

2014

## Recanting Confidential Witnesses in Securities Litigation

Gideon Mark  
*University of Maryland School of Business*

Follow this and additional works at: <http://lawcommons.luc.edu/lucj>

 Part of the [Securities Law Commons](#)

---

### Recommended Citation

Gideon Mark, *Recanting Confidential Witnesses in Securities Litigation*, 45 Loy. U. Chi. L. J. 575 (2014).  
Available at: <http://lawcommons.luc.edu/lucj/vol45/iss3/5>

This Conference Article is brought to you for free and open access by LAW eCommons. It has been accepted for inclusion in Loyola University Chicago Law Journal by an authorized administrator of LAW eCommons. For more information, please contact [law-library@luc.edu](mailto:law-library@luc.edu).

## Recanting Confidential Witnesses in Securities Litigation

Gideon Mark\*

*This Article examines the contentious and recurring issue of how courts should handle confidential witnesses in securities litigation who recant the information attributed to them in complaints or deny that they ever provided such information to plaintiffs' counsel and/or investigators. The use by plaintiffs of confidential witnesses has become ubiquitous in recent years, as a primary unintended effect of the Private Securities Litigation Reform Act of 1995. That legislation raised the bar for pleading securities fraud and established an automatic stay of all discovery and other proceedings during the pendency of a motion to dismiss, absent application of one of two narrow exceptions. The vise-like combination of these features forces plaintiffs to plead their cases with particularity while barring them from obtaining discovery to bolster their scienter and other allegations until all motions to dismiss have been resolved. In response, plaintiffs have turned to confidential witnesses, who typically are current or former employees of the defendant. These witnesses provide information anonymously for use in complaints, mainly because they are fearful of retaliation by defendants. In a recent series of high-profile cases, courts have been confronted with allegations that plaintiffs' confidential witnesses either have recanted the information attributed to them, or denied ever providing such information. This Article examines the contrasting approaches taken by courts to alleged recanting, and provides some specific recommendations for avoiding or resolving this problem in the future.*

---

\* Assistant Professor of Business Law, University of Maryland School of Business. Professor Mark holds degrees from Brandeis University, Columbia University, Harvard University, New York University, and the University of California. Professor Mark thanks Dean Michael J. Kaufman for inviting him to participate in the Loyola University Chicago Annual Institute for Investor Protection Conference. He also thanks Douglas W. Greene for the valuable insight he provided during the drafting of this Article.

## TABLE OF CONTENTS

INTRODUCTION .....	576
I. THE INCIDENCE OF RECANTING .....	582
II. RECENT CASES INVOLVING ALLEGED RECANTING BY CONFIDENTIAL WITNESSES.....	584
A. Campo .....	584
B. SunTrust .....	585
C. Boeing .....	585
D. Lockheed.....	586
III. INSIGHTS FROM THE RECANTING CASES.....	588
A. <i>Courts Should Refuse to Permit the Depositions of CWs         While Motions to Dismiss are Pending</i> .....	588
B. <i>Plaintiffs' Counsel Should Participate in the Interviews         of Their CWs</i> .....	592
C. <i>Some CWs Falsely Recant Because They Feel Pressure         to Do So</i> .....	595
D. <i>False Recanting Occurs in Part Because Courts Permit         Discovery of Confidential Witnesses</i> .....	600
CONCLUSION.....	601

## INTRODUCTION

One of the primary unintended effects of the Private Securities Litigation Reform Act of 1995 (“PSLRA”)<sup>1</sup> has been the widespread use of confidential witnesses in class action securities litigation. Confidential witnesses (“CWs”) are typically current or former employees of the defendant company who anonymously provide information to plaintiffs for use in their class action complaints. The information, provided anonymously because the employees are fearful of retaliation, is usually used by plaintiffs to bolster scienter allegations.

Two specific aspects of the PSLRA have sparked the use of CWs in securities litigation. The first aspect is the PSLRA’s significantly higher bar for pleading securities fraud. The PSLRA amended the Securities Exchange Act<sup>2</sup> to impose two strict pleading requirements, both of which must be satisfied in order for a complaint to survive a

---

1. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

2. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a–78mm).

motion to dismiss. A private securities complaint involving an allegedly false or misleading statement must specify each statement alleged to be misleading, the reason(s) why the statement is misleading, and, if an allegation is made on information and belief, “all facts” on which that belief is formed.<sup>3</sup> In addition, the complaint must, with respect to each act or omission alleged to violate the securities laws, state with particularity facts giving rise to a “strong inference” that the particular defendant acted with the required state of mind.<sup>4</sup> The required state of mind is “scienter,” which the Supreme Court has defined as “a mental state embracing intent to deceive, manipulate, or defraud.”<sup>5</sup>

The second aspect is the PSLRA’s automatic stay of all discovery and other proceedings during the pendency of a motion to dismiss,<sup>6</sup> absent application of one of two statutory exceptions.<sup>7</sup> Congress created the stay to prevent plaintiffs from (1) commencing securities litigation with the intent to use the discovery process to coerce settlements and (2) commencing such litigation as a vehicle to conduct discovery in the hope of finding a sustainable claim.<sup>8</sup> The stay applies to both class actions and individual actions.<sup>9</sup> If a motion to dismiss by any defendant is pending, discovery is stayed for the entire case, even if there are multiple defendants, some of whom have had their motions to dismiss denied and/or have answered.<sup>10</sup> The stay encompasses

---

3. See 15 U.S.C. § 78u-4(b)(1) (2012).

4. *Id.* § 78u-4(b)(2).

5. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193–94 & n.12 (1976).

6. Pre-PSLRA, 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. Such motions were typically denied. Gideon Mark, *Federal Discovery Stays*, 45 U. MICH. J.L. REFORM 405, 434 (2012). Post-PSLRA, discovery is automatically stayed. The statute provides: “In any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.” 15 U.S.C. § 78u-4(b)(3)(B).

7. The two exceptions are when particularized discovery is necessary to preserve evidence or to prevent undue prejudice to the party seeking relief. *Id.* § 77z-1(b)(1); *id.* § 78u-4(b)(3)(B).

8. *In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1332 (3d Cir. 2002); *In re Thornburg Mortg., Inc. Sec. Litig.*, No. CIV 07-0815 JB/WDS, 2010 WL 2977620, at \*6 (D.N.M. July 1, 2010).

9. See, e.g., *Fazio v. Lehman Bros., Inc.*, Nos. 1:02 CV 157, 1:02 CV 370, 1:02 CV 382, 2002 WL 32121836, at \*2 (N.D. Ohio May 16, 2002) (“[B]y its plain language the statutory stay is not limited to class actions.”); *Med. Imaging Ctrs. of Am., Inc. v. Lichtenstein*, 917 F. Supp. 717, 719–21 (S.D. Cal. 1996) (holding that the PSLRA mandates a discovery stay in any private action where a motion to dismiss is pending).

10. See *Lane v. Page*, No. CIV 06-1071, 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

discovery during the pendency of motions to dismiss amended complaints<sup>11</sup> and motions for reconsideration of orders on motions to dismiss,<sup>12</sup> and it is of great practical significance. Original complaints are often amended multiple times in securities litigation, with the result that many months or even years can pass before discovery begins.<sup>13</sup> This is the typical pattern, because plaintiffs have generally failed in their efforts to have the PSLRA's automatic stay lifted, under either the first<sup>14</sup> or second<sup>15</sup> statutory exceptions.

The vise-like combination of the PSLRA's strict pleading requirements and discovery stay explains the ubiquity of CWs. Plaintiffs must plead their cases with particularity, but they are generally barred from obtaining discovery to bolster their scienter and other allegations before all motions to dismiss have been resolved.<sup>16</sup> The result has been almost universal reliance by plaintiffs in class action securities complaints on information provided by confidential

---

resolved.”); *Fazio v. Lehman Bros., Inc.*, Nos. 1:02 CV 157, 1:02 CV 370, 1:02 CV 382, 2002 WL 32121836, at \*2 (N.D. Ohio May 16, 2002) (holding that the stay applies even as to discovery against co-defendants who have not filed motions to dismiss). *But see* *Latham v. Stein*, 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).

11. *Selbst v. McDonald's Corp.*, No. 04 C 2422, 2006 WL 566450, at \*1 (N.D. Ill. Mar. 1, 2006).

12. *McGuire v. Dendreon Corp.*, No. C07-800-MJP, 2009 WL 666863, at \*1 (W.D. Wash. Mar. 11, 2009); *Powers v. Eichen*, 961 F. Supp. 233, 235–36 (S.D. Cal. 1997).

13. *See, e.g., In re SemGroup Energy Partners, L.P. Sec. Litig.*, No. 08-MD-1989-GFK-FHM, 2010 WL 5376262, at \*1 (N.D. Okla. Dec. 21, 2010) (“Thus, this lawsuit has been pending more than two years, during which time plaintiffs have been almost completely precluded from conducting discovery.”).

14. *See, e.g., In re Merrill Lynch & Co. Research Reports Sec. Litig.*, Nos. 02 MDL 1484(MP), 01 CV 6881(MP), 2004 WL 305601, at \*1 (S.D.N.Y. Feb. 18, 2004) (refusing to lift stay because defendants avowed they had taken all necessary steps to preserve all potentially relevant electronic evidence).

