30,000 official tips, complaints, or referrals each year. See Proposed Rules for Implementing the Whistleblower Provisions of § 21F of the Securities Exchange Act of 1934, Exchange Act Release No. 34-63237, 75 Fed. Reg. 70,488 (proposed Nov. 3, 2010) (to be codified at 17 C.F.R. pts. 240 and 249), at 96 [hereafter Proposed Rules].

144. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 328 (2007) (“[T]he case will fall within the jury’s authority to assess the credibility of witnesses . . . .”).


146. Tellabs, 551 U.S. at 311.

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.\textsuperscript{148} Rule 11(b) thus requires that plaintiffs’ counsel conduct reasonable factual inquiry before filing suit.\textsuperscript{149} Both a represented party and his attorney may be sanctioned under Rule 11(b)(3) for the factual insufficiency of a complaint.\textsuperscript{150} Where the party knows that the filing and signing are wrongful, and the attorney reasonably should know, then sanctions against both are appropriate.\textsuperscript{151}

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{152} 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{153} 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 attorney’s fees and other expenses incurred in the action.\textsuperscript{154} 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.\textsuperscript{155} If the

\textsuperscript{148} FED. RIV. CIV. P. 11(b).

\textsuperscript{149} Id.

\textsuperscript{150} Oliveri v. Thompson, 803 F.2d 1265, 1274 (2d Cir. 1986).


\textsuperscript{154} § 78u-4(c)(3)(A)(ii); Simon DeBartolo Gr., LP v. Richard E. Jacobs Grp., 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. § 78u-4(c)(3)(A)(i).

\textsuperscript{155} 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 established its scope. In re Australia and New Zealand
presumption is rebutted the court shall award the sanction that it deems appropriate pursuant to Rule 11.156 A district court’s imposition of sanctions under the PSLRA and Rule 11 is reviewed on appeal for abuse of discretion.157

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.158 Some empirical evidence indicates that this ultimate goal of deterrence has been achieved, in part. Post-PSLRA, fewer frivolous suits have been filed,159 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, 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 case160—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.161

Banking Grp. Ltd. Sec. Litig., No. 08 Civ. 11278(DLC), 2010 WL 187528, at *10 (S.D.N.Y. May 11, 2010).

156. § 78u-4(c)(3)(C).

157. 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). The Second Circuit has held that the review is even more exacting than under the ordinary abuse of discretion standard. ATSI Communics., 579 F.3d at 150; Perez v. Danbury Hosp., 347 F.3d 419, 423 (2d Cir. 2003).

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

159. 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 meritless litigation).

160. 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% 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 Grp. 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 Communcs, 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 ATSI 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 Grp. 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).

161. 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 check”). A 2006 study found only four examples of sanctions in a securities class action 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.”
C. Disclosure of Confidential Witnesses is Not Inevitable Under Rule 26

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

In both Higginbotham\textsuperscript{162} and again on remand in Tellabs II,\textsuperscript{163} 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,\textsuperscript{164} and so have several district courts.\textsuperscript{165} 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.\textsuperscript{166} Parties are not required to 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.”\textsuperscript{167} The parties also must disclose the subject of the information known by the witnesses.\textsuperscript{168} Initial disclosures are required to

\textsuperscript{162} Higginbotham v. Baxter Int’l, Inc., 495 F.3d 753, 757 (7th Cir. 2007) (noting that “anonymity is [not] possible in the long run”).
\textsuperscript{163} Makor Issues & Rights, Ltd. v. Tellabs, Inc., 513 F.3d 702, 711 (7th Cir. 2008).
\textsuperscript{164} See Fla. St. Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 667–68 (8th Cir. 2001) (concluding that, while plaintiff need not identify a confidential witness in a complaint, it will eventually be required to disclose the identity under Rule 26(a)(1)(A)).
\textsuperscript{165} 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.”).
\textsuperscript{166} See FED. R. CIV. P. 26(b)(1) (“Parties may obtain discovery regarding . . . the identity and location of persons who know of any discoverable matter.”).
\textsuperscript{167} 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) (citing to and applying the exemption for prisoners pro se).
\textsuperscript{168} FED. R. CIV. P. 26(a)(1)(A)(i). The majority view appears to be that the PSLRA’s mandatory discovery stay applies to initial disclosures, so that no disclosure takes place in securities cases during the pendency of motions to dismiss, unless one of the statutory stay exceptions applies. See Medhekar v. U.S. Dist. Ct. for the No. Dist. of Calif., 99 F.3d 325, 328–29 (9th Cir. 1996) (holding that initial disclosure requirements under Rule
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).169 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 motion, at a hearing, or at trial,”170 except where the failure to comply with disclosure requirements was substantially justified or harmless.171 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.172

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.173 This is the first point at which parties are compelled to identify the fact witnesses they intend to call at trial. Before then, their


169. 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).


171. 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. 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’s 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, 365 F. App’x 432, 444–45 (4th Cir. 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) (holding plaintiff’s failure 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).

172. See, e.g., Worldwide Network Serv., LLC, v. Dyncorp Int’l, LLC, 365 F. App’x 432, 444 (4th Cir. 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 F. App’x 661, 662 (2d Cir. 2009); Wertz v. Target Corp., No. 08-CV-78 GSA, 2009 WL 651129, at *2 (E.D. Cal. Mar. 12, 2009).

