

# The Importance of Conducting Thorough Investigations of Confidential Witnesses in Securities Fraud Litigation

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*This Article examines the use of confidential witnesses (“CWs”) in investigating and substantiating securities fraud claims. The Private Securities Litigation Reform Act has placed a heavy burden on plaintiffs at the pleading stage, which has caused plaintiffs to perform preliminary investigations and seek confidential information as a basis for their allegations in the complaint. Testimony of CWs is often the centerpiece of the evidence substantiating plaintiffs’ securities fraud claims. As a result, the investigation conducted prior to filing an amended complaint has become a central issue in the realm of securities litigation, subject to attack by the defendants.*

*This Article discusses the legal and ethical considerations for contacting former employees of the defendants who may become “confidential informants” that provide invaluable information for substantiating securities fraud claims. The Article further discusses defendants’ tactics in attacking the method of plaintiffs and their counsel’s investigation, subjecting both lead plaintiff and lead counsel to motions for sanctions for alleged Rule 11 violations pertaining to the*

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*parties' representations in court. The Article provides advice on defending these motions and conducting thorough investigations prior to filing an amended complaint.*

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## INTRODUCTION

This Article discusses the role that Confidential Witnesses (“CWs”) play in securities fraud litigation, and advises on how to conduct an internal investigation related to CW testimony to withstand defendants’ common practice to file motions attempting to throw out the testimony, or even the claims.<sup>1</sup> Often times, attorneys hire investigators to find former employees of the targeted defendant’s corporation who will talk about issues related to the alleged fraud. Investigators tend to interview these witnesses telephonically, taking notes contemporaneously with the interview.<sup>2</sup> The investigators then transpose their interview notes into memoranda for the plaintiffs’ attorneys to review and assess the potential testimony.<sup>3</sup>

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1. This Article addresses issues raised in the 2013 Institute for Investor Protection conference held at Loyola University School of Law, wherein Judge Jed Rakoff was a panelist.

2. See *City of Pontiac Gen. Emps.’ Ret. Sys. v. Lockheed Martin*, 952 F. Supp. 2d 633, 637 (S.D.N.Y. 2013) (noting the plaintiff’s attorney’s reliance on notes taken during a telephone conversation).

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

These 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. This Article discusses the reality of documenting the CW's potential testimony, which typically forms the basis of an amended complaint.

Often, after the defendants' counsel has spoken with a CW, the CW is concerned about getting involved and will recant his or her testimony.<sup>4</sup> Defendants as of late have been luring CWs into recanting their testimony, and then threatening to file a Federal Rule of Civil Procedure 11 ("Rule 11") motion against plaintiffs and their counsel for filing a complaint without a reasonable basis.<sup>5</sup> Further, defendants can seek sanctions from courts for Rule 11 violations.<sup>6</sup>

This Article discusses how to conduct an ethical and thorough investigation to substantiate plaintiffs' claims for violations of securities laws, and how to prevent defendants' counsel from alleging Rule 11 violations against plaintiffs and their counsel when a witness decides to recant his or her testimony. This Article also discusses how plaintiffs' attorneys can fight a Rule 11 motion when they know that they conducted a thorough and ethical investigation despite a witness' recantation.

## I. THE USE OF CONFIDENTIAL WITNESSES

In 1995, Congress passed the Private Securities Litigation Reform Act ("PSLRA") to eliminate abusive practices in federal securities litigation.<sup>7</sup> Among other things, the PSLRA set forth requirements that

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(stating that it was not unreasonable for the plaintiff's attorney to rely on notes taken from interviews conducted by investigators).

4. Gideon Mark, *Recanting Confidential Witnesses in Securities Litigation*, 45 LOY. U. CHI. L.J. 575, 601 (2014).

5. FED. R. CIV. P. 11(b) provides, in relevant part:

By presenting to the court a pleading, written motion, or other paper—whether by signing, filing, submitting, or later advocating it—an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances: (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation; (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law; (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.

6. See FED. R. CIV. P. 11(c) (providing a sanction mechanism).

7. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995)

raised the plaintiffs' burden in pleading federal securities fraud claims. First, the PSLRA heightened the standard to plead scienter to establish securities fraud claims under the Securities Exchange Act of 1934, requiring a federal securities fraud complaint to plead facts "giving rise to a strong inference that the defendants acted with the required state of mind."<sup>8</sup> Second, the PSLRA instituted an automatic discovery stay until the resolution of the defendant's motion to dismiss.<sup>9</sup> As a result, a federal securities plaintiff must, at the outset, plead facts giving rise to a strong inference of scienter without the benefit of formal discovery.<sup>10</sup> In many cases, plaintiffs attempt to meet this burden by relying on statements attributed to former company insiders, usually referred to as CWs.

Plaintiffs' attorneys often employ the use of an investigator to find former employees that held positions at the defendant company such that they may have information about the fraud alleged. Some former employees will agree to discuss their knowledge with investigators while others will not talk to anyone at all. Many of these former employees would like their identities to be kept confidential for a variety of reasons. First, many are still employed in the same line of business or are looking for a job in that field and are concerned that they will gain a reputation as a "whistleblower" if their name gets out. Others simply do not wish to be embroiled in any type of litigation, especially where their former employer is alleged to have committed fraud.