15. The most commonly asserted basis for a claim of undue prejudice is the existence of parallel litigation, or parallel criminal or regulatory investigations, which required class action defendants to produce documents to other plaintiffs, the government, or an investigating body. Courts usually reject this argument. *See, e.g., Kuriakose v. Fed. Home Loan Mortg. Co.*, 674 F. Supp. 2d 483, 486–87 (S.D.N.Y. 2009) (refusing to lift stay where about 400,000 documents had been produced by lead defendant during active investigations conducted by the Securities and Exchange Commission, the U.S. Attorney's Office, and a House of Representatives committee); *see also In re Schering-Plough Corp./Enhance Sec. Litig.*, No. 08-397, 2009 WL 1470453, at \*1 (D.N.J. May 19, 2009) (refusing to modify stay to permit plaintiffs to obtain documents previously produced to government regulators and investigators).

16. *See* Geoffrey P. Miller, *Pleading After Tellabs*, 2009 WIS. L. REV. 507, 530 (noting that the PSLRA's strict pleading requirements and stay “put[] a plaintiff in a vise: the pleading rules require particularized allegations and a strong inference of scienter while the discovery stay deprives the attorney of the conventional means to develop this information”).

witnesses.<sup>17</sup> Allegations based on such information often are the only specific allegations in a complaint supporting a claim of securities fraud.<sup>18</sup> At the same time that plaintiffs have become reliant on the information provided by CWs, courts have become increasingly skeptical of such witnesses.<sup>19</sup>

The common use of CWs in securities litigation has highlighted significant issues concerning pleading and discovery. One recurring issue is the extent to which the information provided by confidential witnesses must be discounted in the aftermath of the 2007 decision by the United States Supreme Court in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* (“*Tellabs*”).<sup>20</sup> In *Tellabs*, the 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 pleading requirement that plaintiffs state with particularity facts giving rise to a strong inference that defendants acted with the required state of mind. The Court held that that to qualify as “strong” an inference of scienter must be more than merely plausible or reasonable.<sup>21</sup> 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

---

17. See, e.g., Douglas H. Flaum & Israel David, *Disclosure of Confidential Witnesses in PSLRA Cases*, N.Y.L.J., May 31, 2012, at 1 (“Of the various tools employed by plaintiffs’ counsel in securities cases, few are more important than the use of confidential witnesses in complaints.”); Andrew W. Stern, Dorothy J. Spenner & Cameron Moxley, *Allowing Discovery of a Confidential Witness’s Identity*, LAW360 (Feb. 15, 2012), [http://www.sidley.com/files/Publication/038bbbf8-aa12-4c7c-a7d2-05b6341d0606/Presentation/PublicationAttachment/bab0c52c-2000-40b0-90eb-09805607f48b/REV\\_Allowing%20Discovery%20Of%20A%20Confidential%20Witness%20Identity%20\\_2\\_.pdf](http://www.sidley.com/files/Publication/038bbbf8-aa12-4c7c-a7d2-05b6341d0606/Presentation/PublicationAttachment/bab0c52c-2000-40b0-90eb-09805607f48b/REV_Allowing%20Discovery%20Of%20A%20Confidential%20Witness%20Identity%20_2_.pdf) (noting that CWs “are increasingly becoming the backbone of class action securities complaints”).

18. See THE ASS’N OF THE BAR OF THE CITY OF N.Y. SEC. LITIG. COMM., 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), available at <http://www.nycbar.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.); see also 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.”).

19. Michele Odorizzi, *Impact of the PSLRA on Securities Litigation*, ASPATORE, June 2013, available at 2013 WL 2137388, at \*4.

20. 551 U.S. 308 (2007).

21. *Id.* at 324.

opposing inference one could draw from the facts alleged.”<sup>22</sup>

The Supreme Court did not address the use of CWs. Nevertheless, numerous federal courts have applied *Tellabs* to assess the use of such witnesses. Many courts, following the lead of the Seventh Circuit in *Higginbotham v. Baxter, International, Inc.*,<sup>23</sup> have concluded that the information supplied by confidential witnesses in securities fraud complaints must be steeply discounted when deciding motions to dismiss.<sup>24</sup> Other courts have rejected *Higginbotham* and eschewed automatic discounting.<sup>25</sup>

---

22. *Id.*

23. 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. Perhaps these confidential sources have axes to grind. Perhaps they are lying. Perhaps they don’t even exist. . . . [A]llegations from ‘confidential witnesses’ must be discounted rather than ignored. Usually that discount will be steep.”).

24. *See, e.g.*, Minneapolis Firefighters’ Relief Ass’n v. MEMC Elec. Materials, 641 F.3d 1023, 1030 (8th Cir. 2011) (citing *Higginbotham* and disregarding allegations by CWs); *Ley v. Visteon Corp.*, 543 F.3d 801, 811 (6th Cir. 2008) (citing *Higginbotham* approvingly), *abrogated on other grounds by* *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1323-25 (2011); *Indiana Elec. Workers’ Pension Fund IBEW v. Shaw Grp., Inc.*, 537 F.3d 527, 535 (5th Cir. 2008) (“Following *Tellabs*, courts must discount allegations from confidential sources.”); Michael J. Kaufman & John M. Wunderlich, *The Judicial Access Barriers to Remedies for Securities Fraud*, 75 LAW & CONTEMP. PROBS. 55, 58 (2012) (“[T]here is a growing trend of discounting allegations that are based on confidential witness statements.”); David Artman, Note, *Who’s Behind Door Number One?: Problems with Using Confidential Sources in Securities Litigation*, 2011 U. ILL. L. REV. 1827, 1843 (noting *Higginbotham*’s strong influence).

25. *See, e.g.*, *Rahman v. Kid Brands, Inc.*, 736 F.3d 237, 244 (3d Cir. 2013). Although influential in other jurisdictions, *Higginbotham* has attracted significant criticism from commentators. *See, e.g.*, Michael J. Kaufman & John M. Wunderlich, *Congress, the Supreme Court and the Proper Role of Confidential Informants in Securities Fraud Litigation*, 36 SEC. REG. L.J. 345 (2008) (arguing that *Higginbotham* is inconsistent with *Tellabs*). The Seventh Circuit revisited the use of CWs approximately six months after *Higginbotham* was decided, when it considered *Tellabs* on remand from the Supreme Court. *See* *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702 (7th Cir. 2008) (“*Tellabs II*”). In that case, the Seventh Circuit purported to distinguish *Higginbotham* and its steep discounting of allegations based on information provided by CWs. 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 CWs 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. While *Tellabs II* can be and has been read to represent a retreat from *Higginbotham*, the earlier case is alive and well. Nothing in *Higginbotham* suggests that the Seventh Circuit’s holding concerning the steep discounting of allegations by confidential witnesses was limited to the specific facts of that case. Moreover, post-*Tellabs II* the Seventh Circuit restated the conclusions it drew in *Higginbotham*. *See* *City of Livonia Emps.’ Ret. Sys. & Local 295/Local 581 v. Boeing Co.*, 711 F.3d 754, 759 (7th Cir. 2013) (“Allegations concerning . . . unnamed confidential sources of damaging information require a heavy discount. The sources may be ill-informed, may be acting from spite rather than knowledge, may be misrepresented, may even be nonexistent—a gimmick for obtaining discovery costly to the defendants and maybe forcing settlement or inducing more favorable settlement terms.”).

A second recurring issue is whether the names of CWs are discoverable. Most courts have held that the PSLRA does not require plaintiffs to identify by name the anonymous sources they use in their complaints.<sup>26</sup> In general, however, the witnesses must be “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.”<sup>27</sup> Discovery is a different matter. Most federal district courts to consider the issue have held that the identities of confidential witnesses who provide information set forth in a securities fraud complaint are generally discoverable, once the PSLRA’s discovery stay has been lifted.<sup>28</sup> A sizable minority has held that the identities are protected from disclosure as attorney work product and/or on public policy grounds.<sup>29</sup> No federal appellate court had resolved the issue by early 2014.

A third recurring issue, which has become especially contentious in the last few years, is how courts should handle the problem of CWs who recant the information attributed to them in complaints, or deny that they ever provided such information, after their identities have been discovered. This third issue is the primary subject of this Article, which proceeds in three parts.

Part I examines the incidence of recanting by CWs in securities litigation, Part II considers four recent high-profile cases involving alleged recanting, and Part III discusses insights to be drawn from the recanting cases. The fundamental conclusions are four-fold: (a) courts should refuse to permit the depositions of CWs while motions to dismiss are pending and should decline to consider the affidavits of

---

26. See Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 J. CORP. L. 551, 558 (2011) (identifying federal circuit courts rejecting notion that CWs who provide information used in securities fraud complaints must be identified by name in the complaints).

27. See, e.g., *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000); *Dawes v. Imperial Sugar Co.*, No. H-11-3250, 2013 WL 5442109, at \*18 (S.D. Tex. Sept. 27, 2013). Courts do not permit plaintiffs to provide this information in camera, in lieu of setting it forth in a complaint. See Joseph C. Weinstein & Joseph P. Rodgers, *Unmasking Confidential Witnesses?*, LAW360 (June 23, 2010), <http://www.law360.com/articles/172877/unmasking-confidential-witnesses> (noting that the U.S. District Court for the Northern District of Illinois refused to allow plaintiffs to provide information regarding confidential witnesses in camera).

