The Association of the Bar of the City of New York
Securities Litigation Committee
Subcommittee 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

Set forth below are separate discussions by the members of the Subcommittee representing, respectively, plaintiffs and defendants in securities litigation. Both provide summaries of current law governing the use of information from, and the disclosure of the identity of, informants, as well as proposals regarding topics on which the law is unsettled or which, in the view of the authors, warrant reconsideration. The members of the Subcommittee generally agreed on the relevant issues and the reports below adopt similar formats. Subcommittee members found, however, that their opposing concerns prevented consensus on most issues. Defense counsel focused on the potential for misuse of information from sources if the existence, knowledge and biases of such sources cannot be tested through the adversarial process. Plaintiffs' counsel focused on the chilling effect and risks to potential sources of a regime in which their disclosure and examination are routine.

VIEW FROM THE PLAINTIFFS' SIDE

Informants play an important role in detecting and prosecuting wrongdoing. They have been described by a former FBI Director as "the single most important tool in law enforcement"[1] and have been recognized by the Supreme Court as "a vital part of society's defensive arsenal."[2] Corporate employee-informants perform a particularly important role by reporting wrongdoing that can inflict widespread injury and could otherwise be nearly impossible to detect.[3]

The importance of informants in securities law enforcement is illustrated by the Sarbanes-Oxley Act of 2002 ("SOX") and the events leading to its enactment. The popular press extensively reported on the efforts of Sherron Watkins, a mid-level manager at Enron Corp., to report suspected fraud at the company, and she was cited in SOX's legislative history.[4] In turn, SOX has been described as "us[ing] whistleblower protection as a key component of enforcement of federal securities laws."[5] SOX mandated a variety of measures to support and protect employees who report wrongdoing.[6] Among these provisions, SOX established a civil remedy for employees of public companies who "file, cause to be filed, testify, participate in, or otherwise assist in a proceeding" relating to violations of federal law (including securities laws)

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[1] Robert M. Bloom, *Ratting: The Use and Abuse of Informants in the American Justice System* 158 (2002) (quoting William Webster).

[2] *McCray v. Illinois*, 386 U.S. 300, 307 (1967).

[3] *See* Marlene Winfield, *Whistleblowers as Corporate Safety Net, in Whistleblowing – Subversion or Corporate Citizenship?* 21-31 (Gerald Vinten ed., 1994).

[4] S. Rep. No. 107-146 (2002).

[5] Daniel P. Westman & Nancy M. Modesitt, *Whistleblowing: The Law of Retaliatory Discharge* vii (2d ed. 2004).

[6] First, SOX required audit committees to "establish procedures for . . . the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters." SOX § 301. Second, SOX enacted severe criminal penalties for "interference with the lawful employment or livelihood" of employees who provide information relating to a federal offense. 18 U.S.C. § 1513(e). Other provisions are noted in the text.

and who are later the subject of retaliation therefor.[7] By its terms, this provision provides protection for individuals who participate in or otherwise assist private securities fraud actions.

Informants are especially valuable in private securities litigation. In 1995, Congress enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA"), with the goal of "combatting . . . abuses" in securities actions.[8] As part of its efforts to deter frivolous litigation, Congress enacted uniquely high pleading standards for private securities actions, and imposed a stay on all discovery until the plaintiff has overcome a motion to dismiss. However, Congress made it clear that it intended to "maintain[] the incentive for bringing meritorious actions,"[9] recognizing that private securities actions are an "indispensable tool" for compensating victims of fraud.[10] 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 need to shield whistleblowers from retaliation is widely acknowledged. SOX is only the most recent statute to prohibit retaliation, and dozens of other state and federal laws protect public and private sector employees who report wrongdoing.[11] In addition, the Supreme Court has held that the First Amendment protects public sector employees who criticize their employers,[12] and courts in many states have extended common law protection to employees who allege retaliation in response to their efforts to prevent or disclose unlawful practices.[13]

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[7] SOX § 806(a).

[8] *See* S. Rep. No. 104-98, at 4 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 683.

[9] *Id.*

[10] *See* H.R. Conf. Rep. No. 369, 104th Cong., 1st Sess. 31, at 31 (1995); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd*, 127 S.Ct. 2499, 2508 n.4 (2007).

[11] Westman & Modesitt, *supra* note 5, at 67, 77 and Appendix C.

[12] The leading case is *Pickering v. Board of Education*, 391 U.S. 563 (1968).

[13] Westman & Modesitt, *supra* note 5, at 132-38.

In the securities context, courts have repeatedly recognized the chilling effects of disclosing a confidential source's identity. In *Novak v. Kasaks*, for example, the Second Circuit observed that disclosing confidential sources' identities at the pleading stage "could deter informants from providing critical information to investigators in meritorious cases or invite retaliation against them . . . ."[14] Other circuit courts have expressed the same view.[15]

The experience of the plaintiffs' counsel on the Subcommittee fully bears out the views expressed by these Court of Appeals. In many cases, witnesses have been willing to provide information only after counsel have solemnly pledged to do all in their power to shield their identities from later disclosure. In discovery, faced with demands by defense counsel for disclosure of witnesses' identities, confidential sources have reacted with alarm at the prospect that their names would be disclosed, and may provide affidavits swearing to their reasons for fearing harm to their livelihoods in the event of disclosure. Even with statutory protections, witnesses see great risk to their reputations and careers by being "outed" as whistleblowers: suspicion on the part of their current employers; ill-will from former employers on whom they depend for references; strained relations in their professional social networks; and the burden and distraction of being embroiled in high-stakes litigation.

While SOX provides important remedies for informants faced with retaliation, federal courts have repeatedly recognized the limited efficacy of remedial measures, and that "the most effective protection from retaliation is the anonymity of the informer."[16] As the Ninth Circuit has observed, informants are far better served "by concealing their identities than by relying on the

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[14] 216 F.3d 300, 314 (2d Cir. 2000).

[15] *In re Cabletron Sys., Inc.*, 311 F.3d 11, 30 (1st Cir. 2002); *New Jersey Carpenters Pension & Annuity Funds v. Biogen Idec, Inc.*, 537 F.3d 35, 52 (1st Cir. 2008); *California Public Employees' Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 147 (3d Cir. 2004); *ABC Arbitrage Plaintiffs Group v. Tchuruk*, 291 F.3d 336, 352-53 (5th Cir. 2002); *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 596 (7th Cir. 2006), *rev'd on other grounds*, 127 S. Ct. 2499 (2007).

[16] *Wirtz v. Cont'l Fin. & Loan Co. of West End*, 326 F.2d 561, 563-64 (5th Cir. 1964).

deterrent effect of *post hoc* remedies under [a statutory] anti-retaliation provision."[17] Other courts have held the same.[18] Moreover, the remedies available only address retaliation against current employees who blow the whistle on wrongdoing at their employer; they provide no protection for a whistleblower who finds him or herself unable to find a new position in the industry with a different employer – which is one of the particular concerns that whistleblowers often have.

I. Use and Disclosure of Confidential Sources at the Pleading/Motion to Dismiss Stage

Under the PSLRA, plaintiffs must allege facts "sufficient to support a reasonable belief" that defendants' statements were false.[19] Additionally, plaintiffs must allege "facts giving rise to a strong inference" that the defendant acted with scienter. *Novak,* 216 F.3d at 307 (quoting 15 U.S.C. § 78u-4(b)(2)). As the Supreme Court has explained, "[t]he inquiry … is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*[20] Even relatively vague individual allegations may be considered as part of this total mix, although more vague allegations may not contribute much to the inquiry.[21]

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[17] *Does I thru XXIII v. Advanced Textile Corp.*, 214 F.3d 1058, 1071 (9th Cir. 2000) (citation omitted).