Judge Jed Rakoff of the Southern District of New York, a leading jurist in securities litigation, has stated that the use of CWs has become an "unintended consequence" of the PSLRA, becoming a problem not only for plaintiffs, but also for defendants and the court itself.<sup>11</sup> There are problems with witness recantation as well as witness reliability. In *City of Pontiac General Employees' Retirement System v. Lockheed Martin*, Judge Rakoff denied the defendants' motion to dismiss, partly based on "reliance on the statements attributable to the [confidential witnesses]."<sup>12</sup> Subsequent to the denial, defense counsel filed a motion for summary judgment, alleging that the witnesses had recanted their

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(codified as amended in scattered sections of 15 U.S.C.).

8. 15 U.S.C. § 78u-4(b)(1) (2012).

9. *Id.*

10. *Id.* § 78u-4(b)(3)(B).

11. *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin*, 952 F. Supp. 2d 633, 635 (S.D.N.Y. 2013).

12. *Id.* at 636.

testimony or denied having made the statements attributed to them.<sup>13</sup> The plaintiffs responded that their investigators' notes confirmed the allegations in the amended complaint pertaining to those witnesses; however, the witnesses later changed their stories because of pressure from defendants.<sup>14</sup> Because of these contradicting statements amongst the parties, Judge Rakoff ordered that the witnesses *and* the investigators appear in court for a hearing.<sup>15</sup>

After the in-court hearing, Judge Rakoff denied summary judgment, stating that his opinion would follow.<sup>16</sup> However, the parties settled the case that day, therefore Judge Rakoff had no reason to issue a full opinion on summary judgment.<sup>17</sup> Nevertheless, he issued a *post-settlement* memorandum because, as he noted, "a few comments may be helpful in light of certain issues presented by [the summary judgment] motion that are likely to recur in future cases."<sup>18</sup> He further explained that:

The sole purpose of this memorandum . . . is to focus attention on the way in which the PSLRA and decisions like *Tellabs* have led plaintiffs' counsel to rely heavily on private inquiries of confidential witnesses, and the problems this approach tends to generate for both plaintiffs and defendants. It seems highly unlikely that Congress or the Supreme Court, in demanding a fair amount of evidentiary detail in securities class action complaints, intended to turn plaintiffs' counsel into corporate "private eyes" who would entice naïve or disgruntled employees into gossip sessions that might help support a federal lawsuit. Nor did they likely intend to place such employees in the unenviable position of having to account to their employers for such indiscretions, whether or not their statements were accurate. But, as it is, the combined effect of the PSLRA and cases like *Tellabs* are likely to make such problems endemic.<sup>19</sup>

He observed:

[T]he competing pressures this process has placed on the confidential witnesses and the impact such pressures had had on their ability to tell the truth. In a nutshell, it appeared to the Court that some, though not all, of the CWs had been lured by the investigator into stating as "facts" what were often mere surmises,

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13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.* at 635.

17. *Id.*

18. *Id.*

19. *Id.* at 638.

but then, when their indiscretions were revealed, felt pressured into denying outright statements they had actually made.<sup>20</sup>

In issuing his Memorandum, Judge Rakoff noted:

In essence, the perhaps-too-easily satisfied “notice pleading” requirements of a quarter century ago have been replaced, so far as securities class actions are concerned, by a “demurrer-like” process that creates considerable hurdles that a plaintiff must overcome before any discovery is permitted. While designed to give district courts a “gatekeeper” responsibility to derail dubious class action lawsuits at the outset, an unintended consequence has been to cause plaintiffs’ counsel to undertake surreptitious pre-pleading investigations designed to obtain “dirt” from dissatisfied corporate employees. Thus in this case, as in many others, the Amended Complaint relied heavily, although not exclusively, on information attributed to “confidential witnesses” (“CWs”).<sup>21</sup>

The same lead counsel from *City of Pontiac* was sanctioned by a Northern District of Illinois Court for misrepresenting a CW’s knowledge of the issues at hand when the lead counsel should have known that the CW was not employed by the company at the time of the fraud; where the plaintiff’s counsel’s investigator doubted the veracity of the CW’s statements; and where the plaintiff’s counsel continued to argue against dismissal even after the CW told the plaintiff’s counsel he refused to cooperate, and recanted his prior statements.<sup>22</sup> Chief Judge Ruben Castillo held:

Counsel failed to conduct a proper investigation before filing the original complaint; counsel blindly relied on their investigators and failed to verify the truth of the confidential source’s allegations before including them in the second amended complaint; and counsel made repeated misrepresentations to the court as to the strength and truth of the confidential source’s allegations.<sup>23</sup>

Because of the hurdles plaintiffs must overcome to establish scienter in securities fraud cases, and because different circuits treat the use of CWs differently, the use of CWs will continue to be a central issue in securities litigation. It is therefore important that plaintiffs’ counsel conduct reliable investigations and corroborate CW statements with other evidence from the case.

Subsequent to the Supreme Court’s opinion in *Tellabs, Inc. v. Makor*

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20. *Id.* at 636–637.

21. *Id.* at 635.

22. *City of Livonia Emps.’ Ret. Sys. v. Boeing Co.*, No. 09 C 7143, 2014 WL 4199136, at \*7 (N.D. Ill. Aug. 21, 2014).

23. *Id.* at \*4.