28. See generally Jennifer H. Rearden & Darcy C. Harris, *Growing Trend Favors Disclosure of Witnesses’ Identities*, 23 A.B.A. SEC. LITIG. (Fall 2012), available at <http://www.gibsondunn.com/publications/Documents/ReardenHarrisGrowingTrendFavorsDisclosureofWitnessesIdentities.pdf> (noting that courts have increasingly required confidential witnesses to reveal their identities during discovery).

29. See Flaum & David, *supra* note 17, at 1. See generally Jeff G. Hammel & Elizabeth R. Marks, *Confidential Witnesses: Reliable Source or Imaginary Friend?*, 45 SEC. REG. & L. REP. (BNA) 1300 (2013) (discussing district court split on discoverability of CWs).

allegedly recanting witnesses in connection with such motions; (b) plaintiffs' counsel should participate in the pre-filing interviews of their CWs, rather than delegating the task to their investigators; (c) some CWs who recant—perhaps many of them—do so falsely, under pressure; and (d) false recanting occurs in part because courts permit discovery of confidential witnesses.

### I. THE INCIDENCE OF RECANTING

As noted above, the PSLRA imposes an automatic stay of discovery and other proceedings while motions to dismiss are pending.<sup>30</sup> When the motions to dismiss are denied, the stay is lifted. In most cases defendants then seek discovery of plaintiffs' confidential witnesses, primarily to test whether the witnesses will confirm the information attributed to them in plaintiffs' complaint.<sup>31</sup> And, as noted above, the unmistakable trend is for federal district courts to permit such discovery to occur. When defendants ascertain the identities of CWs and depose them, the opportunity arises for the witnesses to recant, deny, or modify some or all of the information attributed to them by plaintiffs. In some recent high-profile cases, such recanting<sup>32</sup> has occurred, or has been alleged to have occurred. The new version of events can be used by defendants to support a motion for full or partial summary judgment. But, as indicated below, evidence of recanting often becomes available in the form of declarations or affidavits even before the discovery stay has been lifted. In these situations, the evidence has been used by defendants, properly or not, to support motions to dismiss under Rule 12(b) of the Federal Rules of Civil Procedure ("Federal Rules"), motions to strike under Rule 12(f), motions for reconsideration of denials of motions to dismiss, and/or motions for sanctions under Rule 11.

How common is recanting? There is some dispute about this. Some commentators believe that recanting is quite common.<sup>33</sup> But a review

---

30. See *supra* text accompanying notes 6–15.

31. See Carl H. Loewenson, Jr. & James J. Beha II, *Reliability of Confidential Witnesses in Securities Fraud Complaints*, N.Y.L.J., Sept. 30, 2013, at 2 ("Once a case proceeds to discovery, however, defendants are typically able to learn the identities of confidential witnesses and probe the accuracy of their statements.").

32. "Recanting" is sometimes characterized in criminal cases as an unequivocal repudiation of prior testimony. See, e.g., *United States v. Tobias*, 863 F.2d 685, 689 (9th Cir. 1988). In this Article, the term is sometimes used more broadly to also include denials that purported statements were ever made, and modifications of prior statements.

33. See, e.g., Jonathan C. Dickey & Brian M. Lutz, *The SEC's Final Whistleblower Rules: The Floodgates Open on a New Wave of Whistleblower Claims, as the SEC Authorizes Massive Bounties to Anonymous Tipsters*, 8 SEC. LITIG. REP. 1, 5 (2011) (asserting that CWs "have shown

of recent cases suggests the incidence of actual recanting may be lower than is often asserted. In some cases the declarations submitted by allegedly recanting CWs reflected only immaterial differences between the declarations and plaintiffs' complaints. For example, in *Minneapolis Firefighters' Relief Ass'n v. Medtronic*,<sup>34</sup> the court concluded that differences between the declarations of thirteen CWs and the allegations in plaintiffs' amended complaint were "mostly innocuous"<sup>35</sup> and, with regard to many of the witnesses, the declarations merely challenged the implications drawn in the complaint.<sup>36</sup> Similarly, in *Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Financial Corp.*,<sup>37</sup> the court, after reviewing affidavits from allegedly recanting CWs and the interview notes from plaintiffs' investigator, concluded that "nothing in the affidavit statements of the CWs contradict[s] the statements in the Amended Complaint."<sup>38</sup> And in *BankAtlantic Bancorp, Inc. Securities Litigation* ("BankAtlantic")<sup>39</sup> the

---

themselves to be far too easily coaxed by plaintiffs' counsel or their private investigators to misrepresent, exaggerate, or misstate the facts"); Alison Frankel, *The Confidential Witness Conundrum in Securities Class Actions*, REUTERS, Sept. 20, 2012 [hereinafter Frankel, *Confidential Witness Conundrum*], available at [http://investorshub.advfn.com/boards/read\\_msg.aspx?message\\_id=79784848](http://investorshub.advfn.com/boards/read_msg.aspx?message_id=79784848) ("[T]he truth is that just about every major securities class action firm has seen witnesses say one thing to plaintiffs' investigators and another to former employers after their identity is revealed."); Douglas W. Greene, *How to Solve the Flawed Confidential Witness Issue*, LAW360 (Apr. 8, 2013), <http://www.law360.com/articles/430766/how-to-solve-the-flawed-confidential-witness-issue> (referring to the "recurring and pervasive problem" of flawed CW allegations, but noting that many cases involve only "garden variety inaccuracies"); Kevin LaCroix, *The Confidential Witness Problem in Securities Litigation*, D&O DIARY (July 15, 2013, 4:18 AM), <http://www.dandodiary.com/2013/07/articles/securities-litigation/the-confidential-witness-problem-in-securities-litigation/> ("The pattern recurs often that after the dismissal motion is denied, and the witnesses' identities are known and their testimony is questioned, the witnesses recant.").

34. 278 F.R.D. 454, 463 (D. Minn. 2011).

35. *Id.* at 463–64.

36. *See id.* at 463 ("As with most of the witnesses, what [CW-12] takes issue with are the implications that can be drawn from the way Plaintiffs presented his statements or the information he gave them. But this disagreement does not amount to proof that Plaintiffs misrepresented anything.").

37. No. CV 10-J-2847-IPJ (N.D. Ala. Aug. 23, 2011) (order denying defendant's motion to reconsider and/or certify for interlocutory appeal).

38. *Id.* at 8. In a subsequent order, the court noted that plaintiffs' investigator provided the court with an eight-page signed affidavit, in which she asserted that the information she provided to plaintiffs' counsel for use in the complaint was true and correct. *See Local 703, I.B. of T. Grocery and Food Emps. Welfare Fund v. Regions Fin. Corp.*, No. CV 10-J-2847-S, 2012 WL 6049724, at \*3 (N.D. Ala. Dec. 4, 2012) (documenting the court's receipt of the signed affidavit). *But cf. In re Cabletron Sys., Inc. Sec. Litig.*, 239 F.R.D. 30, 34 (D.N.H. 2006) (noting that information in CW affidavits obtained by defendants was "far less incriminating" than the court had been led to believe by plaintiffs' second amended complaint).

39. 851 F. Supp. 2d 1299 (S.D. Fla. 2011), *aff'd sub nom.* Hubbard v. BankAtlantic Bancorp, Inc., 503 F. App'x 677 (11th Cir. 2012).

court found that, with respect to five of six CWs, there was no basis to conclude that the allegations attributed to them in the first amended consolidated complaint lacked evidentiary support.<sup>40</sup>

## II. RECENT CASES INVOLVING ALLEGED RECANTING BY CONFIDENTIAL WITNESSES

Courts confronted with alleged recanting by CWs in securities fraud cases have taken a variety of approaches. These contrasting approaches, taken in some of the most prominent cases involving this issue, are discussed below.

### A. Campo

*Campo v. Sears Holdings Corp.*<sup>41</sup> is one of the first major cases to consider the problem of flawed allegations by confidential witnesses. In *Campo*, former shareholders of Kmart Holding Corporation sued Sears Holdings Corporation (the legal successor to Kmart), the former chairman of Sears, and the former chief executive officer of Kmart for alleged securities violations. Plaintiff's complaint relied heavily on information provided by three confidential witnesses.<sup>42</sup> Defendants moved to dismiss, and that motion was denied without prejudice in 2008 based on information allegedly provided by the CWs.<sup>43</sup> Subsequently, the court ordered the depositions in 2009 of the CWs to determine whether they supported the allegations attributed to them in the complaint, and whether the motion to dismiss should have been granted. After considering only those allegations by the CWs that were corroborated by them in depositions,<sup>44</sup> the court reversed course and granted the motion to dismiss.<sup>45</sup> On appeal, the Second Circuit unanimously affirmed the judgment of the district court in an unpublished Summary Order. Citing *Higginbotham*, it found no error in the court's order that the confidential witnesses be deposed or in the court's consideration of their deposition testimony in weighing

---

40. *Id.* at 1312. However, the court reached a different conclusion with respect to the sixth CW. The court found a Rule 11 violation with respect to use by plaintiffs of this witness. Because the plaintiffs cited this CW as a source of information in only five paragraphs of the ninety-eight-page first amended consolidated complaint, the violation was de minimus, and defendants were awarded only the reasonable fees and expenses they incurred in deposing that witness and one-tenth of the reasonable fees and expenses they incurred in preparing their motion for sanctions. *Id.* at 1321–22.

