

CONFIDENTIAL WITNESS INTERVIEWS IN SECURITIES LITIGATION*

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INTRODUCTION	789
I. THE IMPORTANCE OF CONFIDENTIAL WITNESSES IN SECURITIES LITIGATION	792
II. CONFIDENTIALITY, SEPARATION, AND SEVERANCE AGREEMENTS	797
III. RECANTING WITNESSES	804
A. <i>Coercion of Recanting Statements</i>	805
B. <i>Best Practices to Minimize Recanting</i>	808
IV. DISCOVERABILITY OF CW INTERVIEW NOTES	817
CONCLUSION	822

INTRODUCTION

This Article examines the widespread use of confidential witnesses (“CWs”) in securities class action litigation¹ following the

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1. Such litigation is both common and costly. During the period of January 1996 to December 2017, approximately 244 securities class action cases were filed on average each year, excluding so-called IPO laddering cases. STEFAN BOETRICH & SVETLANA STARYKH, NERA ECON. CONSULTING, RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION: 2017 FULL-YEAR REVIEW 2 (2018), http://www.nera.com/content/dam/nera/publications/2018/PUB_Year_End_Trends_Report_0118_final.pdf [<https://perma.cc/VLJ5-XZS2>]. “The total value of settlements approved by courts [in securities class action cases] in 2016 was more than \$5.9 billion, almost double the amount approved in 2015.” LAARNI T. BULAN, ELLEN M. RYAN & LAURA E. SIMMONS, CORNERSTONE RESEARCH, SECURITIES CLASS ACTION SETTLEMENTS: 2016 REVIEW AND ANALYSIS 3 (2017), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Settlements-2016-Review-and-Analysis> [<http://perma.cc/F67E-EDEL>]. Securities class action litigation continued at a robust pace in 2017. Plaintiffs filed a record 412 federal securities class action cases in 2017. This number was 52% greater than in 2016 and more than double the 1997-2016 average. So-called “core” filings (those excluding merger and acquisition claims) increased to 214, 15% more than in 2016. See CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2017 YEAR IN REVIEW 5 (2018), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2017-YIR> [<https://perma.cc/JU56-3WSY>].

enactment of the Private Securities Litigation Reform Act of 1995 (“PSLRA”).² CWs are current or former employees (or, less frequently, customers or suppliers) of the defendant company who provide information to plaintiffs for use in their class action complaints,³ typically in an effort to bolster scienter⁴ or falsity⁵ allegations, or both.⁶ This information is furnished anonymously, in the sense that the CWs are not identified by name in the pleadings.⁷ Anonymity is provided because the witnesses are fearful of retaliation by the defendant companies against which they are providing information.⁸ Federal courts have accepted this pleading practice in

2. 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.).

3. *In re Boff Holding Inc.*, Sec. Litig., No. 3:15-CV-02324-GPC-KSC, 2016 WL 5390533, at *30–31 (S.D. Cal. Sept. 27, 2016) (“Confidential witnesses are typically current or former employees, customers, or suppliers, who are fearful of retaliation if their identities are disclosed.” (citing Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 J. CORP. L. 551, 554–55 (2011))); Jeff G. Hammel & Elizabeth R. Marks, *Confidential Witnesses: Reliable Source or Imaginary Friend?*, 45 Sec. Reg. & L. Rep. (BNA) (July 15, 2013), <https://www.bloomberglaw.com/product/blaw/document/x6dbe5og000000> [<http://perma.cc/R2CW-ANVT> (staff-uploaded archive)] (explaining that CWs are “usually former company employees anonymously providing information to plaintiffs for use in their complaints”); Gideon Mark, *Confidential Witnesses in Securities Litigation*, 36 J. CORP. L. 551, 554–55 (2011) (describing CWs as “current or former employees, customers, or suppliers fearful of retaliation if their identities are disclosed”).

4. *See, e.g.*, *Cutler v. Kirchner*, 696 Fed. App’x 809, 815 (9th Cir. 2017) (determining that the plaintiff successfully used allegations attributed to CW to plead scienter against multiple defendants); *Robb v. Fitbit, Inc.*, 216 F. Supp. 3d 1017, 1032 (N.D. Cal. 2016) (“Here, statements by CW 1 and CW 2 are sufficient to establish scienter.”).

5. *See, e.g.*, *In re Stratays Ltd. S’holder Sec. Litig.*, 864 F.3d 879, 883–84 (8th Cir. 2017) (showing that the plaintiffs sought to use CW statements only to establish falsity).

6. *See, e.g.*, *In re Boff Holding, Inc. Sec. Litig.*, No. 3:15-CV-02324-GPC-KSC, 2017 WL 2257980, at *7–13 (S.D. Cal. May 23, 2017) (concluding that information provided by CWs helped establish both falsity and scienter).

7. *See* Robert L. Hickok & James H. S. Levine, *Confidential Witness Statements Post-Tellabs*, PEPPER HAMILTON LLP (June 29, 2010), <http://www.pepperlaw.com/publications/confidential-witness-statements-post-tellabs-2010-06-29/> [<http://perma.cc/L9LB-RCBC>] (discussing the prevalent use of statements from confidential sources in pleadings and explaining such statements are only secured “by ensuring their anonymity”).

8. *See, e.g., id.* (observing that the only way to secure the testimony of current or former employees concerned about retaliation by defendants is to ensure their anonymity). “Retaliation can take many different forms . . . including: being fired, socially ostracized, intimidated, 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.” Gideon Mark, *Recanting Confidential Witnesses in Securities Litigation*, 45 LOY. U. CHI. L.J. 575, 596–97 (2014). The risk of retaliation confronts both current and former whistleblowing employees. *See* Joel H. Bernstein & Eric D. Gottlieb, *Developments in Securities Class Actions—Confidential Witnesses: Increasing Judicial Scrutiny, Discovery, and Millennial Media 2–3* (Mar. 2016) (unpublished manuscript) (on file with North Carolina Law Review) (“Former employees, such as the vast majority of CWs, also can face retaliation.”); Jed S. Rakoff, *Confidential Informants and Securities*

recognition of the risk of retaliation.⁹ While there is some variation between the federal circuits, generally the use of CWs to establish scienter is permissible so long as: (1) the witnesses are described with sufficient particularity to establish their reliability and personal knowledge, and (2) the statements attributed to them are indicative of scienter.¹⁰ The required descriptions often ease the task for defendants to ascertain the witnesses' identities.¹¹

While federal courts have accepted the use of confidential witnesses in securities litigation, that acceptance has been begrudging. Indeed, the Fifth¹² and Seventh¹³ Circuits steeply discount (but do not

Class Actions: Mixed Messages and Motives, 45 LOY. U. CHI. L.J. 571, 572–73 (2014) (observing that the risk of retaliation against CWs “is a genuine problem, even for former employees,” but adding that former employees have “a strong motive to gripe, and to exaggerate”). The risk of retaliation is substantial. “One 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.” See Mark, *supra*, at 597. “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.” *Id.*

9. See, e.g., *In re Cabletron Sys., Inc.*, 311 F.3d 11, 30 (1st Cir. 2002) (observing that requiring plaintiffs to name their confidential internal corporate sources would have a chilling effect on employees who provide “information about corporate malfeasance” (citing *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000))); *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000) (“Imposing a general requirement of disclosure of confidential sources . . . [in complaints] could deter informants from providing critical information to investigators in meritorious cases or invite retaliation against them.”).

10. See, e.g., *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1144–45 (9th Cir. 2017); *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 995 (9th Cir. 2009); *Novak*, 216 F.3d at 314 (“[A] complaint can meet the new pleading requirement imposed by paragraph (b)(1) by providing . . . a sufficient general description of the personal sources of the plaintiffs’ beliefs.”). Plaintiffs in securities class action litigation often struggle when using CWs to establish scienter. See, e.g., *In re Biogen Inc. Sec. Litig.*, 857 F.3d 34, 42–43 (1st Cir. 2017) (holding that CW statements fail to “give rise to strong inference of scienter”); *In re Lifelock, Inc., Sec. Litig.*, 690 F. App’x 947, 953 (9th Cir. 2017) (concluding that CW statements “fail to create an inference of scienter more cogent or compelling than an alternative innocent inference” (quoting *Zucco*, 552 F.3d at 999–1000)); *Hong v. Extreme Networks, Inc.*, No. 15-cv-04883-BLF, 2017 WL 1508991, at *19 (N.D. Cal. Apr. 27, 2017) (holding that statements of three CWs fail to establish scienter); *Fadia v. FireEye, Inc.*, No. 5:14-cv-05204-EJD, 2016 WL 6679806, at *22 (N.D. Cal. Nov. 14, 2016) (“Upon review, however, it is clear that the CW statements fail to establish a strong inference of scienter.”).

11. See Leigh Handelman Smollar, *The Struggle Over the Use of Confidential Witnesses*, POMERANTZ MONITOR (Pomerantz LLP, New York, N.Y.), May–June 2014, at 4, <http://pomerantzlzawfirm.com/assets/monitor/0506-2014.pdf> [<http://perma.cc/FRF4-VHM7>] (“Because the [PSLRA] requires plaintiffs to plead the details of the CW’s position and ability to know the facts alleged, the defendants often can figure out who the CWs are.”).

12. See, e.g., *Ind. Elec. Workers’ Pension Tr. Fund IBEW v. Shaw Grp., Inc.*, 537 F.3d 527, 535 (5th Cir. 2008) (“[C]ourts must discount allegations from confidential sources.” (citing *Higginbotham v. Baxter Int’l, Inc.*, 495 F.3d 753, 756–57 (7th Cir. 2007))); *Izadjoo v. Helix Energy Sols. Grp., Inc.*, 237 F. Supp. 3d 492, 510 (S.D. Tex. 2017) (“Even when a

automatically reject) allegations from CWs. Beyond discounting, the use of CWs has raised a host of thorny legal issues. This Article considers three of those issues, all of which relate to the pre-filing interviews of CWs conducted by plaintiffs' counsel and/or investigators. The three issues are: (1) the use by defendants of confidentiality, separation, and severance agreements to discourage or bar interviews of employees or former employees by plaintiffs' counsel or investigators; (2) interview practices that give rise to alleged recanting by CWs; and (3) efforts by defendants to obtain notes of witness interviews conducted by plaintiffs' counsel or investigators.

I. THE IMPORTANCE OF CONFIDENTIAL WITNESSES IN SECURITIES LITIGATION

Before addressing the three key legal issues identified, this Article first considers the critical role played by CWs in securities litigation. Two specific aspects of the PSLRA have sparked the ubiquitous use of CWs in securities litigation. The first is the statute's creation of an elevated bar for pleading securities fraud.¹⁴ The PSLRA amended the Securities Exchange Act¹⁵ to impose two strict pleading requirements, both of which must be satisfied in order for a complaint to survive a 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

complaint sets out this type of information, the Fifth Circuit has applied *Tellabs* to require district courts to 'discount allegations from confidential sources' because these 'sources afford no basis for drawing plausible competing inferences.'" (quoting *Shaw Grp.*, 537 F.3d at 535)).

13. See, e.g., *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' Perhaps these confidential sources have axes to grind. Perhaps they are lying. Perhaps they don't even exist."); see also *Doshi v. Gen. Cable Corp.*, 823 F.3d 1032, 1037 n.2 (6th Cir. 2016) ("[C]ourts often discount information provided by anonymous sources." (citing *Higginbotham*, 495 F.3d at 756–57)); *Shoemaker v. Cardiovascular Sys., Inc.*, No. 16-568 (DWF/KMM), 2017 WL 1180444, at *8 (D. Minn. Mar. 29, 2017) (noting that courts routinely disregard the statements of CWs when deciding motions to dismiss); *Vallabhaneni v. Endocyte, Inc.*, No. 1:14-cv-01048-TWP-MJD, 2016 WL 51260, at *15–16 (S.D. Ind. Jan. 4, 2016) ("The Seventh Circuit has reacted strongly against reliance on confidential witnesses in securities fraud cases, noting that allegations from such witnesses are to be steeply discounted." (citing *Higginbotham*, 495 F.3d at 757)). But cf. Leigh Handelman Smollar, *The Importance of Conducting Thorough Investigations of Confidential Witnesses in Securities Fraud Litigation*, 46 LOY. U. CHI. L.J. 503, 510 (2015) ("It appears that most courts, including the Second, Third, Fifth, and Ninth Circuits, have abandoned the 'heavily discounted' language of *Higginbotham*.").