*Issues & Rights, Ltd.* (“*Tellabs II*”),<sup>24</sup> in construing the “strong inference” language of the PSLRA, the Seventh Circuit has given mixed opinions addressing the viability of pleading evidence through CWs to establish scienter. For example, the Seventh Circuit in *Higginbotham v. Baxter International Inc.*,<sup>25</sup> found that allegations based on confidential informants should be heavily discounted.<sup>26</sup>

However, two months later, in *Makor Issues & Rights, Ltd. v. Tellabs Inc.* (“*Tellabs III*”),<sup>27</sup> the court did not require that CWs ipso facto require a heavy discount.<sup>28</sup> Judge Posner, who was a member of the panel in *Higginbotham*, wrote the decision in *Tellabs III* in which the circuit court stated that the issue of anonymous informants “led [it] to suggest in [*Higginbotham*] that such allegations must be steeply discounted. But that was a very different case from this one.”<sup>29</sup> While the Seventh Circuit in *Tellabs III* did not revisit the standard it created in *Higginbotham*, it explained that the particular circumstances in *Higginbotham* warranted a discounting of the CW testimony, evidencing the court’s approach in performing a fact-specific inquiry for each case.<sup>30</sup> The Seventh Circuit in *Tellabs III* held that the facts in *Higginbotham* were distinguishable and upheld the complaint, stating that the “confidential sources listed in the complaint in this case, in contrast, are numerous and consist of persons who from the description of their jobs were in a position to know at first hand the facts to which they are prepared to testify” and “the absence of proper names does not invalidate the drawing of a strong inference from informants’ assertions.”<sup>31</sup>

The main difference between *Higginbotham* and *Tellabs III* is that in *Higginbotham* the plaintiffs did not have any other corroborating evidence to support scienter, and they were attempting to hold defendant Baxter International liable for the fraudulent acts of its foreign subsidiaries.<sup>32</sup> In *Tellabs III*, the plaintiffs had other supporting evidence corroborating scienter.<sup>33</sup> In other words, the other evidence in the case gleaned through the plaintiffs’ investigation was consistent

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24. 551 U.S. 308 (2007).

25. 495 F.3d 753, 757 (7th Cir. 2007).

26. *Id.*

27. 513 F.3d 702 (7th Cir. 2008).

28. *Id.* at 711–12.

29. *Id.* at 711.

30. *Id.* at 711–12.

31. *Id.* at 712.

32. *Id.* at 711–12.

33. *Id.*

with the allegations pertaining to the CWs.

It appears that most courts, including the Second, Third, Fifth and Ninth Circuits, have abandoned the “heavily discounted” language of *Higginbotham* so long as the allegations pertaining to the CWs are supported by corroborating evidence and that the CWs held a position within the company that one could attribute their knowledge of the issues at hand.<sup>34</sup>

Judge Rakoff has noted that heightened pleading standards in securities class actions have left CWs in a tough spot: lured by plaintiffs lawyers to exaggerate wrongdoing and then pressured by defendants to recant their testimony.<sup>35</sup> As Judge Rakoff stated in a previous *Loyola University Chicago Law Journal* publication, “I see no reason why such statements should be inherently discounted at the pleading stage just because the informants are unidentified.”<sup>36</sup>

Defense attorneys have different theories on what can be done to address these issues with CWs; however, many of these theories are not practical. For example, some defense attorneys have suggested requiring plaintiffs’ lawyers to include a sworn declaration from CWs verifying their allegations in the complaint. Yet, this defeats the purpose of having “confidential” witnesses. As Judge Rakoff noted,

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34. *N.J. Carpenters Pension & Annuity Funds v. Biogen IDEC Inc.*, 537 F.3d 35, 51 (1st Cir. 2008) (declining to discount pursuant to *Higginbotham* but following *Tellabs II* instead—noting difference within circuit); *Pension Trust Fund for Operating Eng’r v. Assisted Living Concepts, Inc.*, No. 12-CV-884-JPS, 2013 WL 3154116, at \*3 n.5 (E.D. Wis. June 21, 2013) (“[T]here is strength in the number of confidential witnesses, their corroborative aspects, and the specific descriptions of each of them.” (citing *Makor Issues & Rights, Ltd. v. Tellabs, Inc. (Tellabs III)*, 513 F.3d 702, 711–712 (7th Cir. 2008))); *City of Sterling Heights Gen. Emps.’ Ret. Sys. v. Hospira, Inc.*, No. 11 C 8332, 2013 WL 566805, at \*17 (N.D. Ill. Feb. 13, 2013) (“[T]he Seventh Circuit clarified that a particularly troubling use of the confidential sources prompted the holding in *Higginbotham*. There, the plaintiffs described the witnesses ‘merely as three ex-employees of Baxter and two consultants’ and sought to rely upon them exclusively to establish scienter.” (quoting *Tellabs III*, 513 F.3d at 712)); *Ross v. Career Educ. Corp.*, No. 12 C 276, 2012 WL 5363431, at \*4 (N.D. Ill. Oct. 30, 2012) (“[Courts will] determine whether unnamed witnesses were ‘in a position to know at first hand the facts to which they are prepared to testify.’” (quoting *Tellabs III*, 513 F.3d at 712)); *City of Lakeland Emps.’ Pension Plan v. Baxter Int’l Inc.*, No. 10 C 6016, 2012 WL 607578, at \*5 (N.D. Ill. Jan. 23, 2012) (upholding scienter based on accounts from CWs as to how individual defendants were informed about the operations and financial state of company); *Mishkin v. Zynex Inc.*, No. 09-CV-00780-REB-KLM, 2011 WL 1158715, at \*6–7 (D. Colo. Mar. 30, 2011) (declining to follow *Higginbotham* and instead following the Eleventh Circuit’s approach in *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1240 (11th Cir. 2008)); *In re Ambac Fin. Grp., Inc. Sec. Litig.*, 693 F. Supp. 2d 241, 283 (S.D.N.Y. 2010) (“*Higginbotham* . . . was severely limited when that court decided the *Tellabs* case on remand from the Supreme Court.”). *But see* *City of Livonia Emps.’ Ret. Sys. v. Boeing Co.*, 711 F.3d 754, 759 (7th Cir. 2013) (CWs do require “heavy discount” in certain questionable circumstances).