173. 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).
identities are typically protected (sometimes as attorney work product), discoverable only upon a showing of particular need.174 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.175 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.176

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.177 Identification may occur if the witnesses are subsequently interviewed or deposed,178 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 be issued. Such orders have been issued in cases arising under the Fair Labor Standards Act (FLSA).179

174. WILLIAM W. SCHWARZER ET AL., PRACTICE GUIDE: FEDERAL CIVIL PROCEDURE BEFORE TRIAL (NAT. ED.) ¶ 11:878 (2009); Brock v. R.J. Auto Parts and Serv., Inc., 864 F.2d 677, 679 (10th Cir. 1988) (holding that trial court erred in issuing discovery order requiring disclosure of identities of individuals upon whose testimony plaintiff intended to rely); D’Onofrio v. SFX Sports Grp., Inc., 247 F.R.D. 43, 54 (D.D.C. 2008) (holding that defendant was not required to disclose during discovery identities of fact witnesses it intended to call at trial); IBP, Inc. v. Mercantile Bank of Topeka, 179 F.R.D. 316, 323 (D. Kan. 1998) (holding that interrogatory requesting list of all witnesses and substance of their testimony was impermissible because it sought counsel’s trial strategy). But see McKesson Corp. v. Islamic Republic of Iran, 185 F.R.D. 70, 82 (D.D.C. 1999) (holding that party may be compelled to disclose during discovery the identity of trial witnesses). McKesson represents a distinctly minority view. See D’Onofrio, 247 F.R.D. at 53 (concluding, after examining various courts’ interpretations, that the McKesson holding does not seem to be a majority view).

175. SCHWARZER ET AL., supra note 174, ¶ 15.8.1.

176. However, Rule 26 provides for disclosure of witnesses likely to have discoverable information that the disclosing party 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 Amend.


178. See, e.g., In re Harmonic, Inc. Sec. Litig., 245 F.R.D. 424, 427 No. C-00-2287 PJH (EMC), 2007 WL 2701123, at *3 (N.D. Cal. Sept. 13, 2007) (“[P]laintiffs 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 depose third parties who may be only tangentially involved.”).

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 February 2011 only 29 class action securities cases had gone to trial since the PSLRA was enacted in 1995.\(^{180}\) Only eleven of those 29 cases were tried to a verdict and involved post-PSLRA conduct.\(^{181}\) Overall, by January 2011 a mere 0.3% of the more than 2800 securities class actions filed between January 1, 1996 and December 31, 2010 had reached a verdict at trial.\(^{182}\) Confidential witnesses rarely are called to testify in the few such trials which do occur, because typically the outcome of such a trial is determined by the documents, rather than by the witnesses.\(^{183}\) 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 proceed to trial by that date.\(^{184}\) Plaintiffs’ initial complaint was dismissed for failure to meet the PSLRA’s strict pleading requirements.\(^{185}\) 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.\(^{186}\) 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

181. Id. Seven cases involving post-PSLRA conduct were tried by February 2011, 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. Id. 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, A Securities Lawsuit Goes to Trial, THE D&O DIARY (Oct. 24, 2007), http://www.dandodiary.com/2007/10/articles/securities-litigation/a-securities-lawsuit-goes-to-trial/ (noting the foregoing factors and concluding that “given the enormous burden and expense required to try a securities case it arguably makes no economic sense for a plaintiffs’ lawyer to take all of that on and to risk losing it all at trial”). The significance of the first two factors was increased by declining share prices during the recession which began in 2007 and raised the level of potential damages in securities cases. See Bruce D. Angiolillo, Aligning Legal Strategy with Trends in Securities Litigation, ASPATORE, available at 2009 WL 1615207, at *1, *3 (2009) (describing the environment of securities lawsuits in recessionary economic climates). See also 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 defendants exploit the risk-averse nature of plaintiffs’ lawyers in securities class actions 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, such as favorable jury verdicts which incentivize plaintiffs to “forgo settlements in favor of jury decisions”).
182. 2010 YEAR IN REVIEW, supra note 21, at 14.
183. Eth & Blakely, supra note 113 (“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.”).
185. Id. at 381.
days of jury deliberations.\textsuperscript{187}

Similarly, in \textit{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.\textsuperscript{188} The court ordered that disclosure must occur if plaintiffs changed course,\textsuperscript{189} 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\textsuperscript{190} and is contrary to public policy, as is described, \textit{infra}.\textsuperscript{191} In short, mandating disclosure of confidential sources would deter such individuals from providing critical information to investigators in meritorious cases or invite retaliation against them, thus thwarting the filing of such cases.\textsuperscript{192} Precluding disclosure is consistent with the approach used by many courts with regard to the informant’s privilege, discussed \textit{infra},\textsuperscript{193} under which the privilege is generally upheld prior to trial and then yields to protect defendant’s right to a fair trial.\textsuperscript{194}

\textsuperscript{187}Eth & Blakely, supra note 184, at 381.

\textsuperscript{188}In re St. Paul Travelers Sec. Litig. II, Civil No. 04-4697 (JRT/FLN), 2007 WL 1424673, at *1 (D. Minn. May 10, 2007).

\textsuperscript{189}Id.

\textsuperscript{190}See, e.g., Mazur v. Lampert, No. 04-61159-CIV, 2007 WL 917271, at *6 (S.D. Fla. Mar. 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) (ordering 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 Civ. 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).

\textsuperscript{191}See \textit{infra} text accompanying text notes 227–47 (describing the public policies justifying witness confidentiality).

