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The confidential witness conundrum in securities class actions

Alison Frankel

Sept 20 (Reuters) - On Tuesday, U.S. Senior District Judge Jed Rakoff ruled that lawyers at Robbins Geller Rudman & Dowd may not see the notes that Lockheed Martin's lawyers at DLA Piper took when they interviewed former Lockheed employees cited as confidential witnesses in an amended securities fraud complaint against the aerospace company. Rakoff said the notes, as well as DLA's memos on the interviews and emails between DLA and the witnesses, are protected by the work-product doctrine. But that is not the end of the story for the Loc k heed confidential witnesses. Rakoff has scheduled a hearing on Oct. 1, at which he intends to hear testimony from four former Lockheed employees who spoke to a Robbins Geller investigator but subsequently denied telling him any of the juicy allegations attributed to them.

Rakoff's hearing is quite a welcome development. Someone needs to take a hard look at a phenomenon that's become a blight on securities class action litigation: confidential informants who turn around and recant their assertions against former employers. Lockheed's motion for summary judgment painted Robbins Geller in solid black, asserting that the plaintiffs' firm is a serial fabulist when it comes to confidential witness testimony. But the 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.

In the Bank Atlantic case in federal court in Miami, for instance, the defendants moved for sanctions against Labaton Sucharow and other firms partly on the basis of deposition testimony by six confidential witnesses who contradicted allegations the plaintiffs' firms attributed to them. Bernstein Litowitz Berger & Grossmann, Grant & Eisenhofer and Motley Rice faced similar accusations in the Medtronic class action in federal court in Minnesota, in which Medtronic tried to block class certification by arguing that the plaintiffs "misrepresented or actively lied about" the testimony of 13 of 15 confidential witnesses cited in their amended complaint. (In the Bank Atlantic case, U.S. District Judge Ursula Ungaro ordered the plaintiffs to pay defense legal fees related to the deposition of one witness. In Medtronic, U.S. District Judge Paul Magnuson certified the class despite defense assertions; the case settled for $85 million in August.)

Plaintiffs' lawyers believe that the rash of recantations is due to the exposure of their witnesses' identity. Remember, under the rules imposed by the Private Securities Litigation Reform Act, plaintiffs in securities fraud class actions aren't allowed to take discovery from defendants until their cases have survived defendants' motions to dismiss. To meet the high bar for fraud actions when they can't conduct discovery, plaintiffs have little choice but to rely on information from former employees of the defendant. But it's one thing for those employees 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.

That's what Robbins Geller seems to have been trying to show when it moved to compel production of the DLA materials in the Lockheed case. The letter briefs on its motion to see DLA's notes aren't part of the docket, but in Robbins Geller's response to Lockheed's motion, the plaintiffs' firm suggests that the witnesses, who spoke to its investigator on the assumption that their identity would remain confidential, were intimidated by Lockheed and afraid of breaching severance agreements. It's telling, Robbins argued, that the only confidential Lockheed witness who doesn't have a severance deal "validated virtually all of the allegations attributed to him."

As I've previously reported, federal judges in New York are increasingly unlikely to permit witnesses in securities class actions to remain confidential, and all of the allegations of recantation are only going to bolster defense arguments that plaintiffs must reveal where their information is coming from. Unless plaintiffs' lawyers can show that defendants are frightening witnesses into backing away from their stories, the securities class action bar is going to lose the potent weapon of information from confidential informants.

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