35. Jed S. Rakoff, *Confidential Informants and Securities Class Actions: Mixed Messages and Motives*, 45 LOY. U. CHI. L.J. 571, 573–74 (2014).

36. *Id.* at 573.



once the identities of CWs are known, they are then “pressured into denying outright the statements they had actually made.”<sup>37</sup> The fear of retaliation by a defendant company accounts for most witness recantations. Further, it is not practical to have the CW sign a declaration because often it is difficult for an investigator to get a former employee to talk at all, let alone for a second time or to sign documents. Also, legal documents have a “chilling effect” on these witnesses.<sup>38</sup> For this reason, former employees are much more willing to talk if the information they provide does not form the basis of a legal document.

Defense attorneys have also argued that plaintiffs’ lawyers themselves, as opposed to their investigators, should participate in the witness interviews. In arguing so, defendants’ counsel attempt to create a legal standard that does not exist. While this would be a good way to ensure that the plaintiffs’ allegations are accurate, it is impractical for many reasons. First, the imposition of a lawyer—as opposed to an investigator—could have a chilling effect on CW testimony. Also, an investigator may take days to contact a potential witness to get an interview. At the time he or she finally gets the potential witness on the telephone, the lawyer may not be able to talk. Witnesses are busy and are not going to go out of their way to assist in a securities fraud case. Investigators must be allowed to talk to these witnesses whenever and wherever they can—without worrying about the lawyer’s schedule and who else must participate in the interview (which is most often accomplished via telephone). There are, however, certain practices that plaintiffs’ attorneys can engage in with respect to relying on a CW interviewed by his or her investigator.

## II. ETHICAL AND LEGAL CONSIDERATIONS FOR CONTACTING FORMER/CURRENT EMPLOYEES

It is important that the plaintiff’s lawyer familiarize him or herself with the ethical rules that govern a lawyer’s communication with defendants’ former employees. Most states have similar ethical rules, but different jurisdictions interpret these rules differently. Some states allow contact with former employees regardless of whether or not they were deemed in the “control group” at the defendant corporation. For example, Illinois Rule of Professional Conduct 4.2—“Communication With Person Represented by Counsel”—provides that:

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37. *Id.*

38. In this context, a chilling effect is when a witness who would otherwise talk is discouraged from assisting in the case for fear of getting involved in the legal process.

In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.<sup>39</sup>

In Illinois, the leading case that interprets the definition of “represented” for purposes of Rule 4.2 is *Fair Automotive Repair, Inc. v. Car-X Service Systems, Inc.*<sup>40</sup> In *Fair Automotive*, the plaintiff brought suit against the defendant company for slander and business interference.<sup>41</sup> After the defendant engaged representation, the plaintiff hired investigators to pose as customers in defendant’s shops to bait employees into slandering the plaintiff.<sup>42</sup> The defendants objected, claiming first that the investigator effectively was engaging in a deposition by soliciting testimony from defendants’ employees, and second that it was improper for the plaintiffs to speak to the defendants’ employees because they were represented by defendants’ counsel.<sup>43</sup> The court rejected defendants’ argument, finding that the employees were not part of the “control group”:

The [*Consolidation Coal Co. v. Bucyrus-Erie Co.*] case held that, with regard to a corporation, the attorney-client privilege is applicable only to those employees within the corporation’s “control group,” which is defined as those top management persons who had the responsibility of making final decisions and those employees whose advisory roles to top management are such that a decision would not normally be made without those persons’ advice or opinion or whose opinions in fact form the basis of any final decision. Clearly, if the “control group” were applied here to corporate parties under Rule 7–104, that rule was not violated by the investigators’ contacts with the employees at the Car-X shops.<sup>44</sup>

Other Seventh Circuit cases have similarly followed suit, finding that:

[N]ot all employees are considered to be represented by a company’s lawyers under Rule 4.2. If the employee is not represented, then the plaintiff’s attorney would be free to contact that employee. If the employee is represented, however, under Rule 4.2 the plaintiff’s attorney would be required to go through the employee’s lawyer (who is most likely the company’s lawyer) to schedule a deposition or

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39. ILL. RULES OF PROF’L CONDUCT R. 4.2 (2013).

40. *Fair Auto. Repair, Inc., v. Car-X Serv. Sys., Inc.*, 471 N.E.2d 554 (Ill. App. Ct. 1984) (discussing *Consolidation Coal Co. v. Bucyrus-Erie Co.*, 432 N.E.2d 250 (Ill. 1982)).

41. *Id.* at 557.

42. *Id.*

43. *Id.* at 558.