\textsuperscript{192}See, e.g., \textit{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 et al., \textit{Post-Tellabs Treatment of Confidential Witnesses in Federal Securities Litigation}, 2 J. SEC. L., 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.”).

\textsuperscript{193}See \textit{infra} text accompanying text notes 247–83 (discussing application of informant’s privilege).

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 or for trial.\(^{195}\) and is included in Rule 26.\(^{196}\) Post-PSLRA, federal district courts are 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,\(^{197}\) but the remaining, better-reasoned opinions have concluded that the identities are protected from disclosure as attorney work product and on public policy grounds.\(^{198}\)

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No federal appellate court had considered the discoverability issue by early 2011. Appellate resolution of the issue seems unlikely to occur anytime 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.199 Moreover, the circuit courts are split on the question of whether, and to what extent, interlocutory review is available.200 The result of the conflicting approaches

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199. Hernandez v. Tanninen, 604 F.3d 1095, 1101 (9th Cir. 2010).

200. In Carpenter v. Mohawk Indus., Inc., 130 S. Ct. 599, 609 (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. Tanninen, 604 F.3d 1095, 1099 (9th Cir. 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 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. Mohawk, 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’, Nat’l 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) (2006), 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. Mohawk, 130 S. Ct. at 607. 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. Mar. 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. Mohawk, 130 S. Ct. at 607. 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.”).
is that access to interlocutory review and relief is rarely available.\textsuperscript{201} Finally, in general, discovery-related orders are rarely overturned on appeal.\textsuperscript{202}

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 \textit{Novak} test for use of information provided by confidential witnesses, that information may be so detailed 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 minimal confidentiality at stake.\textsuperscript{203}

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.\textsuperscript{204} 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.\textsuperscript{205} 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 750 knowledgeable individuals (and that list was expected to expand),\textsuperscript{206} 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).\textsuperscript{207}


\textsuperscript{202} Awuah v. Coverall North America, Inc., 585 F.3d 479, 481 (1st Cir. 2009) (finding discovery orders are rarely overturned).

\textsuperscript{203} In re Marsh & McLennan Sec. Litig., MDL No. 1744, No. 04 Civ. 8144(SWK), 2008 WL 2941215, at *5 (S.D.N.Y. July 30, 2008). Accord In re Harmonic, Inc. Sec. Litig., 245 F.R.D. 424, 428–29 (N.D. Cal. 2007) (declining to find work product protection in part because “[p]laintiffs have already provided substantial indicators as to who the CWs are”); Miller v. Ventro Corp., No. C01-01287 SBA (EDL), 2004 WL 868202, at *2 (N.D. Cal. Apr. 21, 2004) (“[T]o the extent that the complaint enables identification, there is no confidentiality to preserve.”).


\textsuperscript{205} FED. R. CIV. P. 26(b)(3).

\textsuperscript{206} 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.”).

\textsuperscript{207} In re Marsh & McLennan Sec. Litig., MDL No. 1744, No. 04 Civ. 8144(SWK), 2008 WL 2941215, at
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. This includes witness identities. 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 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 the defendant corporation employed a CW. 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


211. See, e.g., In re ArthroCare Sec. Litig., 726 F. Supp. 2d 696, 720 (W.D. Tex. 2010) (“[T]he complaint should give details such as the person’s . . . specific employment dates.”); Limantour v. Cray, Inc., 432 F. Supp. 2d 1129, 1143 (W.D. Wash. 2006) (describing as “fatal flaw” the failure to provide dates of employment); Central Laborers’ Pension Fund v. Sirva, Inc., No. 04 C 7644, 2006 WL 2787520, at *8 (N.D. Ill. Sept. 22, 2006) (statements must be accompanied by “meaningful cautionary statements identifying important factors”).

212. In re SeeBeyond 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. 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. 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 uniformly 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
the witness worked for defendant during a range such as mid-2011 to mid-2012 or during the class period should suffice, with respect to time. Several courts have so held.\textsuperscript{213} 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{214} 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{215} Courts in cases not involving securities fraud similarly have often concluded that the identities of witnesses interviewed by counsel are protected from disclosure by the work product doctrine.\textsuperscript{216}

\textsuperscript{213} See, e.g., Cornwell v. Credit Suisse Grp., 680 F. Supp. 2d 629 (S.D.N.Y. 2010) (finding sufficient an allegation that CW3 worked for defendant from late 2005 to mid-2007); In re Dot Hill Sys. Corp. Sec. Litig., 2008 WL 4184616, at *10 (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. Mar. 21, 2006) (same); 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.”).


Those cases are germane to this discussion, because compelled disclosure of confidential witnesses who provide 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.\textsuperscript{217}

The mere fact that a party may include confidential witnesses 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, courts have repeatedly held the inclusion of confidential witnesses in a long list of deponents to be insufficient to overcome the informer’s privilege.\textsuperscript{218} Moreover, confidential witnesses used in securities fraud complaints typically are the defendants’ current or former employees.\textsuperscript{219} In light of this fact, defendants are in the best position to know what information each of these individuals may possess, which means defendants usually should be unable to show the substantial need courts require to overcome the qualified privilege.\textsuperscript{220} More
specifically, insofar as parties typically identify confidential witnesses 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 depose them. Thus, the conclusions of certain courts that a long list of potential deponents constitutes substantial need or undue hardship in this context lack merit.

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. 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. This conclusion is reinforced by the fact that courts in general are quite hesitant to find implied waivers of attorney work product protection.