[18] *See Dole v. Local 1942, Int'l Bhd. of Elec. Workers*, 870 F.2d 368, 372 (7th Cir. 1989) ("The most effective means of protection, and by derivation the most effective means of fostering citizen cooperation, is bestowing anonymity on the informant, thus maintaining the status of the informant's strategic position and also encouraging others similarly situated who have not yet offered their assistance.") and *Mitchell v. Roma,* 265 F.2d 633, 637 (3d Cir. 1959) ("The statutory prohibition against retaliation provides little comfort to an employee faced with the possibility of subtle pressures by an employer, which pressures may be so difficult to prove when seeking to enforce the prohibition.").

[19] *Novak*, 216 F.3d at 314 n.1; *see also ABC Arbitrage*, 291 F.3d at 352; *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1099 (10th Cir. 2003) (test is whether "a reasonable person would believe that the defendant's statements were false or misleading").

[20] 127 S.Ct. 2499, 2509 (2007).

[21] *See id.* at 2511.

Courts have recognized that the identities of confidential witnesses need not be disclosed in a complaint or in opposition to a motion to dismiss to meet these standards.[22] Instead, appellate courts have reasoned that a strong inference of scienter or a reasonable belief of falsity may be raised when the source is described with sufficient detail to "support the probability that a person in the position occupied by the source would possess the information alleged."[23] Under this standard, courts test the information provided by the source against the complaint's description of the source. If it is probable that a person meeting the description would possess the information supplied, then the source has been sufficiently described. So, for example, in *In re ATI Technologies, Inc. Securities Litigation*,[24] the court compared unnamed sources' job descriptions with the information provided by the sources: "The question here is whether, if sales of a [computer] chip were a 'disaster', a Hardware and Software Design Manager would likely know about it."[25] Similarly, in *Berson v. Applied Signal Technology, Inc.*,[26] the Ninth Circuit held that sources were sufficiently described because it was "plausible that 'engineers or technical editors' would know, or could reasonably deduce" that the company had suffered certain problems.[27] Other courts have approached the matter in a similar fashion, by comparing the information provided to the description of the source to determine if a source would likely possess such information.[28]

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[22] *See Novak*, 216 F.3d at 314; *ABC Arbitrage*, 291 F.3d at 351-52; *Florida State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 667-68 (8th Cir. 2001); *In re Daou Sys., Inc. Sec. Litig.*, 411 F.3d 1006, 1015 (9th Cir. 2005), *cert. denied*, 546 U.S. 1172 (2006); *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1239-40 (11th Cir. 2008).

[23] *Novak*, 216 F.3d at 314; *see also ABC Arbitrage*, 291 F.3d at 352.

[24] 216 F. Supp. 2d 418 (E.D. Pa. 2002).

[25] *Id.* at 436 n.11.

[26] 527 F.3d 982 (9th Cir. 2008)

[27] *Id.* at 985.

[28] *See, e.g.*, *In re Northpoint Communs. Group, Inc., Secs. Litig. & Con.*, 221 F. Supp. 2d 1090, 1098 (N.D. Cal. 2002) (where there exists a "nexus" between witness statement and description of job

Courts also consider a variety of other factors when determining the weight to accord information provided by a confidential source, including (i) the coherence, plausibility, and detail of the allegations, (ii) the number of witnesses or other information corroborating the statement, and (iii) the reliability of the source of the witness's information (e.g., eyewitness, specific report by other employee, general rumor).[29] As stated by the First Circuit in *In re Cabletron Systems*, search warrants provide a "helpful analogy" for making the initial assessment of plausibility required by the particularized pleading standards of Fed. R. Civ. P. 9(b) and the PSLRA.[30] But critically, detail should not be required merely for its own sake, for such a requirement would provide no guidance to courts or obvious stopping point[31]; instead, all that is necessary is that the complaint, taken as a whole, contains sufficient detail to create a strong inference of scienter, or a reasonable belief in a statement's falsity.[32]

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responsibilities, no need to disclose basis of witness's knowledge; otherwise, source of knowledge must be included); *In re Seebeyond Techs. Corp. Sec. Litig.*, 266 F. Supp. 2d 1150, 1159 (C.D. Cal. 2003) (sources sufficiently described because "information attributed to each [confidential source] does not appear unreliable or clearly beyond the type of knowledge that each source might have."); *In re Netsolve, Inc. Securities Litigation*, 185 F. Supp. 2d 684,0695 (W.D. Tex. 2001), *cited with approval in ABC Arbitrage*, 291 F.3d at 354 (source described as an "engineer" who worked on "customer related technical projects" sufficient because "It is conceivable that an engineering manager who consulted on 'customer-related' projects could have knowledge of the number of AT&T installations."); *Fitzer v. Security Dynamics Techs*, 119 F. Supp. 2d 12, 22 (D. Mass. 2000), *cited with approval in In re Cabletron Sys., Inc.*, 311 F.3d 11 (accepting information provided by anonymous sources because the plaintiff "has described the specific employment positions her sources held. This Court believes that persons in those positions are likely to have knowledge of the facts described.").

[29] *See In re Cabletron Sys., Inc.*, 311 F.3d at 28-30; *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1101 (10th Cir. 2003).

[30] 311 F.3d at 30.

[31] *Cf. Holmes v. Baker*, 166 F. Supp. 2d 1362, 1375 (S.D. Fla. 2001) (observing that "every complaint could be more detailed")

[32] *See Tellabs*, 127 S.Ct. at 2509; *Adams*, 340 F.3d at 1101-03; *cf. South Ferry LP v. Killinger*, 542 F.3d 776, 784 (9th Cir. 2008) ("*Tellabs* counsels us to consider the *totality of circumstances*, rather than to develop separately rules of thumb for each type of scienter allegation." (emphasis added)).

Defense counsel argue that confidential sources should be subject to "discounting," relying on the Seventh Circuit's decision in *Higginbotham v. Baxter International Inc*.[33] However, *Higginbotham* represents an outlier position at odds with the widely-applied multifactor, relevant-facts-and-circumstances test discussed above. *Higginbotham* is premised on a number of errors concerning confidential sources, including the view that "[t]here is no 'informer's privilege' in civil litigation" (discussed below), its assumption that such witnesses must be identified in a plaintiff's initial disclosures, its implication that there is not a basis for protecting the identities of confidential witnesses in later discovery, and its reliance on *In re Silicon Graphics Inc. Securities Litigation,*[34] a decision that had been overruled in relevant part several years earlier by *In re Daou Systems, Inc. Securities Litigation*.[35]

Moreover, *Higginbotham*, though purporting to base its newfound skepticism of confidential sources on the Supreme Court's holding in *Tellabs,* is actually at odds with that decision. As the Supreme Court made clear, allegations in complaint must be taken as true.[36] *Higginbotham*, however, justified the purported "discount" of confidential sources on the grounds that witnesses may be lying, or may not even exist, *see* 495 F.3d at 757, in flat contradiction to *Tellabs*. It is likely for this reason that *Higginbotham* was later limited by the Seventh Circuit's decision on remand in *Makor Issues & Rights, Ltd.v. Tellabs Inc.*[37] There, Judge Posner explicitly brought the Seventh Circuit in accord with other circuits, adopting the

[33] 495 F.3d 753 (7th Cir. 2007)

[34] 183 F.3d 970, 985 (9th Cir. 1999).