44. *Id.* at 560.

otherwise gain information from the employee. Although this requirement might raise the cost of gathering information from the employee, we cannot say that such a requirement amounts to a rule or device that prevents the employee from furnishing information to the plaintiff's attorney.<sup>45</sup>

In particular, the Seventh Circuit clarified the meaning of "represented" as follows:

In analyzing the scope of Rule 4.2, the district court adopted the three-part test that the ABA set out in its official commentary to the Model Rules. The district court also relied heavily on a recent decision from the Northern District of Illinois, in which that court adopted and explained the ABA test. Under the test set out in the Model Rules and *Orlowski*, a defendant's employee is considered to be represented by the defendant's lawyer, and so is covered by the prohibition in Rule 4.2, if the employee meets any one of the following three criteria: (1) she has "managerial responsibility" in the defendant's organization, (2) her acts or omissions can be imputed to the organization for purposes of civil or criminal liability, or (3) her statements constitute admissions by the organization.<sup>46</sup>

Therefore, a former employee's statements cannot bind a corporation because his or her statements cannot be imputed to the corporation. Nor does a former employee have any managerial responsibility. Federal courts in the Seventh Circuit have reached this same conclusion: "[t]he possibility that former employees may reveal damaging information . . . is insufficient to implicate Rule 4.2."<sup>47</sup> "Former employees are outside the scope of Rule 4.2 because, unlike current employees, former employees cannot bind the corporation."<sup>48</sup>

However, in other states, such as Connecticut, the Professional Conduct Rule governing communication with defendants is interpreted much differently. For example, a district court there held that,

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45. *Weibrecht v. S. Ill. Transfer, Inc.*, 241 F.3d 875, 880 (7th Cir. 2001).

46. *Id.* at 881 (citations omitted).

47. *Orlowski v. Dominick's Finer Foods, Inc.*, 937 F. Supp. 723, 728 (N.D. Ill. 1996) (citing *Ahern v. Bd. of Educ. of City of Chi.*, No. 92 C 4074, 1995 WL 680476, at \*1 (N.D. Ill. Nov. 14, 1995)).

48. *EEOC v. Univ. of Chi. Med. Ctr.*, No. 11 C 6379, 2012 U.S. Dist. LEXIS 53298, at \*11 (N.D. Ill. Apr. 16, 2012); see *Brown v. St. Joseph Cnty.*, 148 F.R.D. 246, 253-254 (N.D. Ind. April 12, 1993) (collecting cases, and stating "[t]his court must agree with the majority of courts which have held that Rule 4.2 and its analogue, DR 7-104(A)(1), have no application to former employees who no longer have any relationship with a corporation"); accord. *Thorn v. Sunstrand Corp.*, No. 95 C 50099, 1997 U.S. Dist. LEXIS 15761, at \*7 (N.D. Ill. Oct. 10, 1997) ("Neither Rule 4.2 nor the comment refer to former employees. Courts have, however, agreed that former employees do not constitute parties 'represented by another lawyer' and, therefore, counsel is not restricted from communicating with an adverse party's former employees pursuant to Rule 4.").

“[S]ome former employees continue to personify the organization even after they have terminated their employment relationship[.]” such as “a managerial level employee involved in the underlying transaction, who is also conferring with the organization’s lawyer in marshal[ing] the evidence on its behalf.” For “[t]his kind of employee [who] is undoubtedly privy to privileged information, . . . an opposing lawyer is not entitled to reap a harvest of such information without a valid waiver by the organization.”<sup>49</sup>

State law governs these types of ethical rules, and it is important to thoroughly research this issue prior to reaching out to former control persons. Typically with securities litigation, case-specific facts can make it difficult to determine which state’s law applies. For example, the witnesses can be in one state while the lawyers are in a separate state (sometimes with more than one office around the country); the defendant can be in a completely different state altogether; or the former control person can contact the lawyer. These facts present interesting legal issues that need to be researched. The best way to avoid any ethical violation is to discuss the potential witness list with your investigator *prior* to the interviews. It is important to determine whether under that particular state’s ethical rules, it would be proper to contact certain potential witnesses.

### III. BEST PRACTICES IN CONDUCTING AN INVESTIGATION

Prior to starting the interview, the investigator should clearly do the following. The investigator should make clear to the witness that he or she works for a law firm *adverse* to the company. The investigator should then make clear to the witness that the investigator is not his or her attorney. The investigator should also make clear to the witness that his or her statements *are not confidential*.<sup>50</sup> If the witness truly never wants his or her name disclosed, the testimony cannot be used. Nevertheless, there are ways to persuade the witness to talk. For example, it is ethical to say to the witness that discovery is a long time away and that there is a chance that their identity never gets disclosed if the case settles early. But the investigator can *never* ensure the witness that his or her identity will never be disclosed. Finally, the investigator

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49. Weber v. Fujifilm Med. Sys., USA, No. 3:10 CV 401(JBA), 2010 WL 2836720, at \*2 (D. Conn. Jul. 19, 2010) (alterations in original) (citing Dubois v. Gradco Sys., Inc., 136 F.R.D. 341, 346 (D. Conn. 1991)).

50. Ultimately, we are going to have to reveal this ‘CW’s name through discovery, and in particular, as part of the initial disclosures. Because the pleading requirements have become so particularized, usually the defendant can determine the CW’s identity simply from reviewing the complaint. While our Rule 26 disclosures may be a huge laundry list of names, it is unlikely the CW’s identity will be difficult to ascertain.

should ensure that the witness is not currently employed with the defendants and that the witness did not sign a confidentiality agreement upon his or her departure.<sup>51</sup>

At a minimum, the investigator should review the draft allegations prior to filing the complaint to ensure that the allegations are consistent with his or her notes from the witness interview.

In certain jurisdictions, it is legal to tape a telephone conversation without the consent of all parties. However, the attorney and the investigator need to be familiar with the eavesdropping statute of each state before engaging in this practice. For example, in Illinois, it is *illegal* to record a private telephone conversation without the consent of all parties to the conversation, unless it was unreasonable for the parties to expect privacy.<sup>52</sup> On the other hand, New York's eavesdropping statute allows the taping of a conversation with consent of only one of the parties;<sup>53</sup> hence, the investigator may tape the conversation.