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

15. §§ 78a–78qq.

the statement is misleading, and, if an allegation . . . is made on information and belief, . . . all facts on which that belief is formed.”¹⁶ In addition, the complaint must, with respect to each act or omission alleged to violate the securities laws, state with particularity facts giving rise to a strong inference that the particular defendant acted with the requisite scienter,¹⁷ which the Supreme Court has defined as “a mental state embracing intent to deceive, manipulate, or defraud.”¹⁸

The second relevant change mandated by the PSLRA is the imposition of an automatic stay of all discovery and other proceedings during the pendency of a motion to dismiss,¹⁹ absent application of one or two statutory exceptions. The two exceptions are when particularized discovery is necessary to preserve evidence or to prevent undue prejudice to the party seeking relief.²⁰ Congress created the stay to prevent plaintiffs from commencing securities litigation (1) with the intent to use the discovery process to coerce settlements and (2) as a vehicle to conduct discovery in the hope of finding a sustainable claim.²¹ Federal courts have taken a broad view of both the application of the PSLRA discovery stay and the time when the stay comes into effect.²² If a motion to dismiss by any defendant is pending, discovery is stayed for the entire case, even if some of the claims are asserted under state law.²³ The stay

16. § 78u-4(b)(1).

17. § 78u-4(b)(2)(A).

18. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976).

19. § 78u-4(b)(3)(B). Pre-PSLRA, “defendants in federal securities cases were required to participate in discovery during the pendency of motions to dismiss.” Gideon Mark, *Federal Discovery Stays*, 45 U. MICH. J. L. REFORM 405, 433–34 (2012). “Defendants could avoid discovery only by moving for a protective order, requesting a stay, and showing good cause under [Federal Rule of Civil Procedure] Rule 26(c). Such motions were typically denied.” *Id.* at 434 (footnote omitted). Post-PSLRA, discovery is automatically stayed. § 78u-4(b)(3)(B) (“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.”).

20. *See* §§ 77z-1(b)(1), 78u-4(b)(3)(B).

21. *See, e.g., Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455, 475–76 (2013) (citing H.R. REP. 104-369 (1995)) (explaining that private securities fraud litigation has been subject to abuse, including the extraction of extortionate settlements of frivolous claims); *In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1332 (3d Cir. 2002) (observing that PSLRA discovery stay was intended by Congress to prevent defendants from having to pay nuisance settlements in securities fraud actions).

22. 8A CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE AND PROCEDURE § 2046.2, at 294–95 (3d ed. 2010).

23. *See, e.g., City of Birmingham Ret. & Relief Sys. v. Armstrong*, No. 16-17-RGA, 2016 WL 880503, at *1 (D. Del. Mar. 1, 2016) (mem.) (first citing *Winer Family Tr. v. Queen*, No. 03-4318, 2004 WL 350181, at *3 (E.D. Pa. Feb. 6, 2004) (mem.); then citing

encompasses discovery during the pendency of motions to dismiss amended complaints²⁴ and motions for reconsideration of orders on motions to dismiss,²⁵ and it is of great practical significance. The parties in securities class action cases rarely file motions for summary judgment²⁶ and less than one percent of such cases proceed to trial.²⁷ Consequently, the ultimate outcome of the litigation is substantially dependent on the resolution of motions to dismiss. If plaintiffs survive the motion, “their chances of a major settlement increase exponentially.”²⁸ Not surprisingly, then, a motion to dismiss was filed in ninety-four percent of all securities class actions commenced and resolved during the period January 2000 to December 2017.²⁹ Original complaints are often amended multiple times in securities litigation, typically in response to motions to dismiss, and therefore many months or even years can pass before discovery begins.³⁰ This is the

Spina v. Refrigeration, Serv. & Eng'g, Inc., No. 14-4230, 2014 WL 4996200, at *5 (E.D. Pa. Oct. 7, 2014) (mem.)) (explaining that the automatic stay on discovery under the PSLRA is “applicable even though some of the claims are asserted under state law”).

24. See, e.g., *In re Finisar Corp. Sec. Litig.*, No. 5:11-cv-01252-EJD, 2017 WL 1549485, at *8 (N.D. Cal. May 1, 2017) (recognizing discovery stay pursuant to a motion to dismiss an amended complaint under PSLRA, but ultimately denying plaintiff’s motion for modification of stay as moot because motion to dismiss was denied).

25. See *McGuire v. Dendreon Corp.*, No. C07-800-MJP, 2009 WL 666863, at *1 (W.D. Wash. Mar. 11, 2009) (rejecting plaintiff’s contention that PSLRA’s discovery stay is inapplicable to a motion for reconsideration); *Powers v. Eichen*, 961 F. Supp. 2d 233, 235–36 (S.D. Cal. 1997); but cf. *In re Leapfrog Enter., Inc. Sec. Litig.*, No. 15-cv-00347-EMC, 2017 WL 3263114, at *1 (N.D. Cal. July 28, 2017) (declining to reinstate discovery stay in connection with filing of motion for leave to file motion for reconsideration).

26. “Motions for summary judgment were filed by defendants in 7.5%, and by plaintiffs in only 2.2%, of the securities class actions filed and resolved [during the period between January 2000 to December 2017].” BOETTRICH & STARYKH, *supra* note 1, at 18.

27. CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2016 YEAR IN REVIEW 13 (2017), <https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2016-YIR> [<https://perma.cc/CA7V-9T6W>] (reporting that during the period from 1997 to 2015, less than one percent of securities class action cases reached a trial verdict).

28. William S. Freeman & Catherine T. Zeng, *The Trouble with ‘Confidential Witness’ Allegations*, LAW360 (Feb. 3, 2012, 2:12 PM), <https://www.law360.com/articles/303826/the-trouble-with-confidential-witness-allegations> [<http://perma.cc/N4GJ-DUCQ>]; see also Stephen J. Choi & A.C. Pritchard, *The Supreme Court’s Impact on Securities Class Actions: An Empirical Assessment of Tellabs*, 28 J.L. ECON. & ORG. 850, 851 (2011) (“The PSLRA makes the motion to dismiss the main event in securities fraud class actions.”).

29. BOETTRICH & STARYKH, *supra* note 1, at 19. With regard to those cases in which the motion to dismiss was decided, the following outcomes were reached: granted (38%), granted without prejudice (7%), partially granted and partially denied (30%), and denied (25%). *Id.*

30. See, e.g., *Pension Tr. Fund for Operating Eng’rs v. Kohl’s Corp.*, 266 F. Supp. 3d 1154, 1157 (E.D. Wis. 2017) (noting that second motion to dismiss amended securities fraud complaint was pending for nearly two years when case was reassigned to new judge); *City of Pontiac Gen. Emps.’ Ret. Sys. v. Wal-Mart Stores, Inc.*, No. 12-cv-5162, 2015 WL

typical pattern because plaintiffs generally fail to have the PSLRA's automatic stay lifted under either the first or second statutory exceptions, which, respectively, permit lifting when particularized discovery is necessary to preserve evidence³¹ or to prevent undue prejudice to the party seeking relief.³²

The combination of the PSLRA's strict pleading requirements and discovery stay explains the CW phenomenon.³³ Plaintiffs must plead their cases with particularity,³⁴ but they are generally barred from obtaining discovery to bolster their showing of scienter and other allegations until after all motions to dismiss have been

11120408, at *1 (W.D. Ark. June 18, 2015) (“Thus, this lawsuit has been pending more than three years, during which time Plaintiff has been precluded from conducting discovery.”); *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.”).

31. See 15 U.S.C. § 77z-1(b)(1) (2012); *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, No. 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).

32. See § 78u-4(b)(3)(B). A number of courts interpreting the PSLRA have defined undue prejudice as “improper or unfair treatment amounting to something less than irreparable harm.” See, e.g., *Desmarais v. First Niagara Fin. Grp., Inc.*, No. 15-1226-LPS-CJB, 2016 WL 768257, at *2 (D. Del. Feb. 26, 2016) (quoting *Lusk v. Life Time Fitness, Inc.*, No. 15-1911 (JRT/JJK), 2015 WL 2374205, at *2 (D. Minn. May 18, 2015)); *Dipple v. Odell*, 870 F. Supp. 2d 386, 392 (E.D. Pa. 2012) (quoting *Sarantakis v. Gruttadauria*, No. 02 C 1609, 2002 WL 1803750, at *2 (N.D. Ill. Aug. 5, 2002)). The most commonly asserted basis for a claim of undue prejudice is the existence of parallel litigation, or parallel criminal or regulatory investigations, which require class action defendants to produce documents to other plaintiffs, the government, or an investigating body. Courts usually reject this argument. See, e.g., *Mogensen v. Body Cent. Corp.*, No. 3:12-cv-954-J-20JRK, 2014 WL 12621615, at *2 (M.D. Fla. June 12, 2014) (“The mere fact that documents have been produced to government agencies in connection with a parallel investigation does not support a showing of undue prejudice.”); *Kuriakose v. Fed. Home Loan Mort. Co.*, 674 F. Supp. 2d 483, 490 (S.D.N.Y. Dec. 7, 2009) (refusing to lift stay where about 400,000 documents had been produced by lead defendant during active investigations conducted by the SEC, the U.S. Attorney's Office, and a U.S. House of Representatives committee); *In re Schering-Plough Corp./Enhance Sec. Litig.*, No. 08-397 (DMC), 2009 WL 1470453, at *1 (D.N.J. May 22, 2009) (denying plaintiff's motion to modify stay to obtain documents that were produced to government investigators and regulators).

33. See *Union Asset Mgt. Holding AG v. SanDisk, LLC*, 227 F. Supp. 3d 1098, 1100 (N.D. Cal. 2017) (“The combined effect of the high scienter standard in securities fraud litigation and the strict PSLRA discovery stay is to place great weight at the pleading stage on the statements of confidential witnesses.”); Geoffrey P. Miller, *Pleading After Tellabs*, 2009 WISC. L. REV. 507, 530 (noting that combination of PSLRA's strict pleading requirements and stay “puts 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”).

34. § 78u-4(b)(1)(B) (“[T]he complaint shall state with particularity all facts on which that belief is formed”).

resolved.³⁵ The result has been almost universal reliance by plaintiffs in securities class action complaints on information provided by CWs.³⁶ In the absence of publicly available information from the Securities and Exchange Commission (“SEC” or “Commission”) or Department of Justice (“DOJ”) investigations, allegations based on such information often are the only specific allegations in a complaint supporting a claim of securities fraud.³⁷ CWs, like other securities fraud whistleblowers, thus function to advance the underlying purposes of federal securities laws by protecting investors from corporate misconduct and promoting the integrity of financial markets.³⁸ Indeed, significant evidence suggests that whistleblowers are much more effective than either the SEC or external auditors in uncovering fraud in public companies.³⁹

The critical function of confidential witnesses in securities litigation is analogous to the critical function served by the informants that law enforcement agencies use to investigate criminal conduct. In 2015, it was reported that “federal law enforcement agencies [in the

35. § 78u-4(b)(3)(B) (“[A]ll discovery and other proceedings shall be stayed during the pendency of any motion to dismiss”).

36. See, e.g., *In re Boff Holding, Inc. Sec. Litig.*, No. 3:15-CV-02324-GPC-KSC, 2016 WL 5390533, at *16 (S.D. Cal. Sept. 27, 2016) (“The Court is aware that confidential witnesses have become a staple of securities litigation.”); 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.”).

37. See Christopher Keller & Michael Stocker, *Balancing the Scales: The Use of Confidential Witnesses in Securities Class Actions*, 41 Sec. Reg. & L. Rep. (BNA) 87, 88 (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.”) (quoting HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES AND FEDERAL CORPORATE LAW* § 16.101 (2d ed. 2006)); 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* (2009), <http://www.nycbar.org/pdf/report/uploads/20071798-UseofConfidentialSources.pdf> [<http://perma.cc/Q7YW-KL53>] (“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.

38. 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, 666 (2010).

39. See, e.g., Christina Parajon Skinner, *Whistleblowers and Financial Innovations*, 94 N.C. L. REV. 861, 892 (2016) (“Congress has reported that in the past four years whistleblowers have uncovered 54.1% of frauds in public companies, versus the 4.1% detected by the SEC and external auditors.”).

DOJ and Department of Homeland Security] used more than 16,000 confidential informants as part of investigations into criminal activities and organizations.”⁴⁰ Informants have been described by former FBI Director William Webster as “the single most important tool in law enforcement.”⁴¹ Many courts⁴² and commentators⁴³ agree that confidential informants are essential criminal justice tools. CWs serve an analogous essential function in securities litigation.⁴⁴ Not all plaintiffs in securities class actions rely on information provided by confidential witnesses,⁴⁵ but their use is standard practice and it is common for complaints or amended complaints in such litigation to cite as many as twenty or more CWs.⁴⁶ In short, confidential witnesses are a primary feature of post-PSLRA securities class actions.