[35] 411 F.3d at 1015.

[36] *Tellabs*, 127 S.Ct. at 2509.

[37] 513 F.3d 702 (7th Cir. 2008).

standards articulated in *Novak* and similar cases.[38] Notably, the First Circuit has held that *Tellabs* did not change the law regarding the use of confidential sources,[39] and though Defense Counsel claim that the Fifth Circuit in *Indiana Electrical Workers' Pension Trust Fund IBEW v. Shaw Group, Inc.*[40] followed *Higginbotham*, in fact, a review of that decision demonstrates that the court, despite lip-service to *Higginbotham*, actually evaluated the plaintiffs' allegations using the same pre-*Higginbotham* precedent that had always governed in that circuit.[41]

Nor is Defense Counsel correct to argue that a more stringent approach is necessary to ensure that the complaint presents a "balanced" account of the source's statement, or to prevent defendants from having to endure "protracted" discovery. A complaint is document of advocacy, and need not present any more "balanced" view of the facts than defense counsel's answer and opposing briefs. It is Rule 11, not the PSLRA, that is intended to protect against fabricated or exaggerated allegations.[42] Nor is it relevant that in some cases, a complaint may survive a motion to dismiss but accusations of fraud will turn out to be unfounded; the PSLRA was intended to "erect barriers to frivolous strike suits,"[43] not to "move up the trial to the pleadings stage."[44] The purpose of the statute is not to determine at the point of the filing of the complaint whether defendants have, or have not, engaged in fraud, but is instead intended to protect "*facially* valid claims."[45] No detail beyond this standard is required.

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[38] *Id.* at 712. Nothing in *Makor* supports Defense Counsel's somewhat circular approach, whereby the *Novak* standard for evaluating confidential sources is employed only after the court first determines that the complaint contains allegations that "support strongly the credibility of the anonymous witness."

[39] *N.J. Carpenters Pension & Annuity Funds*, 537 F.3d at 51-52.

[40] 537 F.3d 527 (5th Cir. 2008)

[41] *See id.* at 535, 538-39.

[42] *Green Tree Financial Corp.*, 270 F.3d at 668.

[43] *Cabletron*, 311 F.3d at 30.

[44] *Adams*, 340 F.3d at 1101.

[45] *ABC Arbitrage*, 291 F.3d at 354 (emphasis added).

II. Disclosure of Confidential Sources in Initial Rule 26 Disclosures

Confidential witnesses must be listed in initial disclosures if a plaintiff intends to rely on them at a later stage in the litigation. Provided that the plaintiff does not list an "unreasonable" number of individuals as persons "likely to have discoverable information," however, the confidential witnesses need not be identified as such. Consistent with Fed. R. Civ. P. 26(a)(1)(A) and the 2000 Advisory Committee notes, confidential witnesses on whom the plaintiff does not intend to rely need not be listed.

III. Disclosure of Confidential Sources in Discovery

A. Disclosure of Testifying Sources

If a witness' testimony is to be used in making or defending a summary judgment motion, or at trial, the witness must be identified at some point during discovery to allow cross-examination. Unless a confidential witness has received something of value for providing information, however, the witness need not be identified as a confidential source, and the defendants should be barred through *in limine* order from inquiring whether the witness provided specific information to the plaintiff.

B. Disclosure of Non-Testifying Sources

Federal Rule of Civil Procedure 26(b)(1) provides that information is discoverable if it is "relevant to a party's claim or defense." The party seeking disclosure has the burden of establishing relevance.[46]

For a non-testifying source, it is the defendant's burden to show that the source – who is, by hypothesis, not going to offer evidence – nonetheless may have relevant information. Very often, this will not be the case. For example, if the source has provided information about a

[46] *See PSEG Power N.Y., Inc. v. Alberici Constructors, Inc.*, No. 1:05-CV-657 (DNH/RFT), 2007 WL 2687670, at *7 (N.D.N.Y. Sept. 7, 2007).

particular document, the document either does, or does not, exist as the source described it, and the source's recollection of the document is likely to have little bearing on the defense.[47]

Even where defendants have made a showing of relevance, however, to date, courts have applied two different analyses in evaluating whether confidential sources who will not be relied upon at later stages of the litigation must nonetheless be identified during discovery.

In securities cases, courts have predominantly evaluated protection on the basis of the attorney work product doctrine. As articulated in *In re MTI Technologies Corp. Securities Litigation II*,[48] the justification for protecting confidential source identities as attorney work product is based on the fact that "if the identity of interviewed sources is disclosed, opposing counsel can infer which sources counsel considers important, revealing mental impressions and trial strategy."[49] Based on the attorney work product doctrine, a number of courts have protected confidential source identities.[50]

In non-securities cases, courts have generally focused on the public interests at stake – the same interests that circuit courts have recognized in securities cases when shielding confidential source identities at the pleading stage. In *Gill v. Gulfstream Park Racing Ass'n, Inc.*,[51] the First Circuit addressed a racetrack's efforts to obtain the identities of confidential sources who reported wrongdoing to a trade association. Evaluating whether a protective order should issue pursuant to Fed. R. Civ. P. 26(c), the court held that the "'[t]he "good cause"

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[47] *Cf. Adams*, 340 F.3d at 1102 ("[A]llegations may be objectively verifiable by the defendant without the necessity of the plaintiff divulging how he or she acquired such information. Examples may include allegations of specific contract terms…")

[48] *In re MTI Technologies Corp. Sec. Litig. II*, No. SACV 00-0745 DOC, 2002 WL 32344347, at *5 (C.D. Cal. June 13, 2002).

[49] *Id.* at *3.

[50] *See MTI*, 2002 WL 32344347, at *5; *In re Ashworth, Inc. Sec. Litig.*, 213 F.R.D. 385, 389 (S.D. Cal. 2002); *Elect. Data Sys. Corp. v. Steingraber*, No. 4:02 CV 225, 2003 WL 21653405, at *2 (E.D. Tex. July 9, 2003),

[51] 399 F.3d 391 (1st Cir. 2005).

standard in the Rule is a flexible one that requires an individualized balancing of the many interests that may be present in a particular case'"[52] and "[i]n particular, *considerations of the public interest, the need for confidentiality, and privacy interests are relevant factors to be balanced.*"[53] By failing to recognize and evaluate these interests, the First Circuit held that the district court had abused its discretion.[54]

A similar approach was adopted by Judge Sporkin in *Management Information Technologies, Inc. v. Alyeska Pipeline Service Co.*[55] There, the defendant sought discovery of sources who had allegedly provided the plaintiff with confidential company documents. Judge Sporkin discussed at length the risk of retaliation to which whistleblowers are exposed, and declined to order disclosure of the sources.[56] He described his ruling as "based on the Court's balancing of the interest of third parties with the needs of the defendants to defend themselves in the present proceeding" and noted that the "identities of the confidential informants . . . are at best marginally relevant to the issues at stake in this litigation."[57]

Numerous other courts faced with discovery requests for witness identities have performed similar balancing of public policy and privacy interests against defendants' need for disclosure. Recognizing the chilling effect of disclosure of witnesses' identities on socially-valuable speech, courts have protected: (i) the identities of doctors who reported wrongdoing by a pharmaceutical company sales representative to his employer, based on a concern that the representative might "seek reprisal against them if he learned their identities;"[58] (ii) the identity

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[52] *Id.* at 402 (quoting *United States v. Microsoft Corp.*, 165 F.3d 952, 959-60 (D.C. Cir. 1999)).