More often than not; however, the investigator, the witnesses and the litigation are spread across the country. When this occurs, the federal court where the case presides will make a choice-of-law decision to apply one of the state's eavesdropping statutes. The law in these circumstances is unclear, and courts make the choice-of-law decision on a case-by-case basis. *Golden Archer Investments, LLC v. Skynet Financial Systems*<sup>54</sup> is a good example of this type of analysis. In that case, a New York federal court applied Illinois state law and found the tape-recording illegal. The court noted:

Based on the particular facts of this case, the Court is persuaded that Illinois law governs Defendant's counterclaim. First, Rucker recorded the calls with Silverstein knowing that Silverstein was physically

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51. If the former employee did sign such an agreement, ask to get a copy of it. Defendants cannot shield a fraud by invoking such an agreement. *See, e.g., Brado v. Vocera Comm., Inc.*, 14 F. Supp. 3d 1316 (N.D. Cal. 2014); *Takiguchi v. MRI Int'l, Inc.*, No. 2:13-cv-01183-JAD-VCF, 2013 WL 6528507 (D. Nev. Dec. 11, 2013); *In re JDS Uniphase Corp. Sec. Litig.*, 238 F. Supp. 2d 1127 (N.D. Cal. 2002). These cases provide excellent citations to assist in bringing a motion to limit the scope of a confidentiality agreement to allow these witnesses to discuss matters alleged in the complaint.

52. Until recently, the Illinois Eavesdropping Act criminalized the audio recording of conversations in Illinois without the consent of all parties, but the Illinois Supreme Court concluded that the law was unconstitutional. 720 ILL. COMP. STAT. 5/14-1 (amended 2013), *overruled by* *People v. Clark*, 6 N.E.3d 154 (Ill. 2014); *People v. Melongo*, 6 N.E.3d 120 (Ill. 2014). Governor Pat Quinn signed a new eavesdropping law at the end of 2014 that hinges on parties' reasonable expectations of privacy; for a conversation to be private, at least one party to the conversation must intend for the conversation to be private and the circumstances surrounding that intention must be reasonably justified. S.B. 1342, 98th Gen. Assemb., Reg. Sess. (Ill. 2014).

53. *Golden Archer Inv., LLC v. Skynet Fin. Sys.*, 908 F. Supp. 2d 526, 537-39 (S.D.N.Y. 2012).

54. *Id.*

present in Illinois. In this regard, Rucker knowingly reached into Illinois and committed a tort against an individual and corporate entity in Illinois. Second, the injury caused by the recordings was inflicted in Illinois, where Defendant is located. Indeed, a court in Illinois has held that an individual in New York was liable for violating the Illinois eavesdropping statute by recording conversations without the consent of all parties even though the conversation was recorded in New York.

Whether New York courts will always apply the law of states—such as Illinois—that take a more restrictive approach to the recording of telephone conversations is an issue of state law that may ultimately need to be resolved by the New York Court of Appeals. In an era of global cellular phone access and number portability, it is certainly conceivable that New York courts will endeavor to protect their citizens from liability in foreign jurisdictions and eschew the *lex loci* rule, particularly where it is difficult for a caller to know with certainty where a party to the call is located. However, because Rucker knew that he was recording a telephone conversation with a party in Illinois, and the injury was sustained in Illinois, the Court is persuaded that, as compared to New York, Illinois has the greater “interest in regulating behavior within its borders,” . . . at least with respect to the specific conduct at issue in this case.<sup>55</sup>

Prior to taping a witness telephone conversation, it is important that the attorney and investigator analyze all factual and legal considerations. The attorney should also discuss with the investigator this particular witness’ demeanor and likelihood of speaking to a lawyer, signing an affidavit or declaration, and the witness’ general ability to withstand a defendants’ attempt to persuade the witness to change his or her testimony.

If one witness statement or quotation is particularly important to the allegations, the following steps should be taken *only if* the investigator believes that this witness will speak to a lawyer. The lawyer and the investigator together should speak to the witness a second time to confirm the accuracy of the witness’ statements. The investigator should send the witness the proposed allegations in the complaint to confirm their accuracy. If the witness is willing, the witness should sign an affidavit attesting to the accuracy of the allegations. If the witness is unwilling to actually sign an affidavit, the investigator should confirm with the witness orally or via email that there are no misstatements contained in the proposed allegations. Finally, the investigator should sign an affidavit attesting to the accuracy of the witness statements

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55. *Id.* at 539 (internal citations omitted).

relayed by the CW to the investigator.

If the investigator believes that the witness will refuse to speak to a lawyer or sign any legal document, the investigator should take the following steps. If the investigator has an assistant, the investigator should have the assistant on the follow-up phone interviews with the witness as a second pair of ears. The investigator should orally review the statements with the witness to ensure their accuracy. It can be helpful to tell the witness that the investigator wants to make sure he or she understood his or her statements correctly. If quoting a witness, the investigator should get an affidavit from the witness declaring that the allegations in the complaint accurately reflect what the witness told the investigator on a certain date (prior to filing the complaint).

Investigators should also analyze the information from the potential witness to ensure that it coincides with all of the other evidence gathered in the case. If, for instance, there are ten CWs saying one thing, and one CW states something opposite that may help the case, lawyers should be wary of using this information unless there is corroborating evidence. It is important that a potential witness' testimony is consistent with the other potential witnesses and the investigation.