II. CONFIDENTIALITY, SEPARATION, AND SEVERANCE AGREEMENTS

This Article next addresses companies’ use of confidentiality, separation, and severance agreements to discourage or preclude interviews of their employees or former employees by plaintiffs’ counsel or their investigators. These agreements often include terms providing that the employee shall not disclose any confidential company information to any third party and define confidential

40. U.S. GOV’T ACCOUNTABILITY OFF., GAO-15-807, CONFIDENTIAL INFORMANTS: UPDATES TO POLICY AND ADDITIONAL GUIDANCE WOULD IMPROVE OVERSIGHT BY DOJ AND DHS AGENCIES 1 (2015).

41. See Ethan D. Wohl, *Confidential Informants in Private Litigation: Balancing Interests in Anonymity and Disclosure*, 12 FORDHAM J. CORP. & FIN. L. 551, 554 (2007) (quoting ROBERT M. BLOOM, RATTING: THE USE AND ABUSE OF INFORMANTS IN THE AMERICAN JUSTICE SYSTEM 158 (2002)).

42. See Keller & Stocker, *supra* note 37, at 88 (“Courts have long observed that the U.S. system of criminal justice turns on the availability of confidential informants, and have vigorously defended their use.”).

43. See, e.g., David Artman, Note, *Who’s Behind Door Number One?: Problems with Using Confidential Sources in Securities Litigation*, 2011 U. ILL. L. REV. 1827, 1834 (“Confidential informants are imperative for many investigations—espionage, police work, and war are just a few examples.”).

44. See, e.g., Jed S. Rakoff, *supra* note 8, at 572 (describing CWs as “confidential informants”).

45. See, e.g., *In re Iconix Brand Grp., Inc.*, No. 15 Civ. 4860 (PGG), 2017 WL 4898228, at *18–19 (S.D.N.Y. Oct. 25, 2017) (noting absence from amended securities class action complaint of any statements from CWs).

46. See John C. Coffee, Jr., *Confidential Distortion: Dealing with Confidential Witnesses in Securities Litigation*, CLS BLUE SKY BLOG (Sept. 25, 2017), <http://clsbluesky.law.columbia.edu/2017/09/25/confidential-distortion-dealing-with-confidential-witnesses-in-securities-litigation> [http://perma.cc/F55S-Z8YZ]; see also *Howard v. Liquidity Servs. Inc.*, 322 F.R.D. 103, 110 (D.D.C. 2017) (noting that plaintiffs’ amended complaint is based in part on information supplied by twenty CWs).

information broadly to include any information the employee learned during the course of his employment by the defendant company.⁴⁷ The use of such agreements is common. A 2015 survey of more than 1,200 employees in the financial services industry in the United States and United Kingdom found that nine percent of those surveyed in the U.S. had signed or been asked to sign a confidentiality agreement that would prohibit reporting illegal or unethical activities to law enforcement or regulatory authorities.⁴⁸ And “16 percent of those surveyed reported their company’s confidentiality policies prohibit the reporting of potential illegal or unethical activities.”⁴⁹ This latter figure rose to twenty-eight percent for those respondents earning \$500,000 or more per year.⁵⁰

While the foregoing survey was directly concerned with confidentiality agreements that bar reporting to law enforcement and regulators, these same agreements—in combination with separation and severance agreements—are used by companies to discourage or bar disclosures of illegal conduct to plaintiffs’ counsel.⁵¹ As described below, the judicial response to such agreements has been mixed, both in securities litigation and other kinds of actions. The better response is to treat the agreements in most cases as contrary to public policy and limit them accordingly.

One of the earliest PSLRA-era cases to consider the legality of confidentiality and severance agreements in the context of securities litigation is *In re JDS Uniphase Corporation Securities Litigation*,⁵² in

47. Richard Moberly, Jordan A. Thomas & Jason Zuckerman, *De Facto Gag Clauses: The Legality of Employment Agreements That Undermine Dodd-Frank’s Whistleblower Provisions*, 30 ABA J. LABOR & EMP. L. 87, 108 (2014).

48. See ANN TENBRUNSEL & JORDAN THOMAS, UNIV. OF NOTRE DAME & LABATON SUCHAROW LLP, *THE STREET, THE BULL AND THE CRISIS: A SURVEY OF THE US & UK FINANCIAL SERVICES INDUSTRY* 7, 10 (2015), https://www.secwhistlebloweradvocate.com/pdf/Labatton-2015-Survey-report_12.pdf [<http://perma.cc/SYR4-NXPR>].

49. *Id.* at 7.

50. *Id.*

51. See, e.g., Joseph H. Einstein, *Confidentiality Agreements Are Not a Bar to Informal Witness Interviews*, MEALEY’S LITIG. REP.: DISCOVERY, June 2009, at 1, 2 (“It is not uncommon to find that witnesses otherwise willing to provide valuable information may believe they are unable to do so because they are parties to confidentiality agreements. Such agreements come in many forms, including non-disclosure agreements aimed primarily at protecting trade secrets and business information; termination agreements; or settlements of pending claims or litigations.”); Kathryn Hastings, Comment, *Keeping Whistleblowers Quiet: Addressing Employer Agreements to Discourage Whistleblowing*, 90 TUL. L. REV. 495, 524 (2015) (“[E]mployees who sign legally unenforceable agreements may not be aware of the agreements’ unenforceability and will refrain from whistleblowing in belief that the restrictions are legitimate.”).

52. 238 F. Supp. 2d 1127 (N.D. Cal. 2002).

which the federal district court granted plaintiffs' motion to limit the scope of such agreements—primarily on public policy grounds.⁵³ The court supported its conclusion in part by noting federal public policy in favor of whistleblowers in securities fraud cases,⁵⁴ as expressed in the Sarbanes-Oxley Act's (SOX)⁵⁵ provisions protecting whistleblowers from retaliation.⁵⁶ The court acknowledged that the relevant SOX provision only applies to government or internal investigations, but added that SOX “certainly does not establish a public policy in favor of allowing employers to muzzle their employees with overbroad confidentiality agreements.”⁵⁷ Several subsequent decisions have agreed with this fundamental conclusion and refused to enforce confidentiality agreements in the context of interviews with plaintiffs' counsel or investigators in securities litigation.⁵⁸ Other decisions have been less favorable to plaintiffs.⁵⁹

The reasoning of the court in *JDS Uniphase* is reinforced by the whistleblower provisions of the later enacted Dodd-Frank Wall Street

53. *Id.* at 1138.

54. *Id.* at 1136.

55. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 and 18 U.S.C.).

56. 18 U.S.C. § 1514A (2012). This section protects employees who report alleged violations relating to mail fraud, wire fraud, bank fraud, securities fraud, or any rule or regulation of the SEC, or any provisions of federal law relating to fraud against shareholders. § 1514A(a). This section also protects whistleblowing employees from, *inter alia*, discharge, demotion, suspension, threats, and harassment. *Id.* The remedy available to prevailing employees is compensatory damages, including reinstatement, back pay (with interest), and compensation for special damages. § 1514A(c). It can include such non-economic items as emotional distress and reputational harm. *See, e.g.,* Halliburton, Inc. v. Admin. Rev. Bd., 771 F.3d 254, 266 (5th Cir. 2014); Lockheed Martin Corp. v. Admin. Rev. Bd., 717 F.3d 1121, 1138–39 (10th Cir. 2013).

57. *In re JDS Uniphase Corp. Sec. Litig.*, 238 F. Supp. 2d at 1136.

58. *See, e.g.,* Brado v. Vocera Commc'ns, Inc., 14 F. Supp. 3d 1316, 1319 (N.D. Cal. 2014) (holding that confidentiality agreement did not bar plaintiff investors from using information defendant's former employee orally conveyed to plaintiffs' lead counsel); Takiguchi v. MRI Int'l, Inc., No. 2:13-cv-01183-JAD-VCF, 2013 WL 6528507, at *12 (D. Nev. Dec. 11, 2013) (“[T]he court finds that the [confidentiality] agreement violates public policy by prohibiting the discovery of possible violations of federal securities laws.”); *see also* Chambers v. Capital Cities/ABC, 159 F.R.D. 441, 445 (S.D.N.Y. 1995) (noting that confidentiality agreements “inherently chill communications relevant to the litigation”).

59. *See, e.g.,* Smilovits v. First Solar, Inc., No. CV-12-00555-PHX-DGC, 2012 WL 6574410, at *10–11 (D. Ariz. Dec. 17, 2012) (denying without prejudice plaintiffs' motion to limit confidentiality agreements, pending additional briefing and hearing); Kuriakose v. Fed. Home Loan Mort. Co., 674 F. Supp. 2d 483, 492 (S.D.N.Y. 2009) (denying motion for order declaring non-participation clause in severance agreement unenforceable, in part because plaintiffs failed to present copy of the agreement); *In re Spectrum Brands, Inc. Sec. Litig.*, No. 1:05-cv-02494-WSD, 2007 WL 1483633, at *5–6 (N.D. Ga. 2007) (denying motion for order limiting scope of confidentiality or severance agreements, in large part because plaintiffs waited to file motion until after dismissal of amended complaint).

Reform and Consumer Protection Act (“Dodd-Frank”),⁶⁰ which are somewhat more robust than those set forth in SOX. In any SEC enforcement action yielding \$1 million or more in monetary sanctions, Dodd-Frank requires the Commission to pay between ten and thirty percent of the collected amount to one or more whistleblowers who voluntarily provided original information to the SEC that led to the successful enforcement of the action.⁶¹ Dodd-Frank also prohibits employers from discriminating against whistleblowers in the terms and conditions of employment because they have provided information to the SEC or have assisted the SEC in an investigation or prosecution related to that information.⁶² This provision is enforceable by the SEC,⁶³ but Dodd-Frank also allows a whistleblower who believes his employer has violated this provision to sue in federal court for reinstatement, double back pay owed, and fees and costs.⁶⁴ Further, under Rule 21F-17, promulgated by the SEC in August 2011, employers are prohibited from taking any action that would “impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing or threatening to enforce, a confidentiality agreement . . . with respect to such communications.”⁶⁵

By various metrics, the Dodd-Frank whistleblower program has been successful. By the close of the 2017 fiscal year, the program had generated more than 22,000 tips and awarded approximately \$160 million to 46 whistleblowers, and that information led to successful SEC enforcement actions in which more than \$975 million in financial sanctions were ordered.⁶⁶ But the SEC is not merely focused on using tips to generate sanctions. Another priority of the Commission is the

60. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7, 12, 15, 22, 31, and 42 U.S.C.).

61. 15 U.S.C. § 78u-6(b)(1).

62. § 78u-6(h)(1)(A).

63. 17 C.F.R. § 240.21F-2(b)(2) (2017).

64. 15 U.S.C. § 78u-6(h)(1)(C).

65. 17 C.F.R. § 240.21F-17. The SEC broadly interprets Rule 21F-17. See Matthew T. Martens, Arian M. June & Caroline Schmidt, *Four Key Whistleblower Trends—And How Companies Can Prepare for Them*, 49 REV. SEC. & COMMODITIES REG. 225, 228 (2016); David M. Stuart & Kyle S. Gazis, *The SEC as the Whistleblower Program’s Advocate: Severance Agreements and FCPA Investigations*, FCPA REP., Oct. 12, 2016, at 1, 3.

66. U.S. SEC. & EXCH. COMM’N, 2017 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 1, 23 (2017); see also Amanda M. Rose, *Better Bounty Hunting: How the SEC’s New Whistleblower Program Changes the Securities Fraud Class Action Debate*, 108 NW. U. L. REV. 1235, 1281 (2014) (“All told, it seems likely that the [program] will help to reduce the social harm caused by securities fraud through enhanced deterrence.”).

assessment of confidentiality, severance, and other kinds of agreements that stifle whistleblowing.⁶⁷ In 2015 the SEC brought its first enforcement action against a company, KBR, Inc., for its use of agreements that impeded whistleblowers in violation of Rule 21F-17,⁶⁸ and in subsequent years the SEC significantly stepped up its enforcement efforts in this area. Between April 2015 and January 2017, the SEC issued nine orders enforcing Rule 21F-17.⁶⁹ The SEC brought enforcement actions against KBR, Anheuser-Busch InBev SA/NV, BlackRock, Inc., BlueLinx Holdings, Inc., Health Net, Inc., Homestreet Inc., Merrill Lynch, NeuStar, Inc., and SandRidge Energy, Inc.⁷⁰ Some of these companies used language in contravention of Rule 21F-17 in hundreds of their agreements with employees. NeuStar, Inc., for example, used impermissible non-disparagement clauses in at least 246 severance agreements during the period August 2011 to May 2015,⁷¹ and more than 500 former employees of SandRidge Energy, Inc. signed separation agreements with impermissible restrictive language.⁷²

The SEC continued to examine potential violations of Rule 21F-17 in 2017, following the presidential election.⁷³ But it is not the only federal agency taking an aggressive approach. In September 2016, the Occupational Safety and Health Administration (“OSHA”)—which is charged with enforcing more than twenty federal whistleblowing

67. U.S. SEC. & EXCH. COMM’N, *supra* note 66, at 6, 19–21.

68. See KBR, Inc., Exchange Act Release No. 74619, 2015 WL 1456619, at *2–3 (Apr. 1, 2015); see also Thomas W. White, *SEC Enforcement Actions Under Exchange Act Rule 215-17*, J. INV. COMPLIANCE, 2017, at 1, 2.