[53] *Id.* (emphasis added).

[54] *Id.* at 403.

[55] 151 F.R.D. 478 (D.D.C. 1993).

[56] *Id.* at 481-82.

[57] *Id.* at 482-83.

[58] *Ramirez v. Boehringer Ingelheim Pharm., Inc.*, 425 F.3d 67, 74 (1st Cir. 2005).

of a referee who evaluated a manuscript for a peer reviewed scholarly journal, based on the societal value of the peer review process;[59] (iii) the identities of judges and attorneys who provided adverse comments to a screening committee evaluating the performance of an attorney retained to provide services to indigent criminal defendants, based on the "important societal interest" of an effective evaluation process and chilling effect of disclosures;[60] (iv) the identity of a person who reported suspected child abuse, based on the societal value of such disclosures and the chilling effect of revealing the identity of reporters;[61] (v) the identities of doctors and hospitals who reported adverse reactions to drugs under a voluntary reporting system operated by the Food and Drug Administration;[62] (vi) the identities of doctors and patients involved in medical peer reviews arising from incidents of possible medical error;[63] and (vii) the identities of academic tenure committee members and evaluators.[64]

Courts have also recognized the privacy interests affected by disclosure – interests possessed by confidential informants, as recognized in *Gill* – and protected individuals' identities from disclosure in a range of situations. Based on privacy concerns, courts have protected: (i) abortion records identifying patients in litigation with the Department of Justice over the constitutionality of anti-abortion legislation;[65] (ii) the identity of residents in a group home for

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[59] *Solarex Corp. v. Arco Solar, Inc.*, 870 F.2d 642, 644 (Fed. Cir. 1989), *aff'g* 121 F.R.D. 163 (E.D.N.Y. 1988).

[60] *Mitchell v. Fishbein*, 227 F.R.D. 239, 245-47 (S.D.N.Y. 2005).

[61] *DeLeon v. Putnam Valley Board of Educ.*, 228 F.R.D. 213, 217-21 (S.D.N.Y. 2005).

[62] *In re Eli Lilly & Co., Prozac Prod. Liab. Litig.*, 142 F.R.D. 454, 457 (S.D. Ind. 1992).

[63] *Virmani v. Novant Health Inc.*, 259 F.3d 284, 288 n.4 (4th Cir. 2001).

[64] *Schneider v. Northwestern Univ.*, 151 F.R.D. 319, 324 (N.D. Ill. 1993); *Black v. New York Univ. Med. Ctr.*, No. 94 CIV. 9074 (SS) (NRB), 1996 WL 294310, at *4 n.9 (S.D.N.Y. June 3, 1996).

[65] *Northwestern Mem. Hosp. v. Ashcroft*, 362 F.3d 923, 926-27 (7th Cir. 2004).

juveniles in a civil rights action arising out of improper conduct by employees at the home;[66] and (iii) the names of patients in a nursing home in a suit alleging overcharging for medications.[67]

Citing both public interests and privacy rights, courts have also protected the identities of participants in a study sponsored by the Center for Disease Control in a products liability action,[68] and the names of members of a private medical society in an action alleging anticompetitive conduct by the society.[69]

The balancing of interests performed in the decisions cited above is also well grounded in the body of caselaw addressing disclosure of government informants. Such informants are protected in both civil and criminal litigation by a formal privilege – the "informant's privilege" – first recognized by the Supreme Court in *Roviaro v. United States*.[70] Under *Roviaro*, the privilege is qualified, and when an informant's identity "is relevant and helpful to the defense of an accused, or is essential to a fair determination of a cause, the privilege must give way."[71] In a criminal case, this standard "calls for balancing the public interest in protecting the flow of information against the individual's right to prepare his defense. Whether a proper balance renders nondisclosure erroneous must depend on the particular circumstances of each case, taking into consideration the crime charged, the possible defenses, the possible significance of the informer's testimony, and other relevant factors."[72]

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[66] *Seales v. Macomb Co.*, 226 F.R.D. 572, 578-79 (E.D. Mich. 2005).

[67] *Arenson v. Whitehall Convalescent and Nursing Home, Inc.*, 161 F.R.D. 355, 358 (N.D. Ill. 1995).

[68] *Farnsworth v. Procter & Gamble Co.*, 758 F.2d 1545, 1546-47 (11th Cir. 1985).

[69] *Marrese v. American Acad. of Orthopaedic Surgeons*, 726 F.2d 1150, 1159-60 (7th Cir. 1984) (en banc) (Posner, J.), *rev'd on other grounds*, 470 U.S. 373 (1985).

[70] 353 U.S. 53 (1957).

[71] *Id.* at 60-61.

[72] *Id.* at 62.

In civil litigation, the requesting party can override the informant's privilege by showing that its need for disclosure outweighs the government's interest in confidentiality. This need is evaluated both by assessing the role of the informant in the wrongdoing alleged,[73] and also by directly evaluating the relevancy of the identity of the informant to the facts at issue in the case.[74]

As noted by the court in *Gill*, Fed. R. Civ. P. 26(c) requires the trial court to "undertake 'an individualized balancing of the many interests that may be present in a particular case.'"[75]

In the case of confidential informants, the public's interest in disclosure of wrongdoing, together with the witness' privacy interests, must be balanced against the defendant's need to defend the action. When balancing these interests, it is important to recognize that the harm to be avoided through the order is the danger that potential witnesses will refuse to come forward – *i.e.*, the chilling effect that results from the fear of possible retaliation or harm to reputation, and not the actual retaliation or injury to reputation itself. Even if a witness' fear of adverse consequences is unsupported, such fear can nonetheless silence the witness and prevent disclosure of wrongdoing. Accordingly, the absence of credible evidence of a threat should not impede issuance of a protective order where potential witnesses' *bona fide* concerns are credible due to continued employment in the same industry or other factors.

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[73] *See Suarez v. United States*, 582 F.2d 1007, 1012 (5th Cir. 1978) (refusing disclosure of an informant in a civil tax enforcement case, noting that he was merely a "marginal observer of the activities" of the taxpayers); *Holman v. Cayce*, 873 F.2d 944, 947 (6th Cir. 1989) (refusing disclosure in a § 1983 action alleging a wrongful shooting by an arresting officer where "[t]here was no indication that the informant was an active participant in the burglary or a witness to it").

[74] *Wirtz v. Cont'l Fin. & Loan Co.*, 326 F.2d 561, 563 (5th Cir. 1964) ("It is perfectly plain that the names of informers are utterly irrelevant to the issues to be tried by the trial court.").

[75] *Diamond Ventures, LLC v. Barreto*, 452 F.3d 892, 898 (D.C. Cir. 2006) (quoting *In re Sealed Case (Medical Records)*, 381 F.3d 1205, 1211 (D.C. Cir. 2004) (remanding because the district court failed to perform an appropriate balancing analysis)). *Accord Gill*, 399 F.3d at 400-01; *Chicago Tribune Co. v. Bridgestone/Firestone, Inc.*, 263 F.3d 1304, 1313 (11th Cir. 2001) ("Federal courts have superimposed a balancing of interests approach for Rule 26's good cause requirement.").