41. 635 F. Supp. 2d 323 (S.D.N.Y. 2009), *aff'd*, 371 F. App'x 212 (2d Cir. 2010).

42. *Id.* at 335.

43. *Id.* at 330 n.54.

44. *Id.* at 330.

45. *Id.* at 336.

plaintiff's allegations.<sup>46</sup> According to the Second Circuit, 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."<sup>47</sup> However, the Second Circuit also remarked that anonymity frustrates the process for weighing inferences that was set forth in *Tellabs*.<sup>48</sup>

### B. SunTrust

In *Belmont Holdings Corp. v. SunTrust Banks, Inc.* ("SunTrust"),<sup>49</sup> plaintiff brought a putative class action against defendant SunTrust Banks, Inc., its auditor, and related defendants, alleging securities violations. Defendants successfully moved to dismiss, but plaintiff was given leave to amend. Defendants moved to dismiss the amended complaint, which included numerous allegations attributed to a CW, but that motion was unsuccessful.<sup>50</sup> Defendants later moved for reconsideration, on the basis of three declarations submitted by the confidential witness, who by that point was no longer anonymous.<sup>51</sup> In his declarations the CW contradicted several of the statements attributed to him in the amended complaint and denied having ever made such statements to plaintiff's investigators.<sup>52</sup> On the basis of these declarations the court granted the motion for reconsideration and dismissed the amended complaint.<sup>53</sup> The court found that, based on the CW's declarations, "the positions Plaintiff took in its Amended Complaint were misleading or, at least, unsupported."<sup>54</sup> The court did not, however, impose Rule 11 sanctions.<sup>55</sup>

### C. Boeing

Another prominent decision on this topic is the Seventh Circuit's 2013 opinion in the securities fraud class action against the Boeing Company.<sup>56</sup> In that case plaintiffs sued Boeing and two executives who

---

46. *Campo*, 371 F. App'x at 216 n.4.

47. *Id.* Under the Second Circuit's rules this decision does not have precedential effect, but may be cited.

48. *Id.*

49. 896 F. Supp. 2d 1210 (N.D. Ga. 2012).

50. *Id.* at 1217.

51. *Id.* at 1220–22.

52. *Id.*

53. *Id.* at 1233.

54. *Id.*

55. *Id.*

56. *City of Livonia Emps.' Ret. Sys. and Local 295/Local 581 v. Boeing*, 711 F.3d 754 (7th Cir. 2013).

allegedly deceived investors regarding stress tests conducted on Boeing's new 787-8 Dreamliner aircraft. The first amended complaint was dismissed without prejudice by the district court. The second amended complaint included four new paragraphs concerning a CW described as Boeing's senior structural analyst engineer and chief engineer. Expressly relying on the new allegations attributed to the CW, the district court denied defendants' motion to dismiss the second amended complaint.<sup>57</sup> Subsequently, the CW was identified and deposed, and he denied virtually everything that plaintiffs' investigator had reported.<sup>58</sup> In fact, he had never been a Boeing employee. He had been employed by a contractor for Boeing, but he denied that he ever worked on the Dreamliner 787-8, the model in question.<sup>59</sup> Moreover, none of the plaintiffs' lawyers had met or talked to the CW until six months after they filed the second amended complaint,<sup>60</sup> which included allegations based on information allegedly provided by him. Following his deposition the district court granted defendants' motion for reconsideration and dismissed the case with prejudice.<sup>61</sup> On appeal, the Seventh Circuit, in an opinion by Judge Richard Posner (who was part of the earlier *Higginbotham* panel), cited *Higginbotham*, affirmed the dismissal of the action, and remanded for consideration as to whether sanctions should be imposed on plaintiffs' lawyers under Rule 11.<sup>62</sup>

#### D. Lockheed

As of this writing the most recent opinion involving alleged recanting was issued post-settlement by Judge Jed Rakoff in July 2013 in the securities fraud class action against Lockheed Martin Corporation.<sup>63</sup> In that case, plaintiff, an institutional investor, sued Lockheed and some of

---

57. *City of Livonia Emps.' Ret. Sys. v. Boeing Co.*, No. 09 C 7143, 2011 WL 824604, at \*2 (N.D. Ill. Mar. 7, 2011).

58. 711 F.3d at 760.

59. *Id.*

60. *Id.*

61. *Boeing*, 2011 WL 824604, at \*5.

62. *Boeing*, 711 F.3d at 762. The PSLRA requires that upon final adjudication of private securities actions, courts shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) as to any complaint, responsive pleading, or dispositive motion. If a party is determined to have violated Rule 11, the PSLRA requires that sanctions be imposed after giving such party or attorney notice and an opportunity to respond. 15 U.S.C. § 78u-4(c) (2012). Following remand in *Boeing*, briefing on the sanctions issue was completed in December 2013. The district court had not resolved the issue by mid-March 2014.

63. *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, 952 F. Supp. 2d 633 (S.D.N.Y. 2013).

its directors and officers, principally alleging that defendants had made statements about the first-quarter 2009 performance of one of Lockheed's divisions that they knew were materially misleading.<sup>64</sup> Plaintiff's amended complaint relied heavily on information purportedly provided by multiple CWs, who were current or former Lockheed employees.<sup>65</sup> Defendants moved to dismiss, and that motion was denied,<sup>66</sup> in part on the basis of the information attributed to the CWs. Discovery then commenced. Defendants obtained the names of the CWs and deposed them. Defendants then moved for partial summary judgment, asserting that in their depositions several of the CWs had recanted or denied making the statements attributed to them. In response, plaintiff argued that if the CWs had changed their stories, this was only because Lockheed had pressured them to do so.<sup>67</sup>

Judge Rakoff *sua sponte* ordered plaintiff's investigator and the five CWs implicated by defendants' assertions to appear and testify in court at the October 2012 hearing on defendants' motion for summary judgment. After hearing testimony Rakoff denied defendants' motion in a summary order, with an opinion to follow.<sup>68</sup> The case then settled. Later, in July 2013, Rakoff issued a post-settlement opinion<sup>69</sup> explaining his denial of the motion for summary judgment and making some important observations about the CWs and the investigator in the case. With respect to the investigator, Judge Rakoff concluded that "[the investigator's] report of his findings to plaintiff's counsel was accurate in all material respects."<sup>70</sup> With respect to the CWs, Rakoff noted that their testimony "bore witness to the competing pressures this process has placed on [them] and the impact such pressures had had on their ability to tell the truth."<sup>71</sup> He also noted that some of the CWs "had been lured by the investigator into stating as 'facts' what often were merely surmises, but then, when their indiscretions were revealed, felt pressured into denying outright statements they had actually

---

64. *Id.* at 635.

65. *Id.*

66. *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, 875 F. Supp. 2d 359, 375 (S.D.N.Y. 2012).

67. *Lockheed*, 952 F. Supp. 2d at 636.

68. *See City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, No. 11 Civ. 5026(JSR), 2012 WL 6429784 (S.D.N.Y. Dec. 14, 2012) (denying defendants' motion for summary judgment without expressing opinion on the underlying merit of the pending "omnibus" motion for summary judgment).

69. *Lockheed*, 952 F. Supp. 2d at 633.

70. *Id.* at 637.

71. *Id.* at 636.

made.”<sup>72</sup> Judge Rakoff ultimately determined that the record did not support a finding of misconduct by plaintiff’s counsel or investigator.<sup>73</sup> Finally, Rakoff concluded that the combined effect of the PSLRA and cases like *Tellabs* was likely to make problems associated with the use of CWs “endemic.”<sup>74</sup>

### III. INSIGHTS FROM THE RECANTING CASES

The cases described above yield several insights and suggestions for best practices concerning the issue of confidential witnesses who recant. Those insights and suggestions are described below.

#### A. Courts Should Refuse to Permit the Depositions of CWs While Motions to Dismiss are Pending

The first insight concerns the *Campo* case, which permitted the depositions of CWs prior to resolving a motion to dismiss. In the aftermath of the Second Circuit’s decision in 2010, many defense lawyers expected and hoped that *Campo* would initiate a trend.<sup>75</sup> It did not, and that is appropriate, because *Campo* was decided incorrectly with respect to this issue.

Post-*Campo*, those courts to consider the issue have rejected attempts to depose CWs prior to resolving motions to dismiss. They have done so for multiple reasons. First, the PSLRA’s automatic discovery stay prohibits the taking of such depositions during the pendency of motions to dismiss.<sup>76</sup> Second, the consideration by a court of deposition testimony in this situation violates Rule 12(d) of the Federal Rules,

---

72. *Id.* at 637.

73. *Id.* at 637–38.

74. *Id.* at 638. Judge Rakoff gave final approval to the settlement two weeks later. See *City of Pontiac Gen. Emps.’ Ret. Sys. v. Lockheed Martin Corp.*, No. 11 Civ. 5026(JSR), 2013 WL 3796658 (S.D.N.Y. July 23, 2013) (holding that the proposed settlement was fair, reasonable, and adequate).