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:

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222. See Ross v. Abercrombie & Fitch Co., Nos. 2:05-cv-0819 etc., 2008 WL 821059, at *3 (S.D. Ohio Mar. 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 SLM Corp. Sec. Litig., Master File No. 08 Civ. 1029(WHP), 2011 WL 611854, at *1 (S.D.N.Y. Feb. 15, 2011) (denying motion to compel partly because investigation of 73 former employees did not constitute undue hardship); 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 a list of 55 potential witnesses would not be an unmanageable task); In re Ashworth, Inc. Sec. Litig., 213 F.R.D. 385, 389 (S.D. Cal. 2002) (denying motion to compel partly because 100 potential witnesses was a manageable number). But see Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys., Inc., No. C01-20418JW, 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).


“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.”226 Indeed, it is precisely such risks that motivated the enactment of federal whistleblower statutes, such as the federal Whistleblower Protection Act,227 which are designed to address the problem of retaliation against employees.228 More generally, confidential informants play a vital role in many area of public life, including counter-espionage, law enforcement, and the investigative press.229 Informants have been described by former FBI Director William Webster as “the single most important tool in law enforcement.”230 Whistleblowers are especially critical to the discovery of fraud. According to a 2008 study by the Association of Certified Fraud Examiners, frauds are more likely to come to light through whistleblower tips than through internal audits, internal controls, external audits, or any other means.231

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.”232

Some courts ordering disclosure of the identities of confidential witnesses in securities litigation have recognized the public policy issue,233 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,234 or if the confidential witnesses are for any other reason former, rather than current, employees of the defendant.235 Continued employment by many of the witnesses in the same industry

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234. See, e.g., In re Connetics 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 Connetics Corporation ceased to exist three years ago.").

235. See, e.g., Mazur v. Lampert, No. 04-61159-CIV, 2007 WL 917271, at *5–6 (S.D. Fla. Mar. 25, 2007) (granting defendants’ motion to compel plaintiff to disclose the identities of confidential witnesses where the
has not altered the result. 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. 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.” Under Rule 26(c)(1), a protective order must be premised on good cause 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. Fourth, a number of courts have minimized the public policy issue by noting that confidential witnesses are adequately protected by whistleblower statutes.

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 face a serious risk of retaliation. 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. Accordingly, a specific showing of

witnesses were former employees of the defendant); Miller v. Ventro Corp., No. C01-01287SBA01287 SBA (EDL), 2004 WL 868202, at *2 (N.D. Cal. Apr. 21, 2004) (finding no evidence of likelihood of retaliation, because “[n]one of the twenty-two CWs are current employees of defendants, and Defendants’ company no longer exists in the form that it previously did”). See also John H. Henn et al., Anonymous Sources in Class Action Complaints, 38 REV. SEC. & COMMODITIES REG. 131, 139 (2005) (asserting that former employees, who “seem to make up the bulk of the ranks of anonymous informants relied upon in securities fraud complaints,” are not generally subject to retaliation).

236. See, e.g., In re Connetics Corp. Sec. Litig., No. C 07-02940 SL, 2009 WL 1126508, at *2 (N.D. Cal. Apr. 27, 2009) (finding the argument too attenuated “where the witnesses’ identities will eventually be revealed irrespective of whether plaintiff provides this information”).


240. See, e.g., In re Marsh & McLennan, 2008 WL 2941215, at *5 (holding that an alleged 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. CV. 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 Norfleet v. John Hancock Fin. Servs. Inc., No. 3:04cv1099 (JBA), 2007 WL 433332, at *4 (D. Conn. Feb. 5, 2007) (finding that in a case involving alleged racial discrimination, absent specification of form of retaliation feared by CWs, conclusory assertions that witness feared retaliation in the life insurance industry could not support assertions that genuine risk of retaliation existed).


242. See infra text accompanying notes 267–70 (discussing the risk of retaliation against former employees).

likely reprisal should be unnecessary where plaintiffs seek to prevent disclosure of the identities of confidential witnesses in securities cases. Second, as previously 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.244 Those aspects are discussed, infra.245 Fourth, whistleblower statutes do not adequately protect confidential witnesses, again as discussed infra.246

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. The early disclosure scheme of Rule 26 does not mandate disclosure, and in the typical case the attorney work product doctrine and public policy should protect the identity of confidential witnesses.

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.”247 This observation is erroneous. Pursuant to Roviaro v. United States248—a United States Supreme Court decision from 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 enforcement249 and to make retaliation as difficult as possible.250 Even information

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244. See, e.g., NYC Bar Report/Plaintiffs, supra note 15, 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.]

245. See infra text accompanying notes 305–07 (discussing types of harm resulting from retaliation).

246. See infra text accompanying notes 308–65 (discussing laws aimed at protecting whistleblowers from retaliation).


248. Roviaro v. United States, 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 government holds the privilege).


within the scope of the privilege may be discoverable, under standards established by *Roviaro*. The privilege must yield if disclosure of an informant’s identity is relevant and helpful to the defense of an accused or disclosure of an informant’s identity is essential to a fair determination of a cause. 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. Others courts refer to the privilege as qualified.

In either case, whether the court qualifies the privilege or uses a balancing test, federal courts begin with a presumption in favor of protecting the identity of confidential informants. 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. This is because ―the informant’s privilege is the rule and *Roviaro* is the exception.‖ Defendant bears a “heavy” burden of overcoming the privilege. 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 such cases the government has been required to disclose the informant’s identity unless there was sufficient evidence separate from the confidential communication. Absent this situation the privilege generally applies to conceal an informant’s identity, unless the informant will be a trial

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252. United States v. Vann, 336 F. App’x 944, 949 (11th Cir. 2009).