69. See U.S. SEC. & EXCH. COMM’N, *supra* note 66, at 19–20.

70. See *id.* (discussing SEC actions against HomeStreet, NeuStar, BlackRock, and SandRidge); *SEC Announces Two Enforcement Actions Regarding Restrictive Language in Severance Agreements*, DAVIS POLK & WARDWELL LLP (Dec. 22, 2016), <https://www.davispolk.com/publications/sec-announces-two-enforcement-actions-regarding-restrictive-language-severance/> [<https://perma.cc/5QSV-W899>] (discussing NeuStar and SandRidge enforcement actions); Jay Sherwin, *Whistleblower Protections Trump Confidentiality Provisions: SEC Enforcement of Rule 21F-17*, WOODRUFF SAWYER & CO. (July 26, 2017), <https://wsandco.com/do-notebook/whistleblower-protections-sec-rule-21f-17/> [<https://perma.cc/K4UG-QFDS>] (identifying nine enforcement actions).

71. See NeuStar, Inc., Exchange Act Release No. 79593, 2016 WL 7335658, at *3 (Dec. 19, 2016).

72. See U.S. SEC. & EXCH. COMM’N, *supra* note 66, at 21.

73. See Carmen Germaine, *SEC Whistleblower Program is Business as Usual*, Chief Says, LAW360 (June 28, 2017), <https://www.law360.com/articles/939700/sec-whistleblower-program-is-business-as-usual-chief-says> [<https://perma.cc/HP3A-PMM2>] (reporting that SEC’s Office of the Whistleblower continues to examine severance and other employment agreements to ensure that employees are not prevented from reporting securities law violations to SEC).

laws⁷⁴—issued new policy guidelines for its review of private settlement agreements presented to OSHA for approval in whistleblowing actions.⁷⁵ These guidelines largely mirror the SEC’s perspective on confidentiality and severance agreements that impede whistleblowing.⁷⁶ In May 2017, the Commodity Futures Trading Commission (“CFTC”) amended its whistleblower rules⁷⁷ to more closely align them with the SEC’s program.⁷⁸ The CFTC’s amendments prohibit the enforcement or threatened enforcement of any confidentiality agreement or pre-dispute arbitration provisions in pre-employment, employment, or post-employment agreements that might impede an individual from communicating a possible violation of the Commodity Exchange Act⁷⁹ to the CFTC.⁸⁰ The National Labor Relations Board and Equal Opportunity Employment Commission have similarly attacked confidentiality, separation, and release agreements that potentially discourage whistleblowing.⁸¹

The SEC has been aggressive even absent evidence that companies have taken action to enforce the subject contract provisions or prevent employees from communicating with the

74. Locke Lord LLP, *OSHA Joins SEC in Scrutinizing Separation and Settlement Agreements*, JD SUPRA (Oct. 19, 2016), <http://www.jdsupra.com/legalnews/osha-joins-sec-in-scrutinizing-10559/> [<https://perma.cc/8BCR-4WLC>].

75. MARYANN GARRAHAN, U.S. DEP’T OF LABOR, OCCUPATIONAL SAFETY AND HEALTH ADMIN., *NEW POLICY GUIDELINES FOR APPROVING SETTLEMENT AGREEMENTS IN WHISTLEBLOWER CASES 1* (2016).

76. See Sarah E. Bouchard & Thomas A. Linthorst, *OSHA Increases Scrutiny of Whistleblower Settlement Agreements*, MORGAN, LEWIS & BOCKIUS LLP (Sept. 26, 2016), <https://www.morganlewis.com/pubs/osha-increases-scrutiny-of-whistleblower-settlement-agreements> [<http://perma.cc/E7BT-8RFW> (dark archive)] (“The catalyst for these changes is the perceived use of overbroad confidentiality or nondisparagement clauses.”). Ed Ellis, Chip Jones & Kevin Griffith, *OSHA Joins the SEC in Attacking Confidentiality and Other Provisions in Private Settlement Agreements*, LITTLER MENDELSON P.C. (Sept. 19, 2016), <https://www.littler.com/publication-press/publication/osha-joins-sec-attacking-confidentiality-and-other-provisions-private> [<https://perma.cc/M5CW-62ED>] (“The OSHA guidelines extend the approach recently adopted by the U.S. Securities and Exchange Commission.”).

77. See Press Release, U.S. Commodity Futures Trading Comm’n, CFTC Strengthening Anti-Retaliation Protections for Whistleblowers and Enhancing the Award Claims Review Process (May 22, 2017), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/wbruleamend_factsheet052217.pdf [<http://perma.cc/8KRJ-S42S>].

78. See Lewis Csedrik, et al., *Inside the CFTC’s Enhanced Whistleblower Protections*, LAW360 (June 9, 2017), <https://www.law360.com/articles/932700/inside-the-cftc-s-enhanced-whistleblower-protections> [<https://perma.cc/U2ML-9EA5>].

79. 7 U.S.C. §§ 1–27 (2012).

80. See Csedrik, et al., *supra* note 78.

81. See Rachel B. Cowen & Deborah R. Meshulam, *Redux—Federal Agencies Attack Employment Agreements, and What You Can Do About It: 8 Steps to Consider*, DLA PIPER (Aug. 18, 2016), <https://www.dlapiper.com/en/us/insights/publications/2015/04/federal-agencies-attack-agreements/> [<http://perma.cc/7BQU-7EWX>].

government. This was true, for example, with respect to the SEC's enforcement actions against KBR, Health Net, and BlueLinx.⁸² The SEC has taken action because the mere existence of the clauses in severance and confidentiality agreements has a chilling effect on whistleblowing. Rule 21F-17 unambiguously provides that the mere existence of overly restrictive contract language can result in a violation.⁸³

The SEC's recognition of the importance of preventing the chilling effect of overbroad confidentiality, separation, and severance agreements should help guide courts confronted with such agreements in private securities litigation. Courts should refuse to enforce agreements that restrict the ability of current or former employees to participate in pre- or even post-filing interviews with plaintiffs' investigators or counsel. A common refusal to enforce can reduce the chilling effect of these agreements.⁸⁴ Of course, courts should establish appropriate limits by upholding protection for trade secrets and highly sensitive customer information and by restricting use of the unprotected information employees provide to the pending litigation. Such restrictions are vital, but their use should be the exception rather than the norm. A recent securities class action in California provides a good example of the infrequent situation where restrictions are appropriate.⁸⁵ The federal district court enforced confidentiality agreements in that case and required the return to defendant of 150 pages of highly sensitive customer information, including the names, addresses, telephone numbers, social security numbers, account balances, and tax forms provided to plaintiff by the former employee of defendant.⁸⁶ This information merited protection.⁸⁷

82. See *Recent Whistleblower Actions by SEC and Congress Add Risk to Severance Agreements*, PERKINS COIE LLP (Feb. 10, 2017), <https://www.perkinscoie.com/en/news-insights/recent-whistleblower-protection-actions-by-the-sec-and-congress.html> [<http://perma.cc/G3GX-V2RQ>].

83. See *SEC Brings Additional Enforcement Actions Against Companies with Employment Agreements that Impede Whistleblowing*, SIDLEY AUSTIN LLP (Aug. 22, 2016), <http://www.sidley.com/news/sec-brings-actions-to-enforce-whistleblower> [<https://perma.cc/FG38-C7Q8>] ("It is important to note that the mere existence of improperly restrictive language can lead to a Rule 21F-17 violation.").

84. See Moberly et al., *supra* note 47, at 89 ("Th[e] use of a confidentiality agreement not only punishes an employee after the whistle is blown, but also chills the willingness of employees to blow the whistle in the future due to the fear of being sued by a current or former employer.").

85. *Hous. Mun. Emps. Pension Sys. v. BofI Holding, Inc.*, No. 15cv2324 GPC (KSC), 2017 WL 1102732, at *1 (S.D. Cal. Mar. 23, 2017).

86. *Id.* at *5.

87. *Id.*

In summary, companies have used confidentiality, separation, and severance agreements to discourage or preclude plaintiffs' counsel and/or their investigators from interviewing companies' employees or former employees during securities litigation. Courts should treat these agreements in most cases as contrary to public policy and limit them accordingly. Such treatment would be consistent with the SEC's enforcement of Rule 21F-17 and the similarly aggressive approach taken by other federal agencies.

III. RECANTING WITNESSES

This Article next addresses the problem of recanting confidential witnesses. As noted *supra*, the PSLRA imposes an automatic stay of discovery while motions to dismiss are pending.⁸⁸ When the motions to dismiss are denied, the stay is lifted.⁸⁹ 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.⁹⁰ The clear trend is for federal district courts to permit such discovery, over objections that it is contrary to public policy⁹¹ and undermines work product protection.⁹² When discovery of CWs is taken, the opportunity arises for the witnesses to recant, deny, or modify some or all of the information attributed to them by plaintiffs. In a series of recent high-profile securities fraud

88. See *supra* note 19 and accompanying text.

89. See, e.g., *In re Finisar Corp. Sec. Litig.*, No. 5:11-cv-01252-EJD, 2017 WL 1549485, at *8 (N.D. Cal. May 1, 2017).

90. See Carl H. Loewenson, Jr. & James J. Beha II, *Reliability of Confidential Witnesses in Securities Fraud Complaints*, N.Y. L.J. (Sept. 30, 2013), <https://media2.mofo.com/documents/130930-reliability-confidential-witnesses-securities-fraud-complaints.pdf> [<http://perma.cc/SM3J-VVE8>] (“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.”).

91. Flaum & David, *supra* note 36, at 2 (“Most courts, however, have found that the names of confidential witnesses can be disclosed despite any public policy concerns.”).

92. See, e.g., *Fort Worth Emps.’ Ret. Fund v. J.P. Morgan Chase & Co.*, No. 09 Civ. 3701(JPO)(JCF), 2013 WL 1896934, at *1 (S.D.N.Y. May 7, 2013) (mem.) (noting that in the Southern District of New York, “the majority view, especially more recently,” is that the names of CWs are not entitled to work product protection); Flaum & David, *supra* note 36, at 1 (“[T]he number of cases in which plaintiffs have managed to withhold the names of confidential witnesses on work product grounds is comparatively slim and relatively dated.”); Jennifer H. Rearden & Darcy C. Harris, *Growing Trend Favors Disclosure of Witnesses’ Identities*, SEC. LITIG., Fall 2012, at 11, 15 (“Although the case law is still unsettled, the growing trend requiring plaintiffs to disclose in discovery the identities of specific confidential witnesses referenced in their complaint seems unmistakable.”).

cases such recanting⁹³ has occurred, or has been alleged to have occurred.⁹⁴ The new version of events can be used by defendants to support a motion for summary judgment.

A. Coercion of Recanting Statements

While discovery of CWs can support motions for summary judgment, evidence of recanting often becomes available in the form of declarations or affidavits even before the discovery stay has been lifted. As noted previously, the requirement that plaintiffs be specific when pleading allegations about CWs often enables defendants to learn the sources' identities.⁹⁵ Defendants frequently contact CWs after making positive identifications⁹⁶ and secure affidavits. In these situations, defendants have sought to use the affidavits to support motions to dismiss under Rule 12(b) of the Federal Rules of Civil Procedure ("Federal Rules"),⁹⁷ motions to strike under Rule 12(f),⁹⁸ motions for reconsideration of denials of motions to dismiss,⁹⁹ and/or motions for sanctions under Rule 11.¹⁰⁰

There is considerable dispute about the frequency of recanting by CWs in securities fraud litigation. While some commentators and defense counsel believe that recanting is common,¹⁰¹ and some courts

93. "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 used more broadly to also include denials that purported statements were ever made, and modifications of prior statements.