75. See Bryan B. House, *The Fact Pattern Behind the Boeing Class Action Grounding*, LAW360 (Apr. 2, 2013), <http://www.law360.com/articles/429130/the-fact-pattern-behind-the-boeing-class-action-grounding>; see also Loewenson & Beha, *supra* note 31, at 3 (“[W]hen defendants can identify with particularity potential inaccuracies or discrepancies in confidential witness statements, courts should permit pre-motion-to-dismiss discovery into the identity and reliability of confidential witnesses.”); Joseph C. Weinstein & Joseph P. Rodgers, *Unmasking Confidential Witnesses?*, LAW360 (June 23, 2010), <http://www.law360.com/articles/172877/unmasking-confidential-witnesses> (“Many securities litigators believe *Campo* is a step in the right direction.”).

76. See, e.g., *Belmont Holdings Corp. v. SunTrust Banks, Inc.*, 896 F. Supp. 2d 1210, 1217 n.6 (N.D. Ga. 2012) (noting court’s prior refusal to lift discovery stay to permit deposition of CW); *In re St. Jude Med., Inc. Sec. Litig.*, 836 F. Supp. 2d 878, 912 n.15 (D. Minn. 2011); *In re Cell Therapeutics, Inc.*, No. C10-414MJP, 2010 WL 4791808, at \*2 (W.D. Wash. Nov. 18, 2010).

which generally prohibits consideration of material beyond the pleadings in ruling on a Rule 12(b)(6) motion.<sup>77</sup> Third, the Second Circuit's assertion that anonymity frustrates the inference-weighting requirement set forth in *Tellabs* reflects an overbroad reading of the Supreme Court's decision, "which is confined to discussions of inferences drawn from the allegations of the complaint."<sup>78</sup> Fourth, the endorsement by the Second Circuit of the district court's approach in *Campo* was non-binding dicta.<sup>79</sup>

Courts have taken conflicting approaches when confronted with a closely-related issue: the submission of declarations or affidavits from recanting CWs whose identities have been uncovered by defendants before the discovery stay has been lifted. In *In re St. Jude Medical, Inc. Securities Litigation*,<sup>80</sup> defendants identified one of plaintiffs' CWs and submitted her affidavit during the pendency of a motion to dismiss. The affidavit asserted that the complaint misrepresented her recollections.<sup>81</sup> After expressing doubt about the propriety of addressing the factual accuracy of an affidavit on a Rule 12(b)(6) motion, the court decided to ignore the few allegations attributed solely to that witness.<sup>82</sup>

In *Waldrep v. ValueClick, Inc.*,<sup>83</sup> plaintiffs' securities class action complaint included information purportedly provided by six confidential witnesses.<sup>84</sup> After the complaint was filed, defendants independently identified, located, and interviewed the CWs. Defendants then obtained declarations from the six witnesses, which directly contradicted the information attributed to them in the complaint. Defendants moved to dismiss and for Rule 11 sanctions. Plaintiffs moved to strike the declarations, or alternatively, for discovery related to the Rule 11 motion.<sup>85</sup> The court denied the motions by both plaintiffs and defendants.<sup>86</sup>

---

77. *In re Cell Therapeutics, Inc.*, 2010 WL 4791808, at \*2; cf. *In re St. Jude Med.*, 836 F. Supp. 2d at 901 n.9 (expressing doubt about the propriety of addressing the factual accuracy of an affidavit submitted by a CW in connection with a Rule 12(b)(6) motion).

78. *In re Cell Therapeutics, Inc.*, 2010 WL 4791808, at \*1 n.2.

79. *Id.* at \*2. Commentators have been critical of *Campo*. See, e.g., Kaufman & Wunderlich, *supra* note 24, at 59 & n.22 (2012) (asserting that the decision violates both the PSLRA's discovery stay and Rule 12(d)).

80. 836 F. Supp. 2d at 878.

81. *Id.* at 901 n.9.

82. *Id.* The motion to dismiss was granted in part and denied in part. *Id.* at 912.

83. No. CV 07-05411 DDP (AJWx) (C.D. Cal. 2008) (order denying plaintiffs' motion to strike the declarations of the confidential witnesses).

84. *Id.* at 1.

85. *Id.* at 2.

86. *Id.*

In *In re ProQuest Securities Litigation* (“*ProQuest*”),<sup>87</sup> defendant ProQuest sought and obtained a declaration from a confidential witness who denied most of the allegations attributed to her in the first consolidated class action complaint. The federal district court concluded that by seeking and obtaining a declaration from that CW during the pendency of a motion to dismiss, ProQuest “engaged in discovery which was wholly improper.”<sup>88</sup> The court neither struck the offending declaration on the ground that it violated the discovery stay, nor imposed Rule 11 sanctions for pleading allegations in bad faith. Instead, when ruling on the dismissal motion, it chose to discount, but not ignore, the information attributed to the CW in the complaint.<sup>89</sup>

*In re Par Pharmaceutical, Inc. Securities Litigation*<sup>90</sup> (“*Par Pharmaceutical*”) is a fourth case raising this same issue. In this case, defendants moved for Rule 11 sanctions during the pendency of their motion to dismiss, on the basis of a declaration they obtained from plaintiffs’ CW-1. The witness claimed in her declaration that a private investigator hired by plaintiffs misquoted her, took information out of context, and ignored other information provided by her in order to make improper inferences and conclusions.<sup>91</sup> Plaintiffs moved to strike the declaration, on the basis that its submission violated the PSLRA’s automatic stay provision.<sup>92</sup> The court, after citing *ProQuest*’s “cautious approach,”<sup>93</sup> granted plaintiffs’ motion to strike the declaration submitted by CW-1 and denied defendants’ motion to strike the paragraphs in the second amended complaint that were based on the disputed information.<sup>94</sup>

The court in *Par Pharmaceutical* declined to endorse “any rule *per se*.”<sup>95</sup> The absence of such a rule has resulted in the judicial inconsistency exemplified by the cases discussed above. There should be a uniform approach to this issue, and it should be the same one taken by courts rejecting *Campo*. As indicated, those courts considering the issue have concluded, contrary to *Campo*, that permitting the depositions of CWs before the discovery stay is lifted violates the

---

87. 527 F. Supp. 2d 728 (E.D. Mich. 2007).

88. *Id.* at 740.

89. *Id.* The motion to dismiss was denied. *Id.* at 747.

90. No. 06-cv-3226 (PGS), 2009 WL 3234273 (D.N.J. Sept. 30, 2009).

91. *Id.* at \*11.

92. *Id.*

93. *Id.* at \*12.

94. *Id.* The case later settled. See *In re Par Pharm. Sec. Litig.*, No. 06-3226 (ES), 2013 WL 3930091, at \*8 (D.N.J. July 29, 2013) (approving final settlement following fairness hearing).

95. *Par Pharmaceutical*, 2009 WL 3234273, at \*12.

PSLRA. The same conclusion should apply with respect to the submission of declarations or affidavits from recanting CWs. The PSLRA requires that “all discovery and other proceedings” be stayed pending any motion to dismiss.<sup>96</sup> Courts have tended to interpret this provision broadly.<sup>97</sup> As such, the submission of a declaration from a recanting CW during the pendency of a motion to dismiss may constitute “discovery” or “other proceedings,” and thus fall within the ambit of the PSLRA’s stay. As noted, in *Par Pharmaceutical* the court did strike a recanting CW’s affidavit,<sup>98</sup> and in *ProQuest* the court concluded that by seeking and obtaining a declaration from a CW during the pendency of a motion to dismiss, defendant engaged in discovery which was wholly improper.<sup>99</sup> Other courts have held that the PSLRA’s automatic stay does not encompass investigatory interviews conducted during the pendency of a motion to dismiss.<sup>100</sup> But those cases can be distinguished, at least in part because they did not involve submission to the court of recanting affidavits. They merely involved interviews of prospective witnesses.<sup>101</sup>

In any event, whether or not a recanting confidential witness did make statements attributed to him in a complaint is essentially a credibility question,<sup>102</sup> and a motion to dismiss is not the proper vehicle to test the credibility of witnesses. The Supreme Court was clear in *Tellabs* that credibility assessments are within the purview of the ultimate trier of fact.<sup>103</sup> Accordingly, courts should decline to consider affidavits or declarations from recanting CWs when deciding motions to

---

96. 15 U.S.C. § 78u-4(b)(3)(B) (2012).

97. See, e.g., *Fazio v. Lehman Bros., Inc.*, Nos. 1:02CV157, 1:02CV370, 1:02CV382, 2002 WL 32121836, at \*2 (N.D. Ohio May 16, 2002) (observing that “the reference in the [PSLRA] statute to a stay of ‘all discovery’ is to be interpreted broadly”).

98. See *infra* notes 112–15 and accompanying text.

99. See *infra* note 109 and accompanying text.

100. See, e.g., *In re JDS Uniphase Corp. Sec. Litig.*, 238 F. Supp. 2d 1127, 1133–34 (N.D. Cal. 2002) (finding that plaintiffs had not established a justification for lifting the stay); *In re Tyco Int’l Ltd. Sec. Litig.*, No. 00-MD-1335-B, 2001 WL 3407521, at \*2–3 (D.N.H. Jan. 30, 2001) (denying a request to prohibit third party interviews).

101. See, e.g., *In re JDS Uniphase Corp.*, 238 F. Supp. 2d at 1133–34 (noting that the PSLRA does not prohibit interviewing prospective witnesses).