253. See Chao v. Westside Drywall, Inc., 254 F.R.D. 651, 656 (D. Or. 2009) (referring to the privilege as qualified); Simmons v. City of Racine, PFC, 37 F.3d 325, 328 (7th Cir. 1994) (“The privilege is qualified, however, not absolute.”).


256. Perez, supra note 248, at 201. *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.”).

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).


A district court’s refusal to order disclosure of information relating to a confidential informant typically is reviewed only for an abuse of discretion.

While there is some minor dispute about the issue, the clear majority view—contrary to the Seventh Circuit’s statement in Higginbotham—is that the informant’s privilege applies in both civil and criminal cases. 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. 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 (DOL). 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.

260. See, e.g., United States v. Abahamra, 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 “an informant must be disclosed only upon a showing by the defendant that disclosure is essential to a fair trial”); and United States v. Bauer, 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 such disclosure he will be deprived of his right to 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). United States v. Vincent, 611 F.3d 1246, 1251 (10th Cir. 2010); United States v. Sardinas, 386 F. App’x 927, 940 (9th Cir. 2010). See also United States v. Mendoza-Salgado, 964 F.2d 993, 1001 (10th Cir. 1992) (applying de novo standard of review).

261. See Higginbotham v. Baxter Int’l, Inc., 495 F.3d 753, 757 (7th Cir. 2007). 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.”). Compare Brennan v. Automatic Toll Sys., 60 F.R.D. 195, 196 (S.D.N.Y. 1973) (“The government’s claim of ‘informer’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, Int’l Bhd. of Elec. Workers, 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 informer’s privilege exists in civil cases as well . . . .”); and D’Orazio, III v. Washington T’ship, Civ. 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.”).


The Fifth Circuit has noted three reasons why courts should apply an informant’s privilege 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 a company could subject a former employee 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 merely conjectural—most whistleblowers never work in their fields again.

Sensibly, the Fourth Circuit and district courts elsewhere have agreed that the FSLA protects both current and former employees from retaliation.

Some courts which have held 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. The court is required to evaluate the reliability of the anonymous source in both situations, using the same process. And, the policy considerations are identical. In In re MTI Tech. Corp. Sec. Litig. II, 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 refusal to compel disclosure of informants in FLSA cases. As trial approaches in FLSA cases, the informant’s privilege, typically upheld during discovery, tends to yield, to enable defendants to prepare their cases properly.


268. Hodgson, 459 F.2d at 306.

269. Id. Accord Int’l Ass’n Managers, Inc., at *3.


273. See, e.g., Mizzaro v. Home Depot, Inc., 544 F.3d 1230, 1239–40 (11th Cir. 2008); In re Cabeltron 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.
The computer and Internet, which have revolutionized the dissemination and access to information, have also created new challenges for privacy protection. One of the significant concerns is the privacy of individuals communicating online. This concern has led to the development of privacy laws and regulations, such as the European Union's General Data Protection Regulation (GDPR) and the California Consumer Privacy Act (CCPA). These laws aim to protect individuals' personal information and provide them with more control over their data.

In the United States, the federal government has introduced the Cybersecurity and Infrastructure Security Agency (CISA) to coordinate and enhance cybersecurity efforts across various sectors. At the state level, many states have also established cybersecurity agencies to protect their residents and businesses from cyber threats.

The private sector has also taken steps to protect personal information. Many companies have implemented data protection measures, such as encryption and access controls, to safeguard the data they collect.

In addition, the rise of the 'Internet of Things' (IoT) presents new challenges for privacy protection. IoT devices, such as smart home devices and wearables, collect and transmit vast amounts of personal data. As a result, there is an increased need for robust privacy safeguards to protect individuals' information in this environment.

Overall, the protection of personal information is a multifaceted issue that requires collaboration between the public and private sectors, as well as continuous technological advancements to keep pace with evolving threats.

References:

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,284 with mixed results. By 2010, 36 states and the District of Columbia had enacted shield laws to provide journalists with different degrees of protection for their sources and information.285 The scope of protection varies considerably according to the text of each state’s particular law.286 The vast majority of these laws protect a confidential source’s identity, but many also protect a reporter’s notes or outtakes.287 A number of jurisdictions also recognize a reporter’s privilege under their state constitutions or under common law.288 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.289

At the federal level, the reporter’s privilege derives from Branzburg v. Hayes,290 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.291 In

284. Mary-Rose Papandrea, Citizen Journalism and the Reporter’s Privilege, 91 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, Plugging Leaks: The Necessity of Distinguishing Whistleblowers and Wrongdoers in the Free Flow of Information Act, 40 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.”).


291. Id. at 689. The 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. Id. at 706. Congress has never exercised that freedom. A federal reporter’s privilege has not been codified despite the introduction of numerous bills in the four decades since Branzburg was decided. See Jane E. Kirtley, Mask, Shield, and Sword: Should the Journalist’s Privilege Protect the Identity of Anonymous Posters to News Media Websites?, 94 MINN. L. REV. 1478, 1502–03 (2010) (describing 2009 legislation); Tucker & Wermiel, supra note 288, at 1293–94 (describing 2007 legislation and concluding that “[p]assage of a
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. 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. Numerous federal courts have adopted this formulation of this test. If the party seeking discovery fails to satisfy any one of the three factors the privilege generally is upheld and discovery is denied. 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. While there are dozens of federal statutes concerning whistleblowers who fear retaliation, such laws do not ensure the anonymity of the whistleblower. 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. But this leaked information is subject to media subpoenas. In 2006, for example, 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. 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 newspathering is being poisoned by the subpoena threat.”