The approach adopted in *Roviaro* provides well-developed guidance for balancing this public interest against both the defendant's need to defend the action and the judicial system's policy in favor of liberal discovery. In a number of civil cases, the balancing approach adopted in *Roviaro* has resulted in courts shielding the identity of confidential sources, based on the tangential relationship of the source to the wrongdoing at issue, and the irrelevancy of the source's identity to the facts at issue in the case.[76]

At bare minimum, there is simply no justification for Defense Counsel's suggestion that anonymous sources "be subject to an early deposition" relative to other discoverable matter. Not only have Defense Counsel failed to cite a single case in support of that proposition, but the effect of such an approach would be to harass and intimidate potential witnesses while allowing defendants to withhold or delay production of documents and other information uniquely in their possession that would support or lend credence to the witnesses' account.

IV. Enforceability of Confidentiality Agreements

A related issue that sometimes arises with respect to confidential sources is whether sources who are current or former employees of a company are bound by confidentiality agreements that would bar disclosure of information concerning possible fraud by their current or former employer.

In the context of a governmental investigation, current and former employees are clearly not bound by confidentiality agreements that would limit their ability to provide information

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[76] *Brock v. On Shore Quality Control Specialists, Inc.*, 811 F.2d 282, 284 (5th Cir. 1987) (noting that "[t]he issue to be tried in this case concerns the nature of the duties performed by these individuals, and whether the duties are, as claimed, administrative. The list of 'all persons who have given information to the Department of Labor' is 'utterly irrelevant to the issues to be tried by the trial court.'"); *Usery v. Ritter*, 547 F.2d 528, 531 (10th Cir. 1977) ("[t]he record contains no showing by defendants of their need, or the reasons for their need, of the disclosure of the identity of the informants"); *Suarez*, 582 F.2d at 1012; *Holman*, 873 F.2d at 947.

regarding wrongdoing.[77] Several courts have applied the same rule in the context of civil litigation, holding that because information concerning a fraud is not information in which an employer has a protectible interest, a confidentiality agreement cannot be enforced to prevent an employee from providing private litigants with non-confidential information concerning fraud.[78] A clear enunciation of this principle, and entry of an appropriate order, are necessary to ensure that employees are not deterred by overbroad confidentiality agreements.

VIEW FROM THE DEFENSE SIDE

When Congress enacted the PSLRA in 1995, it adopted more stringent pleading requirements for plaintiffs in securities class actions including requirements with respect to pleading scienter. The legislative history shows that Congress recognized that even weak cases surviving a motion to dismiss often resulted in coercive settlements because of the prohibitive cost of discovery. The legislative history of the PSLRA also makes clear that the PSLRA and its stricter pleading requirements were intended to reduce the number of weak and abusive class actions. Several important cases in recent years, including *Tellabs*, 127 S.Ct. 2499, *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 128 S.Ct. 761 (2008), and *In re Initial Public Offering Securities Litigation (Miles v. Merrill Lynch & Co., Inc.)*, 471 F.3d 24 (2d Cir. 2006), among others, have further

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[77] *E.g.*, *SEC v. Lipson*, No. 97 C 2661, 1997 WL 801712 (N.D. Ill. Oct. 28, 1997).

[78] *In re JDS Uniphase Corp. Sec. Litig.*, 238 F. Supp. 2d 1127, 1137 (N.D. Cal. 2002) ("To the extent that those [confidentiality] agreements preclude former employees from assisting in investigations of wrongdoing that have nothing to do with trade secrets or other confidential business information, they conflict with the public policy in favor of allowing even current employees to assist in securities fraud investigations."); *Chambers v. Capital Cities/ABC*, 159 F.R.D. 441, 444 (S.D.N.Y. 1995) ("Absent possible extraordinary circumstances not involved here, it is against public policy for parties to agree not to reveal, at least in the limited contexts of depositions or pre-deposition interviews concerning litigation arising under federal law, facts relating to alleged or potential violations of such law." (footnote omitted)); *Hoffman v. Sbarro, Inc.*, No. 97 CIV. 4484 (SS), 1997 WL 736703, at *1 (S.D.N.Y. Nov. 26, 1997) ("To the extent that the agreement might be construed as requiring an employee to withhold evidence relevant to litigation designed to enforce federal statutory rights, it is void.").

restricted securities class actions. In part as a result of cases interpreting strictly the pleading requirements of the PSLRA (particularly with respect to scienter), in recent years plaintiffs alleging securities fraud under Section 10(b) of Securities Exchange Act of 1934 ("Section 10(b)") have come to rely increasingly on information obtained from anonymous or "confidential" sources whose credibility is untested.[79] The purported information from these witnesses is often used to attempt to overcome the heightened pleading standards under the PSLRA. This report sets forth the position of defense counsel on the subcommittee with respect to certain issues relating to the use of anonymous sources and argues for enhanced safeguards to prevent questionable lawsuits that are based largely on unreliable anonymous source information from going forward and defeating the goals of the PSLRA.

A. Use and Disclosure of Anonymous Sources at the Pleading/Motion to Dismiss Stage

The use of anonymous sources raises important legal issues at the pleading stage concerning attempts to balance plaintiffs' desire to protect the identity of such sources, who purportedly fear retaliation for their cooperation, against defendants' need for sufficient information to address the dangers of allegations based on anonymous sources contributing to denial of motions to dismiss.[80] Under the PSLRA, the motion to dismiss is arguably the most important stage of a securities class action. Once a motion is denied, discovery moves forward and cases often acquire a settlement value regardless of the merits of the claim.[81] Five recent

[79] The very use of the term "confidential" witness reflects an unjustified assumption that the witness' identity deserves to be kept confidential. In fact, the witnesses are anonymous because plaintiffs' counsel have chosen not to identify the witnesses, based on the witnesses' purported need for confidentiality.

[80] Defense counsel, in fact, question whether any evidence exists that shows anonymous sources have in fact faced retaliation because they provided information to plaintiffs.

[81] The Seventh Circuit recognized this concern as recently as January 5, 2009. *Stark Trading v. Falconbridge Ltd.*, 552 F.3d 568, 574 (7th Cir. 2009) ("Defendants are not to be subjected to the costs of

appellate decisions set forth an approach to evaluating allegations based on information provided by anonymous witnesses when determining whether a complaint has adequately pled scienter: the Seventh Circuit's decision in *Makor Issues & Rights, Ltd., v. Tellabs Inc.*, 513 F.3d 702 (the remand of the Supreme Court's decision in *Tellabs v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007)), *Cabletron Systems, Inc.*, 311 F.3d 11, *Higginbotham*, 495 F.3d 753, *Shaw Group, Inc.*, 537 F.3d 527, and *Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981 (9th Cir. 2009).

Under Section 10(b) and the PSLRA, in order to adequately plead scienter, a plaintiff must allege *facts* that give rise to "a strong inference" of an intent to deceive. Moreover, the pleading of scienter must comply with the Supreme Court's directive in *Tellabs*, 127 S. Ct. at 2510, that "the inference of scienter [must be] cogent and at least as compelling as any opposing inference one could draw from the facts alleged." In *Cabletron* (a pre-*Tellabs* case), the First Circuit established a list of factors that should be considered in evaluating the credibility of information alleged in a complaint to have been provided by anonymous sources. It held that the weight accorded to the information will depend on all the circumstances alleged in the complaint concerning each source and the information provided, including, *inter alia*, the following: (i) the means by which the anonymous source came to possess the information, (ii) the level of detail provided by the anonymous source, (iii) the corroborative nature of other facts alleged, (iv) the coherence and plausibility of the anonymous source's allegations, (v) the likelihood that the anonymous source has personal knowledge of the information provided, and (vi) the number of sources of the information. *Cabletron*, 311 F.3d at 28-30.