Investigators should finally analyze whether the witness' desire to "not get involved" is worth the potential statements that this witness is making. If a witness is really averse to talking, he or she will be more likely to recant his or her testimony once the defendants put pressure on him or her. Because his or her identity will ultimately have to be disclosed, lawyers need to think about how this witness will perform at a deposition. If he or she is too tentative during the investigative process, chances are that he or she will be even more tentative during a deposition process.

#### IV. RULE 11 MOTIONS

Even if plaintiffs' attorneys and their investigators employ the most thorough practices to ensure the accuracy of their complaints, defendants will still attempt to abuse the process by threatening and/or filing Rule 11 motions, which is simply another way of attempting to dismiss the case without having the court rule on the merits of a dismissal motion. Defendants usually threaten to file a Rule 11 motion based on alleged recantations of the CWs, demanding that plaintiffs withdraw the allegations. Because the heightened pleading requirements of the PSLRA require plaintiffs to plead the details of the CW's position and ability to know the facts alleged, the defendants readily determine who that "anonymous" witness is. Once defendants

reach out to the witness, the witness often feels pressure to change his or her testimony and the facts alleged in the complaint. Defendants then will file a Rule 11 motion, claiming that the witness does not believe the facts attributed to him or her.

Such “recantation” should not be the basis for a Rule 11 motion. For example, in *In re TETRA Technologies, Inc. Securities Litigation*,<sup>56</sup> defendants filed a Rule 11 motion, contending that several of the allegations in the amended complaint had no evidentiary support or factual basis because the plaintiffs had misquoted or misconstrued statements made by CWs. The court, in denying defendants’ request for Rule 11 sanctions, set forth the proper Rule 11 inquiry into claims that are well grounded in fact and law:

The court considers three issues: (1) factual questions regarding the attorney’s pre-filing inquiry and factual basis of the filing (2) legal issues of whether the filing is warranted by existing law or a good faith argument, and (3) discretionary issues regarding an appropriate sanction. Reasonableness is measured on an objective basis.<sup>57</sup>

#### A. *Reliance on an Investigator Does Not Violate Rule 11*

Defendants generally claim that because the plaintiffs’ attorneys themselves do not usually speak directly to these informants, but rather have their investigators conduct the witness interviews, that plaintiffs have no reasonable basis upon which to rely on that interview to form allegations in a complaint. In essence, defendants attempt to create a legal standard that does not exist. “The current version of the Rule requires only that an attorney conduct “an inquiry reasonable under the circumstances” into whether “factual contentions have evidentiary support.”<sup>58</sup>

Defendants almost always cite *City of Livonia Employees’ Retirement System v. Boeing Co.*<sup>59</sup> as a basis for Rule 11 sanctions. However, defendants around the country have misrepresented the holding in that case, where the Seventh Circuit *declined* to impose sanctions (despite defendants’ general representation that it imposed sanctions), sending

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56. *In re Tetra Tech., Inc. Sec. Litig.*, No. 4:08-CV-0965, 2009 WL 6325540, at \*39–40 (S.D. Tex. July 9, 2009).

57. *Id.* at 39 (internal citations omitted).

58. FED. R. CIV. P. 11(b), (b)(3); *Harding Univ. v. Consulting Servs. Grp., L.P.*, 48 F. Supp. 2d 765, 769 (N.D. Ill. 1999); see *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1311 (S.D. Fla. 2011), *aff’d sub nom.* *Hubbard v. BankAtlantic Bancorp, Inc.*, 503 F. App’x 677 (11th Cir. 2012) (recent PSLRA case where the court denied the ‘defendants’ Rule 11 motion, specifically rejecting this argument, finding that reliance on an investigator was reasonable).

59. 711 F.3d 754, 762 (7th Cir. 2013).



the case back to the district court for further determination.<sup>60</sup> There, the district court initially denied defendants' motion to dismiss, upholding scienter based solely on allegations pertaining to a CW.<sup>61</sup> Subsequently, the investigator acknowledged that she could not verify what the source had told her and had "qualms" based on inconsistencies between the source's information and what she otherwise believed to be true.<sup>62</sup> Even where the court found that some allegations related to this CW were clearly false<sup>63</sup> and where the CW denied *everything* that the investigator had reported,<sup>64</sup> the Seventh Circuit declined to impose sanctions, noting that an appeals court can only do so in a "clear case."<sup>65</sup> The district court did ultimately impose sanctions against Robbins Geller, finding that the lawyers actually made misrepresentations to the court regarding the CWs.

In *City of Livonia*, Chief Judge Castillo issued sanctions, finding that:

Plaintiffs' counsel knew that the information [the CW] provided the investigator was unverified and potentially unreliable and that [the CW] refused to cooperate further, and yet repeatedly made assurances to the court as to the truth of the allegations. The information turned out to be blatantly false, and if counsel had made any attempt to verify the information, they would have easily discovered this. Instead, they blindly defended the allegations their investigator attributed to [the CW] and made fundamental misrepresentations to the court. Counsel failed to verify the allegations so as to remain ignorant of the truth, and this conduct is reckless and unjustified. The Court agrees with the Seventh Circuit's characterization of Plaintiffs' counsel's conduct as "ostrich tactics"—counsel put their heads in the sand to avoid discovering the truth. Accordingly, the Court finds that Plaintiffs' counsel violated Rule 11(b) by filing its amended complaint and second amended complaint without conducting a reasonable pre-filing investigation and by asserting and defending factual contentions that lacked evidentiary support.<sup>66</sup>

In *City of Livonia*, the investigator did not believe the statements made by the CW based on other evidence that had been gleaned through the investigation, and the CW was not even a former employee of the company. The key to avoiding sanctions is to ensure that there is

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60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 760.