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, the same primary 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. This 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.

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.

Privilege, 91 MINN. L. REV. 515, 516 (2007) (noting that in recent years “the number of subpoenas to journalists has risen dramatically”). But cf. Randall D. Eliason, The Problems with the Reporter’s Privilege, 57 AM. U. L. REV. 1341, 1349 (2008) (“Even if one could establish that the overall number of subpoenas to the media has increased in recent years, this would have to be considered in light of the changed media environment.”). An earlier study found that 31.25% of responding reporters relied on confidential sources in their news stories. See Tucker & Wermiel, supra note 288, at 1322.


300. See id. (“[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 has had on newspathering at the very institutions that pioneered the investigative reporting that supports, nourishes, and sustains our democratic tradition.”). But cf. Wohl, supra note 59, at 579 (“One obvious precedent for protecting the identities of private informants—the reporter’s privilege—in fact provides little guidance because the current status of this privilege is unsettled.”).

301. Makor Issues & Rights, Ltd. v. Tellabs, Inc., 513 F.3d 702, 711 (7th Cir. 2008).

302. 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 & Sanjeev 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 as “An employee who reports employer wrongdoing to a governmental or law-enforcement agency.” BLACK’S LAW DICTIONARY 1627 (8th ed. 2004).


304. Short lists of famous whistleblowers of this era often include Sherron Watkins (Enron), Cynthia
whistleblowers often follows. A recent study found that 82% of the whistleblowing population had been fired, quit their job under duress, or had significantly altered responsibilities, as a result of their whistleblowing activities.\textsuperscript{305} 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.\textsuperscript{306} 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.\textsuperscript{307}

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{308} These measures vary widely in the scope of protection they provide. For example, only 17 state statutes protect private-sector whistleblowers.\textsuperscript{309} 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{310}

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. See BLACK’S LAW DICTIONARY, supra note 302. 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 (describing the whistleblowing activities of Sherron Watkins of Enron, Coleen Rowley of the FBI, and Cynthia Cooper of WorldCom).


\textsuperscript{307} See Rapp, supra note 270, at 121 (“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.”); ALFORD, supra note 306, at 31–32 (“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.”); Gerard Sinzdak, Comment, An Analysis of Current Whistleblower Laws: Defending a More Flexible Approach to Reporting Requirements, 96 CALIF. L. REV. 1633, 1668 (2008) (“[W]histleblowers are frequently the victims of both formal and informal retaliation.”).


\textsuperscript{310} Sinzdak, supra note 307, at 1654 (“By failing to protect internal disclosures, legislators and courts may actually discourage whistleblowers from reporting unlawful activity to anyone.”). Federal laws similarly rarely protect employees who blow the whistle to the media. Id. at 1656.
The primary federal statute providing protection to individuals who blow the whistle on publicly traded companies that engage in fraud is the Sarbanes–Oxley Act 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 Secretary of Labor, who 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 by a preponderance of the evidence 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 such a showing is made, the burden then shifts to the employer to rebut the employee’s claim 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 there is reasonable cause to believe that prohibited retaliation occurred. If reasonable cause is found, OSHA will 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.

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 de novo hearing. The ALJ has broad discretion to limit the discovery and the scope of permissible evidence, in order to expedite the proceeding. 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

312. 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 (2006).
313. § 1514A(a)(1)(C).
314. § 1514A(b)(1)(A).
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.319

The foregoing SOX scheme is seriously deficient in numerous respects, and therefore fails to protect confidential witnesses, contrary to the conclusion of the 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 1273 complaints (1.3%) filed by them under SOX after 2002, while 841 complaints (66%) were dismissed.320 The success rate for SOX whistleblowers is significantly lower than it is for whistleblowers under other types of federal statutes.321

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 routinely 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.322 The DFA expands coverage of section 806 of SOX to include private subsidiaries or affiliates of publicly traded companies, but only if their financial information is included in the consolidated financial statements of such companies.323

319. See Stone v. Instru. Lab. Co., 591 F.3d 239, 249 (4th Cir. 2009) (“In summary, the plain language of § 1514(b)(1)(B) unambiguously establishes a Sarbanes–Oxley whistleblower complaint’s right to 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 de novo, and will be set aside if they are arbitrary, capricious, an abuse of discretion, or otherwise not in accord with law. Klopfenstein v. Admin. Rev. Bd., No. 10-60144, 2010 WL 4746668, at *2 (5th Cir. Nov. 23, 2010); Platone, 548 F.3d at 326. 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, 514 F.3d at 476. The same standard is used by ARBs when reviewing ALJ findings of fact. 29 C.F.R. § 1980.110(b) (2006).

320. Jennifer Levitz, Whistleblowers Are Left Dangling, THE WALL ST. J., Sept. 4, 2008, at A3. 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 (noting that of nearly 1000 complaints filed under § 806 between 2002 and 2007, only six survived the first level of review by ALJs and not a single one survived review by ARBs).


This expansion will encompass most subsidiaries and affiliates of publicly traded companies, but likely not all of them.