102. See *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1312 (S.D. Fla. 2011), *aff’d sub nom.* *Hubbard v. BankAtlantic Bancorp, Inc.*, 503 F. App’x 677 (11th Cir. 2012) (“Whether the confidential witnesses initially made the statements attributed to them in the complaints is essentially a credibility question.”); *Wu Group v. Synopsis, Inc.*, No. C 04-3580 MJJ, 2005 WL 1926626, at \*13 (N.D. Cal. Aug. 10, 2005) (“[W]hether the [CW] statements were made is essentially a credibility question.”).

103. The Supreme Court stated 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.” 551 U.S. 308, 328 (2007).

dismiss or motions to reconsider denials of motions to dismiss.

*B. Plaintiffs' Counsel Should Participate in the Interviews of Their CWs*

A common element in many of the securities cases involving CWs who recant, in whole or in part, is that the pre-filing interviews of the CWs were conducted only by investigators for plaintiffs' counsel, and not by counsel themselves. This was true, for example, in *Boeing*, where none of plaintiffs' lawyers met or spoke with their CW until six months after the filing of the operative second amended complaint.<sup>104</sup> It also was true in *BankAtlantic*, where class counsel relied on the detailed notes and memoranda provided by their investigators, who conducted the CW interviews.<sup>105</sup> And it was true in *Applestein v. Medivation, Inc.*<sup>106</sup> In that case the district court dismissed with prejudice a third amended securities fraud complaint based largely on information allegedly provided by three CWs.<sup>107</sup> The court concluded that the information attributed to two of the CWs contradicted information provided by these same witnesses in the prior second amended complaint, as well as information attributed to a third CW.<sup>108</sup> At the hearing on the motion to dismiss, plaintiffs' counsel acknowledged that neither they *nor their investigators* had spoken to two of the three CWs, and instead they relied on hearsay statements passed onto the third witness.<sup>109</sup> Similarly, in *SunTrust*, plaintiffs' confidential witness never met plaintiffs' investigators in person and apparently never communicated at all with plaintiffs' attorneys.<sup>110</sup>

The failure by counsel for plaintiffs to directly participate in the pre-filing interviews of the CWs that they plan to rely upon for the key allegations in their complaints does not by itself constitute a Rule 11 violation. An attorney has a non-delegable duty to analyze the facts and law that support a pleading or motion, but that duty does not extend to

---

104. See *supra* note 60 and accompanying text.

105. *BankAtlantic*, 851 F. Supp. 2d at 1311.

106. 861 F. Supp. 2d 1030 (N.D. Cal. 2012).

107. *Id.* at 1038–39, 1044.

108. *Id.* at 1038.

109. *Id.* at 1038–39.

110. See *Belmont Holdings Corp. v. SunTrust Banks, Inc.*, 896 F. Supp. 2d 1210, 1232 (N.D. Ga. 2012) (“It appears here that no lawyer representing Plaintiff ever met with or interviewed [the CW] about what he knew, whether he was credible, or even how long he actually worked for SunTrust and the currency of his knowledge.”); Loewenson & Beha, *supra* note 31 (noting that in *SunTrust*, the CW never met in-person with plaintiffs' investigators and never communicated at all with plaintiffs' counsel).

personally gathering the facts.<sup>111</sup> Nevertheless, the failure by plaintiffs' counsel to directly participate in the pre-filing interviews of CWs is a likely source of many of the problems that have developed in recent years. Any witness, confidential or not, may speculate or provide opinions, rather than facts. And an investigator may mistake a witness' conjecture for fact.<sup>112</sup> Later, when the investigator transmits his interview notes or report to counsel, this may result in the drafting of complaints that fail to reflect the CWs' factual knowledge. If counsel were to directly participate in the interviews, then the foregoing problems likely would be reduced, at least in part because an experienced litigator should be better-equipped than an investigator to distinguish conjecture from fact.<sup>113</sup> At the same time, the value of information provided by CWs would increase, perhaps significantly so. Of course, counsel could improperly interpret, infer, and/or extrapolate, based on information provided to them by a CW. But it is likely this would occur less often than when only the investigator conducts the interview.

Some plaintiffs' counsel have argued that it would be unethical for them to personally interview CWs, because it could subject them to being called to testify as witnesses in the securities litigation in which the information from the CWs is to be used.<sup>114</sup> This argument is meritless. If correct, the argument would preclude lawyers from evaluating the credibility of their own potential witnesses in any civil or criminal action.<sup>115</sup>

As a best practice, plaintiffs' counsel should conduct CW interviews in conjunction with counsel's investigators.<sup>116</sup> But this will not always

---

111. *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1311 (S.D. Fla. 2011), *aff'd sub nom.* *Hubbard v. BankAtlantic Bancorp, Inc.*, 503 F. App'x 677 (11th Cir. 2012).

112. Loewenson & Beha, *supra* note 31, at 3.

113. *See id.* (“[M]any problems raised by the use of confidential witnesses could be solved simply by requiring plaintiffs' counsel to take a more active role in assuring the reliability of pre-complaint factual investigations.”).

114. *See SunTrust*, 896 F. Supp. 2d at 1232 (noting that this argument would be a “dubious and unprecedented interpretation of any professional ethics code”).

115. *See id.* at 1232 n.21 (“Plaintiff's misguided interpretation of attorney participation in interviews would prohibit prosecutors from interviewing witnesses during criminal investigations and prohibit a responsible lawyer from evaluating witness credibility during the investigation of criminal charges or civil claims.”).

116. *See* Matthew Tolve, Christin Hill & William Alderman, *Say Hello to My Imaginary Friend! Judge Posner, Seventh Circuit Issue Stern Warning to Plaintiffs' Firms for Again Citing Bogus Confidential Witnesses*, ORRICK SEC. LITIG. & REG. ENFORCEMENT BLOG (Apr. 2, 2013), <http://blogs.orrick.com/securitieslitigation/2013/04/02/say-hello-to-my-imaginary-friend-judge-posner-seventh-circuit-issue-stern-warning-to-plaintiffs-firms-for-again-citing-bogus-confidential-witnesses/> (“[T]he takeaway is clear: plaintiffs' counsel needs to talk to the witnesses it cites in a

happen. At a minimum, if counsel refrain from participating directly in CW interviews, then they should ensure that their investigators follow best practices. In *Lockheed*, plaintiff's investigator did not meet with the confidential witnesses in-person, did not tape-record his telephone calls with them, and did not ask any member of his staff to join him on his telephone calls with the witnesses. Instead, the investigator chose to rely on his non-stenographic notes of the telephonic conversations, made contemporaneously as the calls took place.<sup>117</sup> As noted by Judge Rakoff, these interview practices "were less rigorous than would have been typical of, say, a federal law enforcement agent."<sup>118</sup> In *Lockheed*, the investigator's report of his findings was accurate in all material respects,<sup>119</sup> notwithstanding the foregoing. This may or may not have been the result of good fortune. As a matter of best practices, however, investigators interviewing CWs in securities cases should meet in-person with the witnesses and record the interviews or should conduct the interviews with at least one member of the investigator's staff also present and taking contemporaneous notes. If distance or other factors render in-person interviews unfeasible, then the telephonic interviews should be recorded.

Some members of the defense bar have suggested that courts should require complaints in securities cases to include factual allegations about the experience and reliability of the investigators that plaintiffs use, or about the pre-case investigation itself.<sup>120</sup> Such a requirement seems unnecessary, unduly burdensome, and difficult to apply. It is unclear, for example, what kind of allegations would suffice as to the reliability of an investigator. Moreover, requiring a complaint to include specific details about plaintiffs' pre-case investigation would risk the forced disclosure of attorney work product.

It also has been suggested that plaintiffs' counsel should be required to obtain from each of their CWs a declaration and/or a certification that he has read the complaint and agrees with the description of the

---

complaint, not rely exclusively on the reports of its investigators, even more so when those investigators express doubt about the information they've uncovered."). *But cf.* Max Stendahl, *Robbins Geller Says Boeing Suit Doesn't Warrant Sanctions*, LAW360 (Oct. 29, 2013), <http://www.law360.com/articles/483969/robbins-geller-says-boeing-suit-doesn-t-warrant-sanctions> (citing plaintiffs' counsel in *Boeing* for proposition that prosecutors commonly and properly delegate to investigators the task of interviewing witnesses).

117. *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, 952 F. Supp. 2d 633, 637 (S.D.N.Y. 2013).

118. *Id.*

119. *Id.*

120. *See* Loewenson & Beha, *supra* note 31 (proposing that courts require "factual allegations about investigators' experience and reliability or about the pre-case investigation itself").

information he has provided.<sup>121</sup> According to one proponent of this requirement, “it would prevent most CW problems, and make the ones that do arise much easier to resolve.”<sup>122</sup> It may indeed be the case, as suggested, that most credible CWs with accurate information to provide would want to provide a certification, to avoid the major disruption that can result if a complaint does not accurately reflect the witness’ account.<sup>123</sup> But this proposal may come accompanied by logistical problems. For example, if the certifications are to be filed contemporaneously with the filing of the complaint, they might need to be filed under seal and made inaccessible to defendants, to preserve the CWs’ anonymity at the pleading stage of litigation. If the certifications are not to be filed at the onset of a case, but instead to be held by plaintiffs’ counsel, certainly they should be discoverable once discovery commences.