Cabletron thus requires a review of "the totality of the circumstances" alleged about information from anonymous sources to determine what, if any, weight the information should

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pretrial discovery in a case in which those costs, and the costs of the other pretrial maneuvering common in a big case, are likely to be great, unless the complaint makes some sense.")

be accorded in the scienter analysis. *Id.* at 30. The inference to be drawn from the facts pled that are derived from anonymous sources should then be considered together with other facts pled to determine whether as a whole the facts meet the pleading standard for scienter set forth in the PSLRA (facts giving rise to a strong inference of scienter) and *Tellabs*.

Other courts have followed the *Cabletron* approach described above. *See, e.g., In re Daou Sys. Inc. Sec. Litig.*, 411 F.3d at 1029. Employing the factors outlined in *Cabletron*, some courts have determined at the pleading stage that specific information provided by anonymous sources did not have sufficient indicia of reliability to support a finding of scienter. *See, e.g., Shaw Group*, 537 F.3d at 537 (finding that anonymous source was not "identified sufficiently by his title, work location or dates of employment"); *Limantour v. Cray Inc.*, 432 F. Supp. 2d 1129 (W.D. Wash. 2006) (vague and conclusory statements by anonymous sources do not support inference of scienter); *In re Portal Software Inc. Sec. Litig.*, No. C-03-5138 VRW, 2006 WL 2385250, at *8 (N.D. Cal. Aug. 17, 2006) ("plaintiffs must describe the job title, job description, duties, and dates of employment for the [anonymous] sources").

Most recently, in *Zucco*, the Ninth Circuit relied heavily upon *Cabletron* in determining that a complaint relying upon anonymous sources failed to sufficiently allege scienter. In *Zucco*, the court made clear that the allegations concerning anonymous sources must include sufficient details about the anonymous sources to show that they were in a position to know the information alleged. In this regard, the court stated that "confidential witness statements may only be relied upon where the confidential witnesses are described 'with sufficient particularity to support the probability that a person in the position occupied by the source would possess the

information alleged'".[82] The Court also ruled that the information from the anonymous sources must be such as to raise a strong inference of scienter.

The Seventh Circuit took a more aggressive position on the issues raised by the use of anonymous informants at the pleading stage in its decision in *Higginbotham*, 495 F.3d at 756-57, which calls for an automatic discounting of allegations based on information attributed to anonymous witnesses. Specifically, the *Higginbotham* court stated that "[o]ne upshot of the approach that *Tellabs* announced is that we must discount allegations that the complaint attribute[s] to five 'confidential witnesses,'" who in *Higginbotham* consisted of ex-employees and outside consultants of a parent company that was being sued in connection with allegedly fraudulent accounting practices conducted by its Brazilian subsidiary. *Id.* The opinion explained that "*[u]sually, that discount* [of anonymous witness allegations] *will be steep*" because "[i]t is hard to see how information from anonymous sources could be deemed 'compelling' or how we could take account of plausible opposing inferences. Perhaps these confidential sources have axes to grind. Perhaps they are lying. Perhaps they don't even exist." *Id.* at 757 (emphasis added). The Seventh Circuit could have added that in describing the information derived from such witnesses (often with private investigators as intermediaries), plaintiffs' lawyers, as advocates for their cause, cannot be expected to be balanced in their description of what the anonymous witnesses have to say.

Only months later, the Seventh Circuit addressed the issue again in the decision on remand in the *Tellabs* case. The Court distinguished but did not overrule *Higginbotham,* noting that it "was a very different case from this one." The court gave some weight to the allegations from anonymous informants in *Tellabs* based on a review of the circumstances surrounding those

[82] 552 F.3d at 995 (*internal citation omitted).*

allegations. *See Tellabs*, 513 F.3d at 711-12. Specifically, the court noted that there were numerous anonymous sources listed in the *Tellabs* complaint "who from the description of their jobs were in a position to know first hand the facts to which they are prepared to testify," that the information they provided was "set forth in convincing detail" and that some of information was "corroborated by multiple sources." *Id*. at 712. Despite this, the court stated that it would be better if the anonymous witnesses had been identified in the complaint because "it would be easier to determine whether they had been in a good position to know the facts that the complaint says they learned." It nonetheless concluded that "the absence of proper names does not invalidate the drawing of a strong inference from informants' assertions." *Id*.

Defense counsel believe that *Higginbotham* and the *Tellabs* remand decision should be read together to require that securities complaints based on information obtained from anonymous sources must be accompanied by allegations that strongly support the credibility of that information, or else the anonymous witness information should be disregarded or steeply discounted. Indeed, *Higginbotham* should be viewed as stating the applicable rule when the circumstances concerning the reliability of anonymous witness information provide less than compelling support for the credibility of that information. The *Tellabs* remand decision should be seen as establishing the approach to be adopted when the complaint contains allegations that tend to support strongly the credibility of the anonymous witness' information.

The recent decision of the Fifth Circuit Court of Appeals in *Shaw Group* illustrates how the analyses set forth in both *Higginbotham* and *Tellabs* fit together and also that *Higginbotham* survives the *Tellabs* remand. *See* 537 F.3d at 535. In that opinion, the Fifth Circuit explicitly referred to *Higginbotham*'s requirement that anonymous witness allegations be subject to an automatic discount. In assessing the discounted weight to be accorded such sources the Court

stated "[a]t the very least, [anonymous] sources must be described with sufficient particularity to support the probability that a person in the position occupied by the source . . . would possess the information pleaded." *Id*. (internal citations omitted). Employing a variety of *Cabletron* factors, the Fifth Circuit ultimately concluded that the facts surrounding the anonymous source allegations in *Shaw Group* did not support an inference of scienter. *Id*. at 538-41; *see also Grillo v. Tempur-Pedic International, Inc.*, 553 F. Supp. 2d 809, 820 (E.D. Ky. 2008) (discounting anonymous allegations of GAAP violations "to some extent" based on *Higginbotham* and also finding that the allegations in question lacked sufficient detail to support an inference of scienter).

Additional decisions that demonstrate similar approaches to evaluating anonymous source allegations include *In re Intelligroup Securities Litigation*, No. 04-4980 (GEB), 2007 WL 3376743 (D.N.J. Nov. 13, 2007). There the court refused to consider allegations based on statements made by six witnesses who were identified only by job title. Specifically, the court held that a statement that circumstances relating to defendant's alleged fraud were "common knowledge" within the company "lacks any imprimatur of reliability," because the anonymous witness did not explain how he or she acquired such knowledge. *Id*. at *76. The court found that an anonymous witness' observations as to the defendant's accounting practices were "wholly unreliable," as the complaint failed to explain how the source, who was not part of the defendant's accounting department, obtained personal knowledge about the nature of the defendant's accounting methods. *Id*. at *80. *See also In re Dura Pharm., Inc. Sec. Litig.*, No. 99 CV 0151 JLS, 2008 WL 483613, at *10 (S.D. Cal. Feb. 20, 2008) (holding that an anonymous source was not reliable with respect to allegations of meetings among senior management and with FDA officials where complaint did not explain how source would know about such

meetings); *In re Scottish Re Group Sec. Litig.*, 524 F. Supp. 2d 370, 392-93 (S.D.N.Y. 2007) (allegations sufficiently particularized where anonymous sources "occupied positions that would have allowed for relevant hands-on experience in various parts of the Company").