A second key boundary issue is that several federal appellate courts, including the First, Fourth, Fifth, Seventh, Ninth, and Eleventh Circuits, as well as various district courts, have significantly narrowed SOX whistleblower protection by requiring the employee’s allegations to definitively and specifically relate 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. 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.

Most, but not all, federal courts to consider the issue require that the employee’s belief that a violation occurred be both objectively and subjectively 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.

325. Platone v. United States Dep’t of Labor, 548 F.3d 322, 326 (4th Cir. 2008); Welch v. Chao, 536 F.3d 269, 275 (4th Cir. 2008).
328. Van Asdale v. Int’l Game Tech., 577 F.3d 989, 1000 (9th Cir. 2009).
329. Gale v. U.S. Dep’t of Labor, 384 F. App’x 926, 929 (11th Cir. 2010).
331. 18 U.S.C. § 1514A(a)(1) (2006). 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, 1382 (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).
332. See, e.g., Pearl v. SDT Sys., Inc., 359 F. App’x 680, 681 (8th Cir. 2010) (affirming summary judgment in favor of employer in § 806 case, where employee’s belief concerning understated earnings was not objectively reasonable).
versed in securities law to be cognizant of each of these elements.\textsuperscript{336}

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.\textsuperscript{337} 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.\textsuperscript{338} Moreover, returning to a former job is a very limited option. In cases 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{339} 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 de novo hearing on the merits before an ALJ.\textsuperscript{340}

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{341} This refusal discourages whistleblowing by overseas employees, who are unprotected from retaliation.\textsuperscript{342}

\textsuperscript{336} See Debra S. Katz, Whistleblowing, Sarbanes–Oxley, and Retaliation Claims, American Law Institute—American Bar Association Continuing Legal Education (ALI–ABA Course of Study, Dec. 4–6, 2008), SP024 ALI–ABA 23, 37 (“Allen . . . constitutes a dramatic departure from the purpose of the whistleblower law by requiring employees to become experts in securities law before making complaints.”).

\textsuperscript{337} 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.”).

\textsuperscript{338} Rapp, supra note 270, at 154 (“SOX . . . offers little or no hope of assuaging the other severe disincentives to whistleblowing such as fear of social ostracism or blacklisting.”); Hughes, supra note 337, at 1064 (“SOX . . . does nothing to prevent discrimination by potential future employers.”).

\textsuperscript{339} 29 C.F.R. § 1980.105(c) (2010).


\textsuperscript{341} 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 § 806 was silent as to its extraterritorial application, the legislative history indicated that Congress did not consider the possibility of its application outside of the United States, 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.” Id. at 15. But cf. O’Mahony v. Accenture Ltd., 537 F. Supp. 2d 506 (S.D.N.Y. 2008) (distinguishing Carnero and denying motion to dismiss SOX whistleblower claim filed by an American employee of Bermuda company’s French subsidiary against Bermuda company and its United States subsidiary). See also Matt A. Vega, 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).

\textsuperscript{342} See Daniel Allen Cohn, Note, Carnero v. Boston Scientific Corporation: An Analysis, 6 J. INT’L BUS. & L. 203, 222 (2007) (“The Carnero holding will serve to dissuade potential whistleblowers, employed abroad,
A primary procedural hurdle has been the 90-day statute of limitations for filing SOX claims,\(^3\) which begins to run when an employee has knowledge of an adverse employment action, and which has been strictly enforced.\(^4\) OSHA and ALJs consistently rebuff employees' claims that the limitations period should be tolled or not enforced for equitable reasons.\(^5\) Ninety days is very short, given that most SOX claimants allege that they have lost their jobs,\(^6\) they are likely preoccupied with finding new employment, and fail to realize quickly enough how to protect their rights.\(^7\) The consequences have been harsh. ALJs have dismissed one-third of those SOX claims decided in favor of the employer because the employee failed to satisfy the 90-day statute of limitations.\(^8\) The 2010 DFA doubled SOX's whistleblowing statute of limitations to 180 days after the date of the violation or after the employee became aware of the violation,\(^9\) but even this period is quite short. Other federal whistleblower statutes have more realistic limitations periods that range up to 300 days.\(^10\) The American Recovery and Reinvestment Act of 2009,\(^11\) 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.\(^12\) Instead, the analogous state or federal law governs the applicable limitations period.\(^13\)

A second 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

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\(^{4}\) Katz, supra note 336, at 55.

\(^{5}\) See Coppinger-Martin v. Solis, 627 F.3d 745, 749–50 (9th Cir. 2010) (rejecting equitable tolling and estoppel arguments); Fred W. Alvarez et al., 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 (Mar. 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 estoppel arguments.”).

\(^{6}\) Moberly, supra note 321, at 132.

\(^{7}\) See Terry Morehead Dworkin, 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.”). See also Moberly, supra note 321, at 133 (“No compelling rationale for a 90-day limitations period appears in the literature on labor relations, employee rights, or whistleblowing.”).