More troublesome is the situation where a CW is identified by defendants, who submit a recanting declaration from one of plaintiff’s CWs during the pendency of a motion to dismiss or a motion for reconsideration following denial of a motion to dismiss. For the reasons indicated above, defendants should be precluded from submitting such a declaration. Arguably the submission violates the automatic stay. Moreover, submission of a recanting declaration, followed by unsealing (or submission) of the CW’s certification, would require the court to make a credibility determination in connection with a motion to dismiss. Again, for the reasons indicated above, such a determination should not be made at this stage of the litigation.

### *C. Some CWs Falsely Recant Because They Feel Pressure to Do So*

It is clear that some and perhaps much of the recanting by CWs that has taken place in recent years in securities cases has resulted from pressure and/or fear of retaliation by defendants. Counsel for plaintiffs in securities class actions assert that such recanting as a result of pressure is quite common.<sup>124</sup> Plaintiffs made a form of this argument in *Boeing*. According to plaintiffs, the CW lied at his deposition because

---

121. See Douglas W. Greene, *How to Solve the Flawed Confidential Witness Issue*, LAW360 (Apr. 8, 2013), <http://www.law360.com/articles/430766/how-to-solve-the-flawed-confidential-witness-issue> (discussing three reforms to solve the CW problem).

122. *Id.*

123. *Id.*

124. See, e.g., LaCroix, *supra* note 33 (citing unidentified leading plaintiffs’ lawyer for proposition that “confidential witnesses always recant, because of the financial and other pressure their employer can bring to bear on them, regardless of how precise, specific and detailed their prior testimony had been”).

he wanted to remain in the good graces of defendant Boeing.<sup>125</sup> Specifically, according to plaintiffs, the CW wanted to obtain a job with Boeing.<sup>126</sup> The Seventh Circuit rejected this argument, observing that “left unexplained is why he would not have wanted to remain in those good graces when he was interviewed by [plaintiffs’] investigator.”<sup>127</sup> A reasonable answer to that question is that when he was interviewed by plaintiffs’ investigator his identity as plaintiffs’ CW was unknown to Boeing. At his deposition, of course, his identity was known to Boeing, and the risk of falling out of favor with the company was substantially greater. As the court noted in *BankAtlantic*, discrepancies between statements attributed to a confidential witness in a complaint and the CW’s subsequent deposition testimony may be attributed to “the desire to remain in a former employer’s good graces once the protection of confidentiality has been removed.”<sup>128</sup>

The Second Circuit has observed that 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.<sup>129</sup> Numerous other courts have agreed.<sup>130</sup> This chilling effect and risk of retaliation are precisely why federal courts have adopted a general rule that CWs need not be identified by name in securities fraud complaints.<sup>131</sup> But even as the chilling effect and risk of retaliation have been minimized at the pleading stage, such adverse effects have multiplied as federal courts have permitted discovery of CWs both before (as in *Campo*) and after the PSLRA’s discovery stay has been lifted.

Retaliation can take many different forms, some more subtle than others, including: being fired, socially ostracized, intimidated,

---

125. *City of Latonia Emps.’ Ret. Sys. v. Boeing Co.*, 711 F.3d 754, 760 (7th Cir. 2013).

126. *See* Greene, *supra* note 33 (noting plaintiffs’ argument that CW’s recantation was caused by his desire to work directly for Boeing).

127. *Boeing*, 711 F.3d at 760.

128. *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1312 (S.D. Fla. 2011), *aff’d sub nom. Hubbard v. BankAtlantic Bancorp, Inc.*, 503 F. App’x 677 (11th Cir. 2012).

129. *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000).

130. *See, e.g., In re Cabletron Sys., Inc.*, 311 F.3d 11, 30 (1st Cir. 2002) (asserting that requiring plaintiffs to name their confidential internal corporate sources would “have a chilling effect on employees who provide information about corporate malfeasance”); *Selbst v. McDonald’s Corp.*, Nos. 04 C 2422, 04 C 3635, 04 C 3661, 2005 WL 2319936, at \*6 (N.D. Ill. Sept. 21, 2005) (same); *In re Initial Pub. Offering Sec. Litig.*, 220 F.R.D. 30, 37 (S.D.N.Y. 2003) (noting that the *Novak* rule “encourage[s] whistle-blowers to expose corporate wrong-doing by protecting them from retaliation”).

131. The adoption of this general approach is described in MICHAEL J. KAUFMAN, 26A SECURITIES LITIGATION: DAMAGES § 24:53.10 (2013).

demoralized, humiliated, demoted, or blacklisted; being denied a promotion, overtime, or benefits; and/or being formally disciplined, reassigned, or given a reduction in wages or hours.<sup>132</sup> And it is clear that the incidence of retaliation against whistleblowers is high. One study found that 82% of the whistle-blowing population had been fired, quit their job under duress, or had significantly altered responsibilities, as a result of their whistleblowing activities.<sup>133</sup> 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.<sup>134</sup>

Moreover, retaliation is not limited to current employees. Retaliation also is a serious issue for former employees—the category into which most CWs in securities litigation fall.<sup>135</sup> In an analogous situation, the Fifth Circuit has noted three reasons why the informant's privilege<sup>136</sup>

---

132. See C. FRED ALFORD, *WHISTLEBLOWERS: BROKEN LIVES AND ORGANIZATIONAL POWER* 31–32 (2001) (“The usual practice is to demoralize and humiliate the whistleblower, putting him or her under so much psychological stress that it becomes difficult to do a good job.”); Geoffrey C. Rapp, *Beyond Protection: Invigorating Incentives for Sarbanes-Oxley Corporate and Securities Fraud Whistleblowers*, 94 B.U. L. REV. 91, 120–21 (2007) (“Although the precise incidence of ostracism of whistleblowers is difficult to determine, researchers universally mention it as a leading consequence of blowing the whistle. . . . [S]ocial ostracism of whistleblowers is a more common retaliatory technique than adverse employment action.”); 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.”).

133. See Sarah Johnson, *Study: Sarbox Curbs Fraud Whistleblowing*, CFO.COM (Feb. 13, 2007), <http://www.cfo.com/article.cfm/8694488?f=related>.

134. See ALFORD, *supra* note 132, at 18–19 (“Somewhere between half and two-thirds of whistleblowers lose their jobs, . . . most never work in the field again. In some tight-knit fields there is an informal blacklist.”).

135. See, e.g., Alison Frankel, *Accusations of Confidential Witness Chicanery Backfire on Defense Lawyer*, REUTERS, Dec. 5, 2012, available at <http://blogs.reuters.com/alison-frankel/2012/12/05/accusations-of-confidential-witness-chicanery-backfire-on-defense-lawyer/> (noting that securities fraud complaints commonly rely on information from former employees).

136. Pursuant to *Rovario v. United States*, 353 U.S. 53 (1957), decided by the United States Supreme Court more than fifty 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. *Id.* at 59. The purpose of the privilege is the furtherance and protection of the public interest in effective law enforcement and to make retaliation as difficult as possible. See, e.g., *United States v. Abuhadra*, 389 F.3d 309, 324 (2d Cir. 2004) (“The government's strong and legitimate interest in protecting confidential sources from premature identification is undeniable. Identification not only compromises the government's ability to use such sources in other investigations, it may expose them to retaliation by those against whom they have cooperated.”). The informant's privilege is applicable in both criminal and civil cases. See, e.g., *Holman v. Cayce*, 873 F.2d 944, 946 (6th Cir. 1989) (“Although originally applied in the context of criminal proceedings, the ‘informer's privilege’ is also applicable in civil cases.”); *D.M. v. Cnty. of Berks*, No. 12-6762, 2013 WL 3939565, at \*6 (E.D. Pa. July 30, 2013) (same). *But see* *Higginbotham v. Baxter, Int'l*, 495 F.3d 753, 757 (7th Cir. 2007) (“There is no ‘informer's privilege’ in civil litigation.”). While the informer's privilege likely applies in both civil and criminal cases, in the former it applies to

should be applied with respect to former employees in cases involving the Fair Labor Standards Act (“FLSA”).<sup>137</sup> 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.”<sup>138</sup> Second, it is possible that a former employee could be subjected to retaliation if his new employer discovers that the employee previously cooperated with the government.<sup>139</sup> 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.<sup>140</sup> This risk of retaliation is not mere conjecture—most whistleblowers never work in their fields again.<sup>141</sup> In light of the foregoing factors, a number of courts have agreed that the FLSA protects both current and former employees from retaliation.<sup>142</sup>

It is frequently suggested that appropriate protective orders can protect CWs in securities cases who are fearful about safety or security.<sup>143</sup> But such orders do nothing to protect against the risk of retaliation described above. They also do nothing to protect against the pressure exerted by defense counsel who interrogate CWs during their depositions about possible breaches of the confidentiality clauses in

---

statements given to federal investigators but not to statements given to private attorneys. *See* *Hubbard v. BankAtlantic Bancorp, Inc.*, No. 07-61542-CIV, 2009 WL 3856458, at \*5 (S.D. Fla. Nov. 17, 2009) (“While there may be a privilege that protects persons who give statements to government investigators in the civil context, there is no such privacy for private civil litigation.”).

137. Fair Labor Standards Act of 1938, Pub. L. No. 75-718, 52 Stat. 1060 (codified as amended in scattered sections of 29 U.S.C.).