Overall. the caselaw suggests that courts should apply a two-step analysis in evaluating allegations from anonymous sources contained in securities complaints. First, a court should examine allegations that are based on information from anonymous witnesses in light of the circumstances pled, to help ensure that the weight accorded to such allegations is appropriate, if they deserve to be given any weight at all. Courts should consider factors, such as the means by which the anonymous source came to possess the information, the level of detail provided, and the existence of corroborating facts, in assessing whether any weight should be accorded to the information. Under *Higginbotham*, these factors should be considered to determine whether to disregard the allegations or subject them to a discount, which usually should be steep. Second, the inference to be drawn from the facts pled based on information obtained from anonymous witnesses should be considered together with the other allegations in the complaint to determine whether the complaint as a whole meets the strong inference of intent to deceive pleading standard for scienter under the PSLRA and the Supreme Court's decision in *Tellabs*.

Because a court must accept all well-pled allegations in a complaint as true, absent a rigorous evaluation of the allegations based on anonymous sources under the approaches outlined in *Shaw Group, Higginbotham*, the *Tellabs* opinion on remand, *Cabletron* and *Zucco*, a complaint might withstand a motion to dismiss based solely on unreliable information provided by anonymous witnesses. For example, a complaint could theoretically survive a motion to dismiss – and a defendant could be forced to engage in expensive and protracted discovery and be subjected to substantial economic and reputational risk – even if the anonymous witnesses'

information was either untrue, based on rumor or misunderstanding or misdescribed in the complaint. It is critical to assess the reliability of anonymous source information at the pleading stage because the cost of litigation and settlement resulting from the denial of a motion to dismiss is often so great.

ADDITIONAL SAFEGUARDS

Defense counsel believe that, in order to avoid defendants unfairly incurring the huge cost of securities litigation in cases that survive motions to dismiss and because of the very real dangers of the abusive use of anonymous witnesses, additional safeguards are necessary. One useful approach would be to require plaintiffs' attorneys, who attribute facts in a complaint to anonymous witnesses, to obtain a sworn verification of such allegations from the anonymous source, at the time of filing the complaint, attesting to the accuracy of the description of the anonymous witness' information in the complaint. If the complaint survives a motion to dismiss, the verification should be produced to the defense.

In virtually every case, anonymous sources should be subject to an early deposition if the complaint survives a motion to dismiss, regardless of the witnesses' expected future role in the case, unless there is a showing of extraordinary circumstances justifying not proceeding with such deposition. Subjecting anonymous witnesses to early depositions should be required to see whether such witnesses' testimony supports the allegations in the complaint. This approach was used in *Campo v. Sears Holdings Corp.*, where Judge Sprizzo ordered the depositions of all anonymous sources to be completed within sixty days after he denied the defendants' motion to dismiss.[83] Judge Sprizzo noted that if the anonymous witnesses' testimony did not support the

[83] *See* Order dated April 17, 2008.

allegations in the complaint, he would reconsider the motion to dismiss.[84] Authority for depositions of all confidential witnesses can also be found in *In re Marsh & McLennan Cos., Inc. Sec. Litig.*, No. 04 CV 8144 (SWK), 2008 WL 2941215, at *3 (S.D.N.Y. July 30, 2008), which held that the identities of anonymous witnesses upon whom plaintiffs rely in drafting a complaint are discoverable, regardless of whether plaintiffs plan to call the sources as witnesses at trial.

These measures would provide *some* protection against inaccurate allegations that could result in the waste of substantial defense costs and potentially in unjustified settlements. Additional safeguards that are designed to promote the accurate, balanced use of anonymous source information, if courts are going to allow the use of such information, would help in avoiding unjustified denials of motions to dismiss and thereby further Congress' purpose in passing the PSLRA.

Defense counsel believe that the anonymous witnesses' fear of retaliation can also be addressed through the use of a protective order. Courts regularly engage in balancing considerations to determine what sensitive information should be disclosed during discovery and who can have access to sensitive information. Where shown to be necessary for the protection of the witness, a protective order could permit only a limited group of people to know the identities of the anonymous sources. Such an order would protect those anonymous sources against retaliation while providing defense counsel with necessary information to properly defend their cases. Courts could review *in camera* any evidence that plaintiffs wish to submit concerning why they claim extraordinary circumstances exist necessitating the protection of these witnesses from normal disclosure.

B. Disclosure of Anonymous Sources in Initial Rule 26 Disclosures

[84] *See* Transcript dated April 30, 2008 at 4.

Plaintiffs argue that only anonymous sources on whom a plaintiff may rely later in the litigation must be listed in initial disclosures and that, unless an "unreasonable" number of individuals are listed as persons "likely to have discoverable information", even those anonymous witnesses who will later be relied on arguably need not be identified as anonymous sources.[85]

Defendants' counsel believe that there is no legitimate reason not to identify all anonymous sources in initial disclosures, whether or not they will be relied on later in the litigation, and that anonymous sources should be identified as such. As discussed below, failure to identify listed anonymous sources as such in initial disclosures, in the name of addressing the sources' fear of retaliation, is inconsistent with the spirit of the discovery rules and will only result in increased litigation expense. The burden of the additional time and expense of discovery focused on uncovering anonymous sources will fall disproportionately on defendants, who would have to guess who are the anonymous witnesses and likely take unnecessary depositions.

C. Disclosure of Anonymous Sources in Discovery

1. Disclosure of Non-Testifying Sources

During discovery in securities fraud actions many courts have ordered disclosure of the identities of anonymous witnesses whose statements were relied on in a complaint.[86] In the

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[85] The scope of initial disclosures does not, however, limit the scope of plenary discovery in a matter and this topic is addressed below.

[86] *See e.g., In re Harmonic, Inc. Sec. Litig.*, 245 F.R.D. 424, 428 (N.D. Cal. 2007); *Brody v. Zix Corp.*, No. 3-04-CV-1931-K, 2007 WL 1544638 (N.D. Tex. May 25, 2007). *In re Priceline Inc. Sec. Litig.*, No. 3:00CV01884 (DJS), 2005 WL 1366450 (D. Conn. June 7, 2005); *Plumbers & Pipefitters Local 572 Pension Fund v. Cisco Systems, Inc.*, No. C01-204185W, 2005 WL 1459555 (N.D. Cal. June 21, 2005); *Miller v. Ventro*, No. CO1-01287 SBA (EDL), 2004 WL 868202 (N.D. Cal. Apr. 21, 2004); *In re IPO Sec. Litig.*, 220 F.R.D. 30, 37 (S.D.N.Y. 2002); *In re Theragenics*, 205 F.R.D. 631 (N.D. Ga. 2002); *In re Aetna Inc. Sec. Litig.*, No. CIV. A. MDL 1219, 1999 WL 354527 (E.D. Pa. May 26, 1999). *See also ABC Arbitrage Plaintiffs*, 291 F.3d at 354 (holding that there is no pleading requirement to name anonymous sources "in circumstances in which informants do not wish to be exposed *too early*") (emphasis added).

absence of such a rule, an advocate's unbridled latitude in describing anonymous witness information at the pleading stage creates the risk of seriously infringing the rights of defendants to test the accuracy and reliability of critical information in a plaintiff's complaint.[87] As noted in *Campo* and in *Marsh & McLennan*, anonymous witnesses should be subject to an early deposition if the complaint survives a motion to dismiss, regardless of the witnesses' expected future role in the case, unless there is a showing of extraordinary circumstances justifying not proceeding with such deposition.