\(^{8}\) Private Sector Whistleblowers, supra note 322.


showing that in almost 70% 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.\footnote{354} 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.\footnote{355}

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 worker health and safety issues, has no expertise regarding securities fraud.\footnote{356} OSHA received no additional funding from Congress to deal with SOX claims, even though such claims represented 13\% of its caseload by 2007.\footnote{357} The DOL’s Office of Inspector General—Office of Audit estimated in September 2010 that 80\% of OSHA’s SOX investigations failed to meet one or more of eight elements from OSHA’s Whistleblower Investigations Manual that were deemed essential to the investigative process.\footnote{358} OSHA has not updated the manual since 2003.\footnote{359} Given the foregoing constraints, it is not surprising that SOX claimants invariably fail at the OSHA investigative stage.\footnote{360}

With regard to remedies, recovery for successful claimants under SOX is limited to equitable compensatory damages.\footnote{361} Punitive damages are not authorized\footnote{362} and there is a split of authority as to whether SOX provides damages for reputational injury.\footnote{363} Damages for pain and suffering and mental anguish likewise probably are unavailable.\footnote{364} 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 adequately reward the employee for the risks incurred in reporting alleged misconduct.\textsuperscript{365}

The DFA made a few incremental improvements to section 806 of SOX in 2010, as noted. The statute of limitations was doubled to 180 days and coverage was expanded to include private subsidiaries and affiliates of publicly-traded companies. The DFA also prohibits pre-dispute arbitration agreements and any other agreement, policy, form, or condition of employment that requires a waiver of rights under SOX.\textsuperscript{366} This prohibition is a legislative response to federal cases that upheld the enforcement of clauses requiring arbitration of SOX whistleblower claims\textsuperscript{367} and thereby likely discouraged potential SOX whistleblowers from asserting such claims.\textsuperscript{368} Under the DFA employers probably now lack the ability to compel arbitration.\textsuperscript{369} But the foregoing modest reform measures do nothing to address the host of other defects identified above.

The DFA also created a new parallel regime of protection for whistleblowers who make disclosures that are required or protected under SOX, the Exchange Act, 18 U.S.C. § 1513(e) (which prohibits retaliation against individuals for providing information to a law enforcement officer about the possible commission of a federal offense), or any other law, rule or regulation subject to the SEC’s jurisdiction.\textsuperscript{370} Although the DFA affords protection against retaliation only to individuals who provide information about an actual violation of the securities law,\textsuperscript{371} the SEC’s proposed rules (propounded in November 2010)\textsuperscript{372} state that protection also applies to individuals who provide information about a potential violation of the securities laws.\textsuperscript{373} The new regime includes a much more expansive statute of limitations that ranges up to ten years after the date of the violation\textsuperscript{374} and provides that whistleblowers may commence an action directly in federal court.


\textsuperscript{366} Dodd-Frank Wall Street Reform and Consumer Protection Act § 922(c)(2).


\textsuperscript{368} See, e.g., Sofia E. Biller & Howard S. Suskin, \textit{Are Sarbanes–Oxley Claims Arbitrable?}, 19 STC. LITIG. J. 18, 20 (2009) (“[O]ne result from \textit{Guyden} may be to chill potential SOX whistleblowers from asserting SOX claims and, consequently, erode the deterrent features of SOX.”); Beverley H. Earle & Gerald A. Madek, \textit{The Mirage of Whistleblower Protection Under Sarbanes–Oxley: A Proposal for Change}, 44 AM. BUS. L.J. 1, 44 (2007) (“[P]utting whistleblowers’ and employers’ conflicting interests on equal footing in mandatory arbitration might well discourage whistleblowers and so undermine the public policy goal behind Section 806.”).

\textsuperscript{369} Miranda Tolar, \textit{Whistleblower Claims in the Corporate Context: An Employer’s Perspective}, ASPATORE, 2010 WL 4774893, at *3 (Nov. 2010).

\textsuperscript{370} Dodd–Frank Wall Street Reform and Consumer Protection Act § 922(a).

\textsuperscript{371} Id.

\textsuperscript{372} Proposed Rules, \textit{supra} note 143. Final regulations are due in April 2011.

\textsuperscript{373} Proposed Rule 240.21F-2(a)-(b).

\textsuperscript{374} Under DFA § 922(a), an action must be filed within six years after the date on which the violation occurred or within three years after the date when facts material to the right of action are known or reasonably should have been known by the employee alleging a violation, but not more than ten years after the date of the violation. Dodd–Frank Wall Street Reform and Consumer Protection Act § 922(a).
district court without first obtaining OSHA adjudication.\textsuperscript{375}

In general, whistleblower statutes, including SOX 806, have failed to provide an adequate level of protection for witnesses subject to retaliation. Indeed, whistleblower statutes have been significantly less effective than anonymity in protecting informants confronted with possible retaliation.\textsuperscript{376} Not surprisingly, then, the majority of corporate employees who observe corporate wrongdoing fail to report it,\textsuperscript{377} and of those who do report, a substantial percentage, in retrospect, would not have done so.\textsuperscript{378} It remains to be seen if the DFA’s new regime constitutes an improvement. In certain respects it is clear that it does not. For example, the DFA has no explicit provision for the recovery of non-pecuniary damages, such as emotional distress or loss of reputation damages. And the DFA does not provide for the recovery of punitive damages.

Overall, contrary to the unsupported summary conclusion of the Seventh Circuit and other federal courts, SOX and other whistleblower statutes historically have failed 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.

V. Conclusion

In 2009, a Fifth Circuit panel that included retired Supreme Court Justice Sandra Day O’Connor (sitting by designation) observed: “To be successful, a securities class-action 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.”\textsuperscript{379} Courts which read \textit{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

\textsuperscript{375} Id.
\textsuperscript{376} 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”).
\textsuperscript{378} Rapp, \textit{supra note} 270, at 118–19.
\textsuperscript{379} Alaska Elec. Pension Fund v. Flowserve Corp., 572 F.3d 221, 235 (5th Cir. 2009) (\textit{per curiam}).
securities class actions will not be barred.