94. *See, e.g.*, *In re Millennial Media, Inc. Sec. Litig.*, No. 14 Civ. 7923(PAE), 2015 WL 3443918, at *5 (S.D.N.Y. May 29, 2015); *City of Livonia Emps.' Ret. Sys. v. Boeing Co.*, 306 F.R.D. 175, 182 (N.D. Ill. 2014) (mem.); *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, 952 F. Supp. 2d 633, 636 (S.D.N.Y. 2013) (describing events in which, allegedly, "several of the confidential witnesses . . . had 'recanted' statements attributed to them . . . and/or had denied making such statements in the first place.").

95. *See supra* note 11 and accompanying text.

96. *See* Heather Speers, *Confidential Witness Allegations in Securities Fraud Litigation*, CORP. COUNSEL, Winter 2017, at 6, 9 ("Defense counsel often attempt to contact CWs to investigate allegations in the complaint.").

97. FED. R. CIV. P. 12(b); *see, e.g.*, *Union Asset Mgmt. Holding AG v. Sandisk LLC*, 227 F. Supp. 3d 1098, 1099–1100 (N.D. Cal. 2017).

98. FED. R. CIV. P. 12(f); *see, e.g.*, *Hatamian v. Advanced Micro Devices, Inc.*, No. 14-cv-00226-YGR(JSC), 2016 WL 2606830, at *1 (N.D. Cal. May 6, 2016).

99. *See, e.g.*, *In re Genworth Fin., Inc. Sec. Litig.*, No. 14 Civ. 2392 (AKH), 2016 WL 858679, at *1 (S.D.N.Y. Mar. 3, 2016).

100. FED. R. CIV. P. 11. *See, e.g.*, *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1309–10 (S.D. Fla. 2011).

101. *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*, SEC. LITIG. REP. (Gibson, Dunn & Crutcher LLP, New York, N.Y.), July/Aug. 2011, at 1, 6, <https://www.gibsondunn.com/wp-content/uploads/documents/publications/Dickey-Lutz-SECFinalWhistleblowerRules->

share this belief,¹⁰² a review of recent cases suggests the true incidence has been exaggerated. In a number of cases the declarations submitted by allegedly recanting CWs reflected only immaterial differences between the declarations and the material attributed to them in plaintiffs' complaints.¹⁰³ Moreover, it seems likely that much

JulyAugust2011.pdf [<https://perma.cc/P9C4-8YX4>] (asserting that CWs “have shown 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*, NAT’L LEGAL NEWS FROM REUTERS (Sept. 20, 2012), <https://1.next.westlaw.com/Document/10fc3f310037211e2bc49ffde052dcc84/View/FullText.html> (“[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> [<http://perma.cc/S9DG-ZZWH>] (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), <http://www.dandodiary.com/2013/07/articles/securities-litigation/the-confidential-witness-problem-in-securities-litigation/> [<http://perma.cc/4SNE-4Y32>] (“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.”).

102. See, e.g., *In re Millennial Media, Inc. Sec. Litig.*, No. 14 Civ. 7923(PAE), 2015 WL 3443918, at *12 (S.D.N.Y. May 29, 2015) (noting the “growing body of cases chronicling the repudiation by CWs of statements attributed to them in securities class-action complaints”).

103. See, e.g., *In re Genworth Fin., Inc. Sec. Litig.*, No. 14 Civ. 2392 (AKH), 2016 WL 858679, at *2 (S.D.N.Y. Mar. 3, 2016) (finding that deposition testimony and declaration of two CWs were somewhat inconsistent with allegations attributed to them in complaint but did not constitute recantations); *City of Pontiac Gen. Emps.’ Ret. Sys. v. Lockheed Martin Corp.*, 952 F. Supp. 2d 633, 637–38 (S.D.N.Y. 2013) (mem.) (“[T]he only statement attributed to the CWs in the Amended Complaint that the Court found clearly inaccurate was the result, not of any mis-reporting by [the CW], but of mis-drafting by counsel.”); *Minneapolis Firefighters’ Relief Ass’n v. Medtronic, Inc.*, 278 F.R.D. 454, 463–64 (D. Minn. 2011) (mem.) (concluding that differences between the declarations of 13 CWs and the allegations in plaintiffs’ amended complaint were “mostly innocuous”); *Local 703, I.B. of T. Grocery and Food Emps.’ Welfare Fund v. Regions Fin. Corp.* No. CV 10-J-2847-IPJ, 2011 WL 12627599, at *3 (N.D. Ala. Aug. 23, 2011) (mem.) (reviewing affidavits from allegedly recanting CWs and the interview notes from plaintiffs’ investigator and concluding that “nothing in the affidavit statements of the CWs contradict[s] the statements in the Amended Complaint”); *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1312 (S.D. Fla. 2011) (finding 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). In *BankAtlantic* 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. *In re BankAtlantic Bancorp*, 851 F. Supp. 2d at 1321. Because the plaintiffs cited this CW as a source of information in only five paragraphs of the 98-page first amended consolidated complaint, the violation was *de minimis*, 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.

of the recanting that does occur is the product of coercion by defendants and their counsel, and/or the fear of retaliation experienced by confidential witnesses. Counsel for plaintiffs in securities class actions assert that such recanting as a result of pressure is quite common¹⁰⁴ and some courts have found that recanting was in fact the product of pressure. An example of such a judicial finding is a case involving defendant Lockheed Martin Corporation, wherein 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.”¹⁰⁵ Judge Jed Rakoff’s careful post-settlement opinion denying Lockheed’s motion for summary judgment suggests that plaintiff was correct, at least in part. As the opinion notes, some of the CWs “felt pressured into denying outright statements they had actually made.”¹⁰⁶ 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.¹⁰⁷ This is a clear example of a prominent federal judge accepting plaintiff’s argument that recanting was the product of pressure exerted by defendant, at least in part.

It is frequently suggested that appropriate protective orders can shield those CWs in securities litigation who are fearful about their safety or security.¹⁰⁸ But such orders do nothing to protect against the risk of retaliation. They also do nothing to guard against the pressure exerted by defense counsel who interrogate CWs during their depositions about possible breaches of their confidentiality and/or severance agreements.¹⁰⁹ Under Rule 26(c)(1) of the Federal Rules, a protective order must be premised on good cause,¹¹⁰ and courts typically find that general statements regarding a serious risk of retaliation do not satisfy the standard. Rather, plaintiffs are required

104. See, e.g., LaCroix, *supra* note 101 (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”); Smollar, *supra* note 11, at 4 (“[F]ear of retaliation by the former employer accounts for most of witness recantation.”).

105. *City of Pontiac Gen. Emps.’ Ret. Sys.*, 952 F. Supp. 2d at 636.

106. *Id.* at 637.

107. *Id.* at 637–38.

108. See, e.g., Loewenson & Beha II, *supra* note 90.

109. See Frankel, *supra* note 101 (“[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.”).

110. See FED. R. CIV. P. 26(c)(1).

to make a specific showing that disclosure will cause a clearly defined and serious injury.¹¹¹ Federal courts generally decline to find such injury, especially where the CW is a former employee.¹¹²

B. Best Practices to Minimize Recanting

There is no doubt that some share of recanting by CWs is genuine, in the sense that (1) there are material differences between what was attributed to the witness in the complaint and what he subsequently testifies to, and (2) such differences are not the product of coercion, pressure, or fear of retaliation.¹¹³ This share is unlikely to

111. See, e.g., *In re Marsh & McLennan Cos. Sec. Litig.*, MDL No. 1744, No. 04 Cv. 8144(SWK), 2008 WL 2941215, at *5 (S.D.N.Y. July 30, 2008) (holding that claimed 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.*, 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 request for 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”).

112. See, e.g., *In re BofI Holding, Inc.*, Sec. Litig., 318 F.R.D. 129, 135 (S.D. Cal. 2016) (“Lead Plaintiff’s argument that the confidential witnesses harbor a ‘legitimate fear of retaliation’ is not supported by specific ‘reliable, non-conclusory’ evidence.”); *Plumbers & Pipefitters Local Union No. 630 Pension-Annuity Tr. Fund v. Arbitron, Inc.*, 278 F.R.D. 335, 344 (S.D.N.Y. 2011) (rejecting use of protective orders to guard against risk of retribution by CWs’ current, future, or past employers); Flaum & David, *supra* note 36, at 2 (noting that courts are reluctant to find a realistic possibility of retaliation if the CWs are no longer employed by the defendant). In *In re BofI Holding, Inc.*, the federal district judge found that defendants’ contacts with CWs “had and has the potential to . . . pressure confidential witnesses to give untruthful statements.” 318 F.R.D. at 135. Nevertheless, he held that the Rule 26(c) protective order issued by the magistrate judge was contrary to law as overbroad. *Id.* at 133. The district judge issued a much narrower order. *Id.* at 135–36.

113. One prominent example is *City of Livonia Employees’ Retirement System v. Boeing Co.*, 306 F.R.D. 175 (N.D. Ill. 2014). In that case the district court held, following remand from the Seventh Circuit, that plaintiffs’ counsel failed to conduct a reasonable pre-filing investigation, warranting Rule 11 sanctions. *Id.* at 183. The district court noted that counsel filed the original complaint before interviewing their sole CW, who was critical to the case. *Id.* at 180. Counsel filed the amended complaint and second amended complaint after their investigator interviewed the CW, but they never personally interviewed him and never attempted to verify the information he allegedly provided to the investigator. *Id.* at 181. Moreover, the investigator noted in her report that some of the information the CW provided was unreliable. *Id.* At his deposition following denial of defendant Boeing’s motion to dismiss the CW recanted all of the material allegations attributed to him in the second amended complaint. *Id.* at 177. Plaintiffs’ counsel met the CW for the first time at this deposition. *Id.*; see also Laura J. O’Rourke, Baker McKenzie, *A Cautionary Tale Regarding the Use of ‘Confidential Witnesses’ in Pleadings*, LEXOLOGY (Sept. 24, 2014), <http://www.lexology.com/library/detail.aspx?g=0fc50900-e8dd-44d5->

be *de minimis*, and it continues to vex litigants, counsel, and judges. Various solutions to the problem have been proposed, and they are discussed below.

One major factor likely contributing to the recanting problem is that plaintiffs' counsel typically delegates to investigators the task of interviewing confidential witnesses.¹¹⁴ From an ethical perspective, there is nothing improper about such a delegation. Rule 11 imposes an affirmative duty on an attorney signing any pleading or motion to conduct an inquiry reasonable under the circumstances into whether factual contentions have evidentiary support,¹¹⁵ and the PSLRA requires counsel to conduct a more diligent pre-filing investigation in cases involving securities fraud than in other cases¹¹⁶—in part because “the mere filing of a broad, class action securities complaint is a market relevant event for any reputable company.”¹¹⁷ Counsel's non-delegable duty to investigate does not extend to personally gathering the facts,¹¹⁸ but the use of investigators may multiply the risk of error. Any witness, confidential or not, may speculate, recount hearsay, or provide opinions, rather than facts, and an investigator may mistake a witness' conjecture for fact.¹¹⁹ Subsequently, when the investigator

a4b1-50a2fe99b83f [perma.cc/34HL-BRF2] (“[A] reasonable take-away from [Boeing] for any counsel that may utilize investigators and confidential witnesses is that the ‘ostrich’ approach can be sanctionable, and that more is required.”).

114. See Charles Davidow et al., *Best Practice for Dealing with Confidential Witness Allegations in Securities Fraud Complaints: The Implications of In re Millennium Media and Other Recent Decisions*, 47 Sec. Reg. L. Rep. (BNA) (July 27, 2015), <https://www.bloomberglaw.com/product/blaw/document/XFNL9BD8000000> [<https://perma.cc/CH3Q-N3YZ> (staff-uploaded archive)] (“The witness accounts are commonly collected by hired investigators or junior personnel in the office of plaintiffs' counsel.”); see also *Bolling v. Gold*, No. C13-0872JLR, 2015 WL 6870617, at *6–7 (W.D. Wash. Nov. 9, 2015) (citing with approval cases criticizing failure of plaintiffs' counsel in securities fraud litigation to personally interview CWs or confirm accuracy of CWs' purported statements to investigators).

115. FED. R. CIV. P. 11(b).

116. *Auto. Ind. Pension Tr. Fund v. Textron Inc.*, 682 F.3d 34, 40 (1st Cir. 2012) (observing that PSLRA “leaves a plaintiff's counsel with a greater than usual burden of investigation before filing a securities fraud complaint”).