In arguing against discovery of the identity of anonymous sources, plaintiffs' counsel rely heavily on inapposite authority from criminal cases and specialized proceedings that would be senseless to apply in the normal civil litigation context. For example, Plaintiff's reliance on criminal cases such as *Roviaro* and its progeny is fundamentally misplaced because they are based on policy and constitutional considerations applicable to criminal cases but not to civil cases, including, the threat of physical harm or death faced by government informants in criminal proceedings. *Roviaro v. United States*, 353 U.S. 53, 59 (1957).

Plaintiffs' counsel's citations to *Brock v. On Shore Quality Control Specialists, Inc.*, 811 F.2d 282, 284 (5th Cir. 1987), *Usery v. Ritter*, 547 F.2d 528, 531 (10th Cir. 1977), *Suarez v. United States*, 582 F.2d 1007, 1012 (5th Cir. 1978), and *Holman v. Cayce*, 873 F.2d 944, 947 (6th Cir. 1989) as instances where the *Roviaro* analysis has been applied in civil cases are clearly inapposite.[88] Both *Usery* and *Brock* permitted the Secretary of Labor to invoke the privilege to

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[87] As noted above a widely recognized purpose of the PSLRA and the heightened pleading standard it imposed was to deter the filing of "strike suits." *See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 171 (2d Cir. 2005). Congress was concerned about the "routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer." H.R. Conf. Rep. No. 104-369, at 31 (1995).

[88] *Usery* does not quote *Roviaro* directly, but similarly holds that "[t]he interest in the government in protecting its sources must be weighed against the defendants' need for the information." *Usery*, 547 F.2d at 531.

protect the anonymity of sources who provided information about alleged violations of the Fair Labor Standards Act. *See Usery*, 547 F.2d at 531; *Brock*, 811 F.2d at 284. Similarly, *Suarez* and *Holman* applied the *Roviaro* test in order to determine whether the identity of sources that provided police officers with information regarding criminal activity should be kept confidential. *See Suarez*, 582 F.2d at 1009; *Holman*, 873 F.2d at 945. Although the informant's privilege has been used in civil cases as well as criminal,[89] the privilege is available in civil cases only to government informers. Private securities litigation does not implicate this public policy. The rest of plaintiffs' attempts to import concepts from other types of litigation are similarly inappropriate.

The securities cases that have considered whether the identity of anonymous witnesses must be disclosed at the discovery stage do not reference *Roviaro* and generally conclude that the identities of anonymous witnesses described or mentioned in a complaint are non-privileged and discoverable, without evaluating each witness' specific level of involvement or the relevancy of his information. *See Brody v. Zix Corp.*, No. 3-04-CV-1913-K, 2007 WL 1544638, at *1 (N.D. Tex. May 25, 2007) ("[p]laintiffs cannot avoid their disclosure obligations under the federal rules by characterizing these witnesses, who unquestionably have knowledge of relevant facts, as 'confidential sources'"); *Mazur v. Lampert*, No. 04-61159-CIV, 2007 WL 917271, at *2 (S.D. Fla. Mar. 25, 2007) (noting that the identity of people having knowledge of any discoverable matter is discoverable under Rule 26); *Miller v. Ventro Corp.*, No. C01-01287 SBA, 2004 WL 868202, at *2 (N.D. Cal. Apr. 21, 2004) (the identities of the twenty-two anonymous witnesses, upon whose statements plaintiffs built their complaint, must be disclosed to defendants).

[89] Note, however, the Seventh Circuit's holding in *Higginbotham.*, 495 F.3d. at 757, that "there is no 'informer's privilege' in civil litigation."

Securities opinions generally analyze anonymous witness issues in the discovery phase within the framework of the work product privilege and public policy considerations, and they typically reject plaintiffs' arguments that identities should be kept anonymous under either theory. For example, in *In re IPO Sec. Litig.*, 220 F.R.D. 30 (S.D.N.Y. 2003). Judge Scheindlin held that the names of individuals who had personal knowledge of the facts underlying the allegations are not privileged work product. *Id*. at 35-36; *see also Brody*, 2007 WL 1544638, at *1 (work product privilege did not protect *identities* of former employees who provided facts alleged in complaint) (*emphasis added*); *Mazur*, 2007 WL 917271, at *2 (work product rule "does not apply to the facts of a case that are known or gathered in preparation for litigation or trial, the most obvious example of which is the identity of witnesses and persons with knowledge").

With respect to the *IPO* plaintiffs' public policy argument, Judge Scheindlin found that their fears of retaliation were unfounded and insufficient to justify withholding disclosure:

> The issue here does not raise the policy considerations addressed in the Sarbanes-Oxley legislation or the Novak rule, both of which encourage whistleblowers to expose corporate wrongdoing by protecting them from retaliations. Once a litigation is pending, the balance of interests change. *While it is important to protect whistle-blowers, it is also important, once the whistle is blown, to allow all parties an equal opportunity to engage in the robust discovery permitted by the Federal Rules. Id*. at 37 (emphasis added).

See also Miller, 2004 WL 868202, at *3 (declining to enter a protective order limiting disclosure of witnesses' identities where all were former employees of defendants and there was no evidence of likelihood of retaliation); *Brody*, 2007 WL 1544638, at *2 (conclusory assertion that witnesses may be exposed to retaliation does not support plaintiffs' public policy argument); *Mazur*, 2007 WL 917271, at *5 (public policy considerations may be relevant at the beginning of

the litigation, but when a case proceeds to discovery, "whatever policy protections prevented the disclosure of that witness's identity also evaporate when balanced against the operative requirements of Rule 26."). Thus, there is ample authority to support compelling disclosure of the identity of anonymous sources relied upon in a securities complaint in order to prevent unfounded lawsuits from going forward. This authority reflects the courts' recognition that once a case moves into the discovery phase, the balance shifts such that the need for a party to defend itself through access to the sources of plaintiffs' claims outweighs plaintiffs' arguments for protecting a confidential source's identity, absent strong proof of real danger to the witness.

D. Enforceability of Confidentiality Agreements

A related issue that sometimes arises with respect to anonymous sources is whether sources who are current or former employees of a company are bound by confidentiality agreements that would bar disclosure of information concerning possible fraud by their current or former employer.

Defense counsel believe that an employer's contractual rights to confidentiality should not be abrogated absent a compelling showing that it is against public policy. Mere assertion by plaintiffs that information may be useful to civil plaintiffs in a fraud case is clearly an inadequate showing.[90] Moreover, plaintiffs should not be the sole arbiters of whether their interests trump the contractual right to confidentiality. It should be for a Court to determine if extraordinary circumstances warrant abrogating such contractual rights.

[90] *See In re Spectrum Brands, Inc.*, No. 1:05-cv-02494-WSD, 2007 WL 1483633 (N.D. Ga. May 18, 2007).