138. *Hodgson v. Charles Martin Inspectors of Petroleum, Inc.*, 459 F.2d 303, 306 (5th Cir. 1972); *accord* *Dole v. Int’l Ass’n Managers, Inc.*, No. 90-0219PHX RCB, 1991 WL 270194, at \*3 (D. Ariz. Apr. 2, 1991) (discussing how an informant will likely face difficulties in gaining future employment in large part due to the difficulty the witness may have obtaining adequate references from his or her previous employer).

139. *Hodgson*, 459 F.2d at 306.

140. *Id.*; *accord* *Dole*, 1991 WL 270194, at \*3.

141. *Rapp*, *supra* note 132, at 118.

142. *See, e.g.*, *Darveau v. Detecon, Inc.*, 515 F.3d 334, 343 (4th Cir. 2008) (noting that the FLSA protects both current and former employees from retaliation); *Phillips v. M.I. Quality Lawn Maint., Inc.*, No. 10-20698, 2010 WL 4237619, at \*4-6 (S.D. Fla. Oct. 21, 2010) (rejecting the argument that retaliation claims must be dismissed when brought by former employees); *Dole*, 1991 WL 270194, at \*3 (explaining that the threat of retaliation exists for former employees); *Donovan v. Forbes*, 614 F. Supp. 2d 124, 126 (D. Vt. 1985) (stating that present or former employees who have provided information to the Department of Labor under the FLSA are protected from disclosure).

143. *See, e.g.*, *Loewenson & Beha*, *supra* note 31 (“Witnesses with legitimate concerns about safety or security can be protected by appropriate protective orders.”).

their severance agreements.<sup>144</sup> Under Rule 26(c)(1) of the Federal Rules, a protective order must be premised on good cause,<sup>145</sup> and 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.<sup>146</sup> Courts generally decline to find such injury, especially where the CW is a former employee.<sup>147</sup>

In *Boeing*, the merits of plaintiffs' argument that their CW lied at his deposition to remain in Boeing's good graces are unclear.<sup>148</sup> In other cases, however, it is apparent that recanting witnesses have falsely recanted under pressure. In *Lockheed*, plaintiff argued that the recanting CWs had changed their stories "because of financial and other pressures Lockheed had brought to bear upon them once they had been identified by name."<sup>149</sup> Judge Rakoff's careful opinion suggests that plaintiff was correct, at least in part. As the opinion notes, some of the CWs "felt

---

144. See Frankel, *Confidential Witness Conundrum*, *supra* note 33 ("[I]t's one thing for [CWs] to talk to plaintiffs' investigators. It's another for them to stick by their allegations when their former employers' lawyers start grilling them in depositions about the confidentiality provisions in their severance agreements.").

145. See FED. R. CIV. P. 26(c)(1) (stating that a court may, for good cause, issue a protective order).

146. See, e.g., *In re Marsh & McLennan Sec. Litig.*, No. 04 Cv. 8144(SWK), 2008 WL 2941215, at \*5 (S.D.N.Y. July 30, 2008) (stating that the 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 the 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.*, No. C01-20418JW, 2005 WL 1459555, at \*7 (N.D. Cal. June 21, 2005) ("Plaintiffs have not provided any evidence indicating that there is a real fear of retaliation from Cisco."); *In re Aetna Inc. Sec. Litig.*, No. CIV. A. MDL 1219, 1999 WL 354527, at \*5 (E.D. Pa. May 26, 1999) (denying protective order because plaintiffs failed to make specific showing that defendant "ha[d] attempted to intimidate individuals connected with this case or ha[d] a history of such intimidation in other cases").

147. See, e.g., *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron, Inc.*, 278 F.R.D. 335, 344 (S.D.N.Y. 2011) (rejecting the applicability of protective orders to guard against the risk of retribution by CWs' current, future, or past employers); Flaum & David, *supra* note 17, at 2 (noting that courts are reluctant to find a realistic possibility of retaliation if the CWs are no longer employed by the defendant).

148. What is clear is that, as noted above, contrary to plaintiffs' allegations, their CW had never been employed by the company, and he had never been interviewed by plaintiffs' counsel before his deposition was taken. See *supra* notes 125–27; see also Paul C. Gluckow & David B. Edwards, *Recent Trends Regarding the Use of Confidential Witnesses in Securities Litigation*, 45 REV. SEC. & COMMODITIES REG. 141, 144 (2012) ("At best, a recanting confidential witness creates discrepancies that plaintiffs can attempt to explain away through faulty memory, the passage of time, or a whistleblower's desire to stay in the good graces of the defendant. But, at worst—in [*Boeing*], for example—a recanting confidential witness can result in dismissal and/or sanctions due to lack of adequate evidentiary support.").

149. *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, 952 F. Supp. 2d 633, 636 (S.D.N.Y. 2013).

pressured into denying outright statements they had actually made.”<sup>150</sup> The opinion also notes that there was only one statement attributed to the CWs in the amended complaint that was clearly inaccurate, and that was the result of a drafting error by counsel that was later corrected.<sup>151</sup>

Another example is *In re Dynex Capital, Inc. Securities Litigation* (“*Dynex*”).<sup>152</sup> In *Dynex* the court denied in part a motion to dismiss the second amended complaint, relying heavily on a number of allegations that were purportedly derived from statements of nine CWs. Discovery then took place. Near the close of discovery lead plaintiff identified the nine CWs.<sup>153</sup> Defendants moved for case-dispositive sanctions after five of the CWs provided declarations asserting that they did not make the statements attributed to them in the second amended complaint, and a sixth CW declared that he had no recollection of making the statements attributed to him.<sup>154</sup> In response, plaintiffs’ counsel submitted declarations stating that they had interviewed the CWs and all of the paragraphs in the second amended complaint accurately reflected what was communicated in their interviews. They also submitted their notes of their purported interviews with the CWs.<sup>155</sup> The court denied the motion for case-dispositive sanctions, noting, *inter alia*, that the interview notes did not contradict the declarations submitted by plaintiffs’ counsel.<sup>156</sup> Importantly, the court also accepted as plausible scenarios both that (1) some of the CWs recanted to remain in the good graces of Dynex, their former employer,<sup>157</sup> and (2) the CWs may have been pressured by defense counsel to change their statements.<sup>158</sup>

*D. False Recanting Occurs in Part Because Courts Permit Discovery of Confidential Witnesses*

As noted above, some and perhaps much of the recanting by CWs in securities cases that has occurred in recent years has been a direct result of pressure and/or fear of retaliation by defendants. In turn, the opportunity for this pressure to be exerted is a direct result of the unmistakable trend for courts to compel discovery of the names of

---

150. *Id.* at 637.

151. *Id.* at 637–38.

152. No. 05 Civ. 1897(HB)(DF), 2011 WL 2581755 (S.D.N.Y. Apr. 29, 2011), *adopted by* 2011 WL 2471267 (S.D.N.Y. June 21, 2011).

153. *Id.* at \*2.

154. *Id.*

155. *Id.*

156. *Id.* at \*4.

157. *Id.*

158. *Id.* at \*4 n.7.

confidential witnesses once the discovery stay has been lifted (and sometimes earlier). Most federal district courts to have considered the issue now reject the argument that the identities of CWs are protected from disclosure by the attorney work product doctrine or on public policy grounds.<sup>159</sup> Accordingly, once a case proceeds to discovery, defendants are typically able to unmask the witnesses. This environment fosters an atmosphere in which defendants are able to pressure their current and former employees to recant. Perhaps it is time for courts to reexamine the discoverability of CW identities.

#### CONCLUSION

As Judge Rakoff noted in *Lockheed Martin*, the widespread use of confidential witnesses in securities litigation is an unintended consequence of the PSLRA (and cases like *Tellabs*).<sup>160</sup> Judge Rakoff concluded that problems associated with the use of CWs are likely to become endemic.<sup>161</sup> One such problem is recanting by the witnesses. Recanting may not occur as often as some observers suggest, but it has occurred on a number of occasions. And some percentage, perhaps a substantial percentage, of this recanting is false. Various solutions to the problem of flawed CWs have been proposed, but some of these proposals are as flawed as the witnesses. Permitting the depositions of CWs prior to the resolution of motions to dismiss is both unwise and contrary to the express provisions of the PSLRA. Likewise, courts should decline to consider declarations by recanting CWs in the context of motions to dismiss. One solution that could prove effective is for plaintiffs' counsel to actively participate in the interviews of each of the CWs whom they intend to use as source material for allegations in their complaints, rather than delegating the interviews to their investigators. Such participation is likely to solve many of the current problems. A second possible solution is for plaintiffs' counsel to obtain from each of their CWs a certification that he or she has read the complaint and agrees with the description of the information he or she provided. This proposal has some logistical problems, but if those can be overcome, it may prove viable. Finally, it may be time for courts to reconsider their current majority view that the identities of CWs in securities cases are discoverable, even if the witnesses will not testify at trial. Limiting

---

159. See, e.g., *In re Bear Stearns Cos., Inc. Sec., Derivative, and ERISA Litig.*, No. 08 MDL No. 1963, 2012 WL 259326, at \*3 (S.D.N.Y. Jan. 27, 2012) (citing cases finding no work product protection for identities of CWs).

160. *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, 952 F. Supp. 2d 633, 638 (S.D.N.Y. 2013).

161. *Id.*

discoverability, as some courts currently do, could help solve the problem of false recanting.