117. *City of Livonia Emps.' Ret. Sys. v. Boeing Co.*, 306 F.R.D. 175, 180 (N.D. Ill. 2014).

118. *In re Millennium Media, Inc. Sec. Litig.*, No. 14 Civ. 7923(PAE), 2015 WL 3443918, at *11 (S.D.N.Y. May 29, 2015) (“To be clear, Rule 11's command that counsel conduct ‘an inquiry reasonable under the circumstances’ does not require counsel personally to participate in an initial witness interview. It is, of course, permissible and customary, not to mention economical, for facts to be gathered first by investigators.”) (quoting *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1311 (S.D. Fla. 2011)).

119. *Id.* at *12 (“[T]he investigator may have mistaken hearsay, opinion, or conjecture for facts, or the investigator's interview memo may not have carefully distinguished

transmits his interview notes or summary to plaintiffs' counsel, this may result in the drafting of complaints that fail to reflect the CWs' factual, personal knowledge. Of course, counsel could just as easily as their investigators improperly interpret, infer, and/or extrapolate, based on information provided to them by a CW. But the risk of error (and subsequent recanting) is likely magnified when only the investigator conducts the witness interview.

What interview practices should plaintiffs' counsel and their investigators employ in order to minimize the risk of recanting? In *In re Millennial Media, Inc. Securities Litigation*,¹²⁰ one of the most prominent cases involving CW recanting, Judge Paul Engelmayer issued guidance in dicta, and most of it appears practical. First, when plaintiffs' investigator—rather than plaintiffs' counsel—conducts the CW interview, counsel should independently confirm the accuracy of the investigator's memorandum of the witness interview.¹²¹ This is sensible, although not necessarily feasible. In many cases, plaintiffs delegate the interview task to investigators because whistleblowing witnesses are reluctant to speak with counsel,¹²² a particular CW is less significant, or an attorney is unavailable. If a CW will speak freely only with investigators in the pre-filing stage of the litigation, and that CW is the only known source of the information attributed to him—which he very often is¹²³—then it is not always clear that confirmation or corroboration can occur. This can be problematic for plaintiffs, because some federal courts expressly require that information attributed to a CW in a complaint be corroborated.¹²⁴

between them.”). *See generally* Loewenson & Beha II, *supra* note 90 (emphasizing the doubt cast on CW testimony by numerous courts).

120. No. 14 Civ. 7923(PAE), 2015 WL 3443918 (S.D.N.Y. May 29, 2015).

121. *Id.* at *12. *Accord* Lopez v. Ctpartners Exec. Search, Inc., 173 F. Supp. 3d 12, 31 n.7 (S.D.N.Y. 2016).

122. *See* Smollar, *supra* note 13, at 505 (“CWs often do not wish to be embroiled in any kind of litigation or to talk to lawyers, especially when the discussion revolves around the alleged fraud committed by their former employer while he or she was employed there.”).

123. Michael B. Eisenkraft, *Dealing with Confidential Witness Recantation Statements*, LAW360 (Jan. 23, 2017), <https://www.law360.com/articles/883453/dealing-with-confidential-witness-recantation-statements> [<https://perma.cc/Y42E-J6YZ>] (noting that in the absence of discovery, CWs “are often the only sources of information as to what the defendants knew and when they knew it”).

124. *See, e.g., In re Daou Sys., Inc. Sec. Litig.*, 411 F.3d 1006, 1015 (9th Cir. 2005); *In re Huff Corp. Sec. Litig.*, 577 F. Supp. 2d 968, 993 (S.D. Ohio 2008). *Cf.* Smollar, *supra* note 13, at 519–20 (“The key to avoiding sanctions is [for plaintiffs] to ensure that there is corroborating evidence to the CW statements.”). *But cf.* Zaghian v. Farrell, 675 F. App'x. 718, 720 n.1 (9th Cir. Jan. 12, 2017) (noting that allegations attributed to CW were sufficiently particular, without expressly requiring corroboration); John H. Henn, Brandon F. White & Matthew C. Baltay, *Anonymous Sources in Securities Class Action Complaints*,

Setting aside the foregoing concerns, how could this best practice be enforced? One mechanism would be for a court to request a certification by plaintiffs' counsel that he or she has contacted each CW and obtained confirmation from the witnesses of the essential allegations attributed to them. "Absent such a certification, the court could find that it is unable to draw any reliable inferences from the allegations" attributed to the CWs,¹²⁵ or at least substantially discount such allegations.¹²⁶ Certification alone would not preclude defendants from seeking to obtain recanting declarations, but this possibility could be minimized if plaintiffs' counsel hire independent counsel for their CWs. This would preclude direct communication between defense counsel and the CWs, except in the presence of independent counsel, and likely reduce both the pressure for CWs to recant and the threat of retaliation against them.¹²⁷

Second, Judge Engelmayer suggested that plaintiffs' counsel should notify witnesses in advance that they will be identified as CWs in publicly filed complaints and this designation exposes them to the risk of identification by name.¹²⁸ Engelmayer characterized this suggestion as one reflecting basic decency, rather than one informed by case law or an ethics canon,¹²⁹ although elsewhere in his opinion he stated that "it is a best practice—if not an ethical imperative—for counsel, before designating a person as a CW in a Complaint, to notify that person of counsel's intent to do so."¹³⁰ Whether as a best practice or an ethical requirement, the provision of notice should become the norm.¹³¹ Notice would enable potential witnesses to make better-informed decisions as to whether to become CWs and simultaneously reduce the risk of recanting.

38 REV. SEC. & COMMODITIES REG. 131, 136 (2005) (suggesting that *Daou's* addition of a corroboration requirement was unintended).

125. Coffee, Jr., *supra* note 46.

126. See Kevin LaCroix, *Addressing the Use of Confidential Witnesses in Securities Litigation*, D&O DIARY (Oct. 8, 2017), <http://www.dandodiary.com/2017/10/articles/securities-litigation/addressing-use-confidential-witnesses-securities-litigation/> [perma.cc/JFB9-VMU9] (suggesting use of substantial discounting in absence of certification).

127. Coffee, Jr., *supra* note 46.

128. *In re Millennial Media, Inc. Sec. Litig.*, No. 14 Civ. 7923(PAE), 2015 WL 3443918, at *13 (S.D.N.Y. May 29, 2015). *Accord Lopez v. Ctpartners Exec. Search, Inc.*, 173 F. Supp. 3d 12, 31 n.7 (S.D.N.Y. 2016).

129. *In re Millennial Media*, 2015 WL 3443918, at *13–14.

130. *Id.* at *1.

131. See Smollar, *supra* note 13, at 524 ("Plaintiffs' attorneys need to make sure to disclose to the CW that his or her testimony is not confidential."); Speers, *supra* note 96, at 7 ("Additionally, plaintiffs' counsel should ensure that each interviewee is notified of counsel's intent to designate him or her as a CW and that such designation may result in the public disclosure of the witness's name.").

Third, Judge Engelmayer suggested that when an investigator conducts a witness interview telephonically, either a colleague of the investigator should join the call or the call should be recorded.¹³² In fact, plaintiffs' investigators in securities fraud litigation do tend to interview CWs telephonically, taking notes contemporaneously with the interview, rather than conducting the interviews face-to-face.¹³³ There may be several explanations for this, including expense and exigency.¹³⁴ Recording telephonic interviews may not always be an option, given that some jurisdictions prohibit the taping of telephone conversations without the consent of all parties to the call,¹³⁵ but investigators should seek consent. Where there is no recording, the investigator should be joined on the call by at least one other colleague.¹³⁶ Both recordings and joint calls can help reduce the incidents of recanting, by corroborating the lead investigator's accounts of the witnesses' statements.

Plaintiffs' counsel would be wise to comply with Judge Engelmayer's suggested procedures. The opinion is the first to set forth guideposts for conducting acceptable CW interviews and counsel failing to adhere to this guide run the risk, at least in his courtroom, of losing motions to permit discovery of CWs before motions to dismiss are resolved.¹³⁷ The Southern District of New

132. *In re Millennial Media*, 2015 WL 3443918, at *6 n.4. This third suggestion echoes comments made by Judge Rakoff two years earlier in the *Lockheed* case. See *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.*, 952 F. Supp. 2d 633, 637 (S.D.N.Y. 2013) (noting that the investigator's testimony "revealed that his interview practices were less rigorous than would have been typical of, say, a federal law enforcement agent; for example, he did not ask any other member of his staff to be with him on his phone calls with the CWs, nor did he ask the CWs if he could tape-record the calls or meet with them in-person, preferring to rely, instead, on his non-stenographic notes of the telephone conversations made even while the conversations were continuing.").

133. Smollar, *supra* note 13, at 504.

134. See *id.* at 511 ("Investigators must be allowed to talk to these witnesses whenever and wherever they can.").

135. See Carol M. Bast, *Conflict of Law and Surreptitious Taping of Telephone Conversations*, 54 N.Y. L. SCH. L. REV. 147, 148 (2010) ("Although the federal government and a majority of states allow surreptitious taping of a telephone conversation with one-party consent, this practice violates state statutes in ten states.").

136. See Gregory A. Markel et al., Practice Note, *Securities Litigation: Defending Against Confidential Witness Allegations*, THOMSON REUTERS PRACTICAL LAW <http://us.practicallaw.com/w-000-6239?source=relatedcontent> [https://perma.cc/E6FA-E2M4 (staff uploaded archive)] (stating that best practices for plaintiffs include (1) having at least two individuals participate in any interviews of CWs, (2) the investigator or counsel meeting the CW in person, rather than solely over the phone, and (3) requesting permission to record the interview).

137. See Davidow et al., *supra* note 114 ("Following *Millennial Media*, if plaintiffs' counsel failed to comply with any of Judge Engelmayer's procedures in obtaining the

York, where Judge Engelmayer sits, is the locus of many securities class action filings. Even if other district court judges fail to expressly endorse his approach, counsel would be wise to accept it voluntarily. His suggestions offer the opportunity to minimize the widespread problem of alleged CW recanting in securities litigation.

Competing proposals to deal with the recantation problem seem ill-advised. One suggestion, publicly offered by defense counsel for Millennial Media in the securities litigation, is that Congress should amend the PSLRA to require plaintiffs, through their counsel, to file sworn certificates stating they have confirmed the accuracy of any CW statements used in the complaint and have notified any quoted individuals that they may be witnesses at trial.¹³⁸ This is not a radical suggestion, given that the PSLRA already requires plaintiffs to file sworn certifications stating, *inter alia*, that they have reviewed the complaint, authorized its filing, and are willing to act as representative plaintiffs.¹³⁹ But it does seem designed primarily to chill the willingness of CWs to assist plaintiffs and their counsel. Requiring notice to CWs that they may be trial witnesses seems like an intimidation tactic, especially since so few securities class actions actually do proceed to trial.

A second proposal, also from the defense bar, is 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-filing investigation itself.¹⁴⁰ This requirement appears both unnecessary and unduly burdensome. It is unclear what kind of allegations would suffice as to the reliability of a plaintiff's investigator, and mandating that a complaint include a detailed description of plaintiff's pre-filing investigation risks the forced disclosure of attorney work product.

A third proposal, again from the defense bar, is that plaintiffs' counsel "be required to obtain from each [CW] a declaration and/or a certification that he or she has read the complaint and agrees with the

confidential witness statement, a court may be more likely to grant a motion for discovery into the confidential witness allegations pre-motion to dismiss, or at least to be sensitive to these issues in considering a motion to dismiss.").

138. See Lyle Roberts, *Time for Securities Lawyers to Stand Behind Their 'Confidential Witnesses,'* FORBES (Aug. 19, 2016), <https://www.forbes.com/sites/danielfisher/2016/08/19/time-for-securities-lawyers-to-stand-behind-their-confidential-witnesses/#e3a9205a6e04> [<https://perma.cc/7THM-34L6>] ("It is time for Congress to close the 'confidential witness' loophole.").

139. See 15 U.S.C. § 78u-4(a)(2)(A) (2012).

140. See Loewenson & Beha II, *supra* note 90.

description of the information he or she provided.”¹⁴¹ According to one proponent of this requirement, it “would prevent most CW problems, and make the ones that do arise much easier to resolve.”¹⁴² While it may be true that many CWs with accurate information to offer would want to provide a certification to avoid the disruption that can result if a complaint fails to accurately reflect the witness’ account,¹⁴³ there could be a chilling effect on many other witnesses who are reluctant to sign formal documents under oath.¹⁴⁴ Moreover, the proposal creates logistical complications. Requiring plaintiffs’ initial case filings to include sworn declarations from the CWs referenced in the complaint “defeats the purpose of having ‘confidential’ witnesses.”¹⁴⁵ If the certifications are to be filed contemporaneously with the filing of the complaint, they would have to be filed under seal and made inaccessible to defendants in order to preserve the CWs’ anonymity at the pleading stage of litigation. Otherwise, defendants could unmask CWs simply by accessing their signed declarations, which would elevate the substantial risk of retaliation.

Other problems would arise where a CW is identified by defendants who submit a recanting declaration during the pendency of a motion to dismiss or a motion for reconsideration following denial of a motion to dismiss. Submission of a recanting declaration, followed by unsealing of the CW’s certification, would require the court to (1) improperly consider extrinsic evidence, (2) make an improper credibility determination, and (3) permit a violation of the PSLRA’s stay of discovery and other proceedings. First, it is well established that in general courts are barred from considering extrinsic evidence when deciding motions to dismiss.¹⁴⁶ Recanting declarations should be encompassed by this prohibition.¹⁴⁷ Second,

141. Greene, *supra* note 101.

142. *Id.*

143. *Id.*

144. Smollar, *supra* note 11, at 4 (“[A]ny requirement that former employees sign a formal legal document, especially under oath, would have a chilling effect on their willingness to reveal what they know.”).

145. Smollar, *supra* note 13, at 510.

146. See FED. R. CIV. P. 12(b); see also *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997) (“As a general matter, a district court ruling on a motion to dismiss may not consider matters extraneous to the pleadings.”); *Pension Benefit Guar. Corp. v. White Consol. Indus., Inc.*, 998 F.2d 1192, 1196 (3d Cir. 1993) (“To decide a motion to dismiss, courts generally consider only the allegations contained in the complaint, exhibits attached to the complaint and matters of public record.”).

147. See Eisenkraft, *supra* note 123 (“[R]ecantation affidavits from confidential witnesses are no different than any other extrinsic evidence and cannot be considered on a

whether a recanting CW did make statements attributed to him in a complaint is essentially a credibility question,¹⁴⁸ and a motion to dismiss is not the proper vehicle to test the credibility of witnesses. The Supreme Court has been clear that credibility assessments are within the purview of the ultimate trier of fact.¹⁴⁹ Accordingly, courts should decline to consider affidavits or declarations from recanting CWs when deciding motions to dismiss or motions to reconsider denials of motions to dismiss. Third, as noted previously, the PSLRA requires that “all discovery and other proceedings” be stayed pending any motion to dismiss¹⁵⁰ and courts have tended to interpret this provision broadly. 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. Several courts have so held.¹⁵¹ Other

motion to dismiss when every allegation must be taken as true.”). Less clear-cut are motions for reconsideration following the denial of motions to dismiss. In securities litigation, where the PSLRA establishes a high scienter pleading standard, some courts will consider extrinsic evidence—including CW recanting declarations—on motions for reconsideration if a manifest factual error was made by the court when deciding the initial motion to dismiss. This may be limited to situations where the error was based on fraud by the plaintiff, carelessness by plaintiff’s counsel in making its factual allegations, or by the court’s own misperception of the facts. *See Belmont Holdings Corp. v. SunTrust Banks, Inc.*, 896 F. Supp. 2d 1210, 1220–24 (N.D. Ga. 2012); *see also City of Livonia Emps.’ Ret. Sys. v. Boeing Co.*, 711 F.3d 754, 759–60, 761 (7th Cir. 2013) (affirming dismissal of action following successful motion for reconsideration that included deposition testimony from CW that he had no personal knowledge of facts attributed to him in complaint); John D. Pernick & Ryan D. Nassau, *Testing and Attacking Confidential Witness Allegations at an Early Stage*, AM. BAR ASS’N SEC. LITIG. COMM. (Mar. 20, 2014), <http://apps.americanbar.org/litigation/committees/securities/articles/winter2014-0314-testing-attacking-confidential-witness-allegations-at-an-early-stage.html> [https://perma.cc/7S8S-EXMH] (“For the most part, courts are reluctant to consider disputes regarding the accuracy of CW allegations in the context of a motion to dismiss, although they seem to be more receptive to such evidence in the context of a motion for reconsideration.”).

148. *See In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1312 (S.D. Fla. 2011) (“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.”).

149. *See, e.g., Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 328 (2007) (stating that it is “within the jury’s authority to assess the credibility of witnesses, resolve any genuine issues of fact, and make the ultimate determination whether [defendants] acted with scienter”).

150. 15 U.S.C. § 78u-4(b)(3)(B) (2012).

151. *See, e.g., In re ProQuest Sec. Litig.*, 527 F. Supp. 2d 728, 740 (E.D. Mich. 2007) (concluding that by seeking and obtaining a declaration from a CW during the pendency of a motion to dismiss, defendant ProQuest “engaged in discovery which was wholly improper”). In *Union Asset Management. Holding AG v. SanDisk LLC*, 227 F. Supp. 3d 1098 (N.D. Cal. 2017), defendant SanDisk tried to finesse the issue by submitting a recanting declaration ostensibly to support its request to deny leave to amend, rather than

courts have held that the PSLRA's automatic stay does not encompass investigatory interviews conducted during the pendency of a motion to dismiss,¹⁵² but those cases can be distinguished, at least in part because they did not involve submission to the court of recanting affidavits.¹⁵³ They merely involved interviews of prospective witnesses.¹⁵⁴ Overall, the proposal that plaintiffs' counsel 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 information he has provided seems unwise.

Some of the reasons set forth above also undermine yet another approach to the problem of recanting witnesses—permitting their depositions during the pendency of motions to dismiss. This approach has been endorsed in dicta by the Second Circuit, in *Campo v. Sears Holding Corp.*¹⁵⁵ Many defense lawyers expected and hoped that *Campo* would initiate a trend.¹⁵⁶ It did not,¹⁵⁷ and that is appropriate, because *Campo*'s dicta missed the mark. Post-*Campo*, those courts considering the issue have rejected attempts to depose CWs prior to resolving motions to dismiss, in part because the PSLRA's automatic discovery stay prohibits the taking of such depositions during the

in direct support of its motion to dismiss. *Id.* at 1099. The district court properly rejected this end-run, by granting plaintiff's motion to strike the recanting declaration and denying SanDisk's motion to dismiss. *Id.* at 1099–1101. Other courts have disagreed, and relied on recanting declarations to dismiss securities cases with prejudice, following reconsideration of the denial of motions to dismiss. *See, e.g., Belmont Holdings Corp. v. SunTrust Banks, Inc.*, 896 F. Supp. 2d, 1210, 1220–21 (N.D. Ga. 2012) (CW submits multiple declarations contradicting statements attributed to him in amended complaint and denying having ever made such statements to plaintiffs' investigators).

152. *See, e.g., In re JDS Uniphase Corp. Sec. Litig.*, 238 F. Supp. 2d 1127, 1134 (N.D. Cal. 2002) (holding that plaintiff's proposed interviews with former employees were not within the scope of discovery because “[n]either the former employees nor the defendants [were] required to participate in these interviews in any way”); *In re Tyco Int'l Ltd. Sec. Litig.*, No.00-MD-1335-B, 2001 WL 34075721, at *2–3 (D.N.H. Jan. 30, 2001) (holding that a voluntary interview of Tyco's former employee was not within the scope of discovery because “[t]here is not the slightest hint in the congressional record that the discovery stay was intended to apply to either parties' own investigation”).

153. *See JDS Uniphase*, 238 F. Supp. 2d at 1133–34; *Tyco*, 2001 WL 34075721, at *2–3.

154. *See JDS Uniphase*, 238 F. Supp. 2d at 1133–34; *Tyco*, 2001 WL 34075721, at *2–3.

155. 371 F. App'x 212, at 216 n.4 (2d Cir. 2010).

156. *See* Bryan B. House, *The Fact Pattern Behind the Boeing Class Action Grounding*, LAW360 (Apr. 2, 2013, 12:02 PM), <http://www.law360.com/articles/429130/the-fact-pattern-behind-the-boeing-class-action-grounding> [<https://perma.cc/78FL-7AMT>]; *see also* Joseph C. Weinstein & Joseph P. Rodgers, *Unmasking Confidential Witnesses?*, LAW360 (June 23, 2010, 11:59 AM), <http://www.law360.com/articles/172877/unmasking-confidential-witnesses> [<https://perma.cc/GU3F-KB4R> (staff uploaded archive)] (“Many securities litigators believe *Campo* is a step in the right direction.”).

157. *See* Pernick & Nassau, *supra* note 147 (“Other courts have been reluctant to follow *Campo*.”).

pendency of motions to dismiss.¹⁵⁸ *Campo*'s approach also violates Rule 12(b), which generally prohibits consideration of material beyond the pleadings in ruling on a Rule 12(b)(6) motion.¹⁵⁹

In summary, recanting CWs are a significant recurring problem in securities litigation, even though the incidence of genuine recanting has been overstated. The root of the recanting problem can be traced to the manner in which these individuals are interviewed pre-filing by plaintiffs and their investigators. Judge Engelmayer set forth some best practices for handling such interviews, and they appear to be both practical and preferable to the competing proposals most often publicized by defense counsel.¹⁶⁰

IV. DISCOVERABILITY OF CW INTERVIEW NOTES

A third contentious aspect of CW interviews by plaintiffs' counsel and/or investigators is whether notes of those interviews are discoverable. Defendants may seek discovery of interview notes for multiple reasons, both disclosed and undisclosed. The reasons may include the opportunity to discover evidence that impeaches the CWs or evidence that tends to reveal plaintiff's litigation strategy. As discussed below, plaintiffs generally resist discovery, often by claiming work product protection.

The discoverability issue has numerous prongs. The first is whether interview notes enjoy work product protection. As to this, "[c]ourts have consistently held that notes and memoranda . . . with respect to a witness interview 'are opinion work product entitled to

158. See, e.g., *Belmont Holdings Corp. v. SunTrust Banks, Inc.*, 896 F. Supp. 2d 1210, 1217 n.6 (N.D. Ga. 2012); *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).

159. *In re Cell Therapeutics*, 2010 WL 4791808, at *2 ("The only permissible way under the FRCP's [sic] to consider extrinsic evidence such as Defendants propose is to convert Defendants' pending motion to dismiss to a motion for summary judgment."). Cf. *In re St. Jude Medical Inc. Sec. Litig.*, 836 F. Supp. 2d at 901 n.9 (expressing doubt about the propriety of addressing factual accuracy of an affidavit submitted by a CW in connection with a Rule 12(b)(6) motion).

160. Judge Engelmayer's recommended best practices may be gaining traction. In July 2017, the Duke Law Center for Judicial Studies sponsored a conference on "Emerging Issues in Securities Class Actions" that was limited to invited federal judges and prominent securities lawyers. See Coffee, Jr., *supra* note 46; *Emerging Issues in Securities Class Actions*, DUKE LAW, <https://law.duke.edu/judicialstudies/conferences/july2017/> [<https://perma.cc/Z926-GZC7>]. The purpose of the conference was to lay the groundwork for the adoption of bench-bar best practices in six aspects of securities litigation, the first of which was the use of confidential witnesses. *Id.*

almost absolute immunity.”¹⁶¹ This is true whether or not the witness is an employee of the defendant.¹⁶² Defendants sometimes try to undercut this consistent holding by arguing that they seek the production of interview notes reflecting facts learned by plaintiffs during CW interviews, and neither the attorney-client privilege nor the work product doctrine protects underlying facts.¹⁶³ But this argument should generally fail, because it is rarely feasible to separate the purely factual components of interview notes from that portion reflecting the attorneys’ mental impressions, conclusions, opinions, or legal theories.¹⁶⁴

A separate but related prong is whether notes of interviews conducted by plaintiffs’ investigators enjoy the same degree of protection extended to notes of interviews conducted by plaintiffs’ counsel. The issue is important because, as noted, CW interviews are frequently conducted by investigators. This phenomenon is not unique to class action securities litigation. Attorneys often must rely on the assistance of investigators and other agents during litigation in a broad spectrum of subject areas. Courts have recognized this necessity and have held that the work product doctrine protects both materials prepared by agents for the attorneys and those prepared by the attorney for himself.¹⁶⁵ Agents whose materials prepared in

161. *Murphy v. Kmart Corp.*, 259 F.R.D. 421, 428 (D.S.D. 2009) (quoting *Baker v. Gen. Motors Corp.*, 209 F.3d 1051, 1054 (8th Cir. 2000)); *see also Hickman v. Taylor*, 329 U.S. 495, 511 (1947) (noting that work product may include facts and theories reflected in interviews); *Buck v. Indian Mountain Sch.*, No. 15 CV 123 (JBA), 2017 WL 421648, at *3 (D. Conn. Jan. 31, 2017) (finding that the attorney’s “notes of witness interviews, which include his mental impressions and thought processes, are protected work-product”).

162. *See Michaelbrent Collings, Discoverability of Attorney Interview Notes*, L.A. LAW. Dec. 2006, at 12, <https://www.lacba.org/docs/default-source/lal-back-issues/2006-issues/december-2006.pdf> [<https://perma.cc/HWP9-7VLJ>] (“[T]he standing or status of a witness does not seem to matter in the determination of whether attorney notes are discoverable.”).

163. *See Gucci Am., Inc. v. Guess?, Inc.*, No. 09 Civ. 4373(SAS)(JLC), 2010 WL 2720015, at *3 (S.D.N.Y. June 9, 2010).

164. FED. R. CIV. P. 26(b)(3)(B); *see Upjohn Co. v. United States*, 449 U.S. 383, 399 (1981) (“Forcing an attorney to disclose notes and memoranda of witnesses’ oral statements is particularly disfavored because it tends to reveal the attorney’s mental processes”); *SEC v. NIR Grp., LLC*, 283 F.R.D. 127, 135 (E.D.N.Y. 2012) (denying motion to compel disclosure of witness interview notes, because attorney’s mental impressions in notes “cannot be adequately extricated from the facts”).

165. *Gucci Am., Inc. v. Guess?, Inc.*, 271 F.R.D. 58, 74 (S.D.N.Y. 2010) (citing *United States v. Nobles*, 422 U.S. 225, 238–39 (1975)). *Accord NIR Grp., LLC*, 283 F.R.D. at 134 (“The work product privilege protects documents produced by staff working at an attorney’s direction, in addition to those prepared by the attorney herself.”).

anticipation of litigation are protected by the work product doctrine include investigators.¹⁶⁶

A third prong concerns the requisite showing by defendants to overcome the work product protection extended to CW interview notes created by plaintiffs' counsel and investigators. Work product may be subject to disclosure upon an adverse party's demonstration of substantial need for the materials and undue hardship in obtaining the substantial equivalent.¹⁶⁷ Defendants in class action securities litigation sometimes argue that they have substantial need for CW interview notes to confirm the veracity of certain allegations set forth in the complaint, or because CWs allegedly have recanted certain allegations attributed to them.¹⁶⁸ This argument should fail in most cases, insofar as CWs typically can be deposed once the PSLRA discovery stay is lifted and their availability for deposition undermines a claim of substantial need for work product material. As noted by one federal district court, "the party seeking discovery can ask the witness himself about the events in issue, and, if the witness recalls the events in issue, the need for notes or other materials prepared by opposing counsel is, thereby, eliminated."¹⁶⁹ Moreover, as noted, defendants' claims that CWs have recanted, or that the allegations attributed in complaints to the CWs are inaccurate, often are meritless. A recent example is *In re Barrick Gold Securities*

166. *Constable v. Cty. of Westchester*, 254 F.R.D. 160, 164 (S.D.N.Y. 2008) ("Agents include those who are enlisted by legal counsel to perform investigative or analytical tasks to aid counsel in preparing for litigation.") (citing *Kayata v. Foote, Cone & Belding Worldwide, L.L.C.*, No. 99 CIV. 9022 VM KNF, 2000 WL 502859, at *2 (S.D.N.Y. Apr. 26, 2000)).

167. FED. R. CIV. P. 26(b)(3)(A)(ii); see *FTC v. Staples, Inc.*, Civ. Action No. 15-2115 (EGS), 2016 WL 259642, at *3 (D.D.C. Jan. 21, 2016) ("'[U]ndue hardship' is generally found only in extreme circumstances such as unavailability due to death, brain injury or where a witness's geographic location is beyond the court's subpoena power.") (citing EDNA SELAN EPSTEIN, *THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK-PRODUCT DOCTRINE* 927-32 (5th ed. 2007)).

168. See, e.g., *In re Barrick Gold Sec. Litig.*, No. 13-cv-3851 (SAS), 2016 WL 1459674, at *1-2 (S.D.N.Y. Apr. 8, 2016).

169. *A.I.A. Holdings, S.A. v. Lehman Bros., Inc.*, No. 97 Civ. 4978(LMM)(HB), 2002 WL 31385824, at *9 (S.D.N.Y. Oct. 21, 2002); see also *Staples, Inc.*, 2016 WL 259642, at *3-5 (denying motion to compel production of witness interview notes, because defendants could "interview or depose as many of the third parties that were interviewed or deposed by the Plaintiffs as desired"); *SEC v. Neil*, No. C 14-00122 WHA, 2014 WL 2931096, at *1, 5 (N.D. Cal. June 27, 2014) (denying defendant's request to compel production of raw notes and memoranda from SEC's informal interviews with voluntary witnesses); *SEC v. Stanard*, No. 06 Civ. 7736 (GEL), 2007 WL 1834709, at *2 (S.D.N.Y. June 26, 2007) (rejecting claim of substantial need for interview notes because "[d]efendants are free to question each of the witnesses at their depositions, and at trial").

*Litigation.*¹⁷⁰ In that case, decided in 2016, the federal district judge denied defendants' motion to compel the production of CW interview notes created by plaintiffs' investigator after conducting an in camera inspection of the notes and determining that the amended complaint's attributions to the CWs accurately reflected the contents of the notes.¹⁷¹ Overall, in most securities cases, courts should reject defendants' efforts to overcome work product protection by showing substantial need for CW interview notes created by plaintiffs' counsel and investigators.

A fourth prong concerns whether plaintiffs waive the protection of the work product doctrine by selectively using CW interview notes as both a shield and a sword. It is well established that waiver can occur where a party makes "deliberate, affirmative, and selective use of work product" materials,¹⁷² and the use of such materials as both a shield and a sword can result in waiver.¹⁷³ Here, the argument by defendants may be that if a CW allegedly recants, either before or during his deposition, and plaintiffs' counsel then seeks to impeach the CW's deposition testimony by using the investigator's interview notes, this constitutes selective use of the notes as both a shield and a sword. This argument should fail, at least where the impeachment effort is limited to questioning the CW about the substance of his conversations with the investigator, rather than questioning the witness about the interview notes.¹⁷⁴ If the CW is not questioned about the notes, there is no proscribed use of them as both a shield and a sword.

A fifth prong is whether the work product doctrine protects the identities of those persons interviewed by an attorney or his agent in anticipation of litigation. While this has been described as an unsettled question,¹⁷⁵ the better-reasoned decisions distinguish

170. No. 13-cv-3851 (SAS), 2016 WL 1459674 (S.D.N.Y. Apr. 8, 2016).

171. *Id.* at *1, *3.

172. SEC v. Gupta, 281 F.R.D. 169, 173 (S.D.N.Y. 2012).

173. See Seneca Ins. Co. v. Western Claims, Inc., 774 F.3d 1272, 1278 (10th Cir. 2014) ("[A] litigant cannot use the work product doctrine as both a sword and shield by selectively using the privileged documents to prove a point but then invoc[e] the privilege to prevent an opponent from challenging the assertion." (quoting Frontier Ref., Inc. v. Gorman-Rupp Co., 136 F.3d 695, 704 (10th Cir. 1998))); Chevron Corp. v. Donziger, No. 11 Civ. 0691 (LAK) (JCF), 2013 WL 4045326, at *4 (S.D.N.Y. Aug. 9, 2013) (applying the sword-shield doctrine and ordering production of documents).

174. See Constabile v. Cty. of Westchester, 254 F.R.D. 160, 167 (S.D.N.Y. 2008) (finding no proscribed use by plaintiffs of investigator's report as both shield and sword, and therefore no waiver of work product protection).

175. See US Bank Nat'l Ass'n v. PHL Variable Ins. Co., Nos. 12 Civ. 6811(CM)(JCF), 13 Civ. 1580(CM)(JCF), 2013 WL 5495542, at *9 (S.D.N.Y. Oct. 3, 2013).

between discovery requests seeking an identification of persons knowledgeable about the adverse party's claim or defenses from those seeking an identification of persons who have been contacted or interviewed by counsel concerning the case. The former requests are permissible, while the latter are not. They are impermissible because such requests seek to disclose the mental processes and strategic assessments of counsel.¹⁷⁶ A sub-issue arises from a situation in which plaintiffs rely on a particular CW in an early iteration of their filed complaint, but remove references to that individual in a subsequent version of the complaint. If defendants seek disclosure of that CW's identity, is that tantamount to seeking identification of persons who have been interviewed by counsel and therefore impermissible? At least one court has addressed this issue and concluded that the defendants' request did not seek work product, because defendants merely sought the identity of a CW who plaintiffs identified in their initial complaint as someone with knowledge of their claims.¹⁷⁷ It is not clear that this perspective is correct. All CWs in securities cases will have been interviewed by plaintiffs' counsel or their investigators, so a discovery request seeking the identification of a CW included in an original complaint but then omitted from an amended complaint arguably does seek the identification of a witness interviewed by counsel or her agent.

Overall, the discoverability of notes taken by plaintiffs' counsel and/or investigators during the course of interviewing CWs pre-filing is another thorny issue in securities litigation. Defendants may seek these notes to discover impeachment material, or perhaps to covertly discover plaintiffs' litigation strategy. Whatever the motive, such notes should be protected from disclosure in most cases by the attorney work-product doctrine, whether the interview was conducted by counsel or investigators retained by counsel on behalf of plaintiffs.

176. See, e.g., *Hamilton v. RadioShack Corp.*, No. C 11-00888 LB, 2012 WL 2327191, at *2 (N.D. Cal. June 18, 2012) (denying motion to compel disclosure of witnesses who were interviewed by opposing counsel because disclosure would involve protected work product); *Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Sys.*, No. C01-20418, 2005 WL 1459555, at *4 (N.D. Cal. June 21, 2005) (identifying names of investigatory interviewees "would allow Defendants to infer the importance of these witnesses, revealing Plaintiff's legal theories and conclusion[s]"); *In re MTI Tech. Corp. Sec. Litig. II*, No. SACV 00-0745 DOC, 2002 WL 32344347, at *3 (C.D. Cal. June 13, 2002) ("[T]he identity of witnesses interviewed by opposing counsel is protected . . . [I]f the identity of interviewed witnesses is disclosed, opposing counsel can infer which witnesses counsel considers important, revealing mental impressions and trial strategy.").

177. See *Hatamian v. Advanced Micro Devices, Inc.*, No. 14-cv-00226-YGR (JSC), 2015 WL 5604392, at *2 (N.D. Cal. Sept. 24, 2015).

CONCLUSION

CWs play an essential role in securities class action litigation, as an unintended consequence of the PSLRA. The use of CWs by plaintiffs has generated a series of vexing issues. One set of issues concerns the use by companies of confidentiality, separation, and severance agreements to preclude or chill the opportunity for employees or former employees to be interviewed by plaintiffs' counsel or investigators during the pre-filing phase of litigation. Courts should generally refuse to enforce these agreements on public policy grounds and consistent with the recent approach taken by the SEC under Rule 21F-17. A second set of issues concerns CWs who recant or are alleged to have recanted. Recanting is less common than defendants often assert and much of the recanting that does occur is the result of pressure exerted by defendants. Still, some recanting is genuine. Recanting likely could be minimized if plaintiffs' counsel and investigators followed prudent guidance concerning CW interviews provided by Judge Engelmayer in a decision he issued in 2015. Finally, the use of CWs raises a spectrum of issues concerning the discoverability of notes of CW interviews. In most situations those notes should be protected from discovery by the work product doctrine, whether the interview was conducted by counsel or counsel's investigator. Courts generally should reject defendants' efforts to overcome work product protection by arguing substantial need. Proscribed use by plaintiffs of the notes as both a shield and a sword can be avoided by careful counsel. Finally, the identities of those CWs who are interviewed by plaintiffs' counsel or investigators should be protected by the work product doctrine.

Notwithstanding the numerous problems created by the widespread reliance by plaintiffs on CWs in securities litigation, courts should not take steps that would significantly restrict their use. Given the obstacles imposed by the PSLRA, the opportunity to use CWs often represents the only viable opportunity for plaintiffs to survive a motion to dismiss. If this opportunity disappears, then private securities litigation may go with it. And that would be a tremendous disservice to the investing public. Plaintiffs' lawyers no doubt have abused their use of CWs in multiple cases, but that abuse—exaggerated by defendants—does not justify some of the drastic remedial measures suggested by the defense bar. Alternative moderate steps are much more appropriate.