64. *Id.*

65. *Id.* at 762.

66. *City of Livonia Emps.' Ret. Sys. v. Boeing Co.*, No. 09 C 7143, 2014 WL 4199136, at \*7 (N.D. Ill. Aug. 21, 2014).

corroborating evidence to the CW statements. In other words, ensuring what the CW is saying is consistent with all other evidence gathered in the case through investigation and research.

*B. Sanctions Are Warranted Only if Allegations Are  
“Utterly Lacking” Support After Resolving All  
Doubts in Favor of Counsel*

“Sanctions may not be imposed unless a particular allegation is utterly lacking in support.”<sup>67</sup> “This standard differs from the pre-1993 amendments. Under the former Rule, a signature on a pleading certified that the contentions therein were ‘well-grounded in fact.’”<sup>68</sup> This is particularly true in cases like this where discovery is stayed and the bulk of information required to prove the case is solely within the defendants’ possession.<sup>69</sup>

Rule 11 pertains to the parties’ representations in court.<sup>70</sup> “Under Rule 11, an attorney must make some reasonable inquiry into the facts and the law. The reasonableness of the inquiry is a fact-based question, dependent on the circumstances of the case at hand.”<sup>71</sup> The standard for determining whether Rule 11 sanctions should be imposed is a high threshold. The *In re BankAtlantic Corp.* court clearly sets forth the standard, finding that the legal and factual claims must be “objectively frivolous”:

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67. O’Brien v. Alexander, 101 F.3d 1479, 1489 (2d Cir. 1996).

68. Harding Univ. v. Consulting Serv. Grp., 48 F. Supp. 2d 765, 769 (N.D. Ill. 1999) (citing FED. R. CIV. P. 11).

69. See Henderson v. Jupiter Aluminum Corp., No. 2:05CV81, 2006 U.S. Dist. LEXIS 7777, at \*21 (N.D. Ind. Feb. 15, 2006) (“[S]everal factors should be examined, including . . . the attorney’s ability to do a sufficient pre-filing investigation; and whether discovery would have been beneficial to the development of the underlying facts.”).

70. FED. R. CIV. P. 11(b) provides, in relevant part:

By presenting to the court a pleading, written motion, or other paper—whether by signing, filing, submitting, or later advocating it—an attorney or unrepresented party certifies that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances: (1) it is not being presented for any improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of litigation; (2) the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law; (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information.

71. *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, 851 F. Supp. 2d 1299, 1311 (S.D. Fla. 2011) (citing *Worldwide Primates, Inc. v. McGreal*, 87 F.3d 1252, 1254 (11th Cir. 1996)), *aff’d sub nom. Hubbard v. BankAtlantic Bancorp, Inc.*, 503 F. App’x 677 (11th Cir. 2012).

A legal claim is frivolous if no reasonably competent attorney could conclude that it has any reasonable chance of success or is a reasonable argument to change existing law.

A factual claim is frivolous if no reasonably competent attorney could conclude that it has a reasonable evidentiary basis, because it is supported by no evidence or only by “patently frivolous” evidence. When, however, the evidence supporting a claim is reasonable, but only weak or self-serving, sanctions cannot be imposed.<sup>72</sup>

Rule 11 is not a best-practices standard.<sup>73</sup> Further, “whether the confidential witnesses initially made the statements attributed to them in the complaints is essentially a credibility question. In this context, Rule 11 sanctions are not appropriate.”<sup>74</sup>

### C. Rule 11 Analysis Cannot Be Made In Hindsight

A Rule 11 motion cannot be based on hindsight. The Court must assess whether plaintiff’s complaint had a reasonable basis based on what counsel knew “*at the time the complaint was filed*, not what subsequently was revealed in discovery.”<sup>75</sup> Thus, “Rule 11 does not allow an award of sanctions just because things went poorly after an investigation that was adequate in light of what was known (and how much time was available) before the paper was filed.”<sup>76</sup> In addition, when considering inability to ultimately prove a factual allegation, even after the benefit of discovery, is not grounds for a Rule 11 sanction.<sup>77</sup> Therefore, where a witness recants his or her testimony *after* the filing of the amended complaint, Rule 11 sanctions are not appropriate because the plaintiff’s attorney had a reasonable basis to make those allegations at the time the complaint was filed. A court must “resolve all doubts in favor of the signer.”<sup>78</sup>

### D. Rule 11 Motions Based on CW Testimony Should Be Denied as Premature

A court is required *sua sponte* to review the pleadings after *final*

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72. *Id.* at 1308 (internal citations omitted).

73. FED. R. CIV. P. 11 advisory committee’s note, *reprinted in* 97 F.R.D. 165, 198 (1983).

74. *In re BankAtlantic Bancorp, Inc.*, 851 F. Supp. 2d at 1312.

75. *Corley v. Rosewood Care Ctr.*, 388 F.3d 990, 1014 (7th Cir. 2004).

76. *LaSalle Nat’l Bank v. Cnty. of DuPage*, No. 82C6517, 1992 U.S. Dist. LEXIS 7748, at \*6–7 (N.D. Ill. June 3, 1992) (denying Rule 11 motion), *aff’d*, 10 F.3d 1333 (7th Cir. 1993).

77. *See* FED. R. CIV. P. 11 advisory committee’s note, *reprinted in* 146 F.R.D. 583, 586 (1993) (“The certification is that there is (or likely will be) ‘evidentiary support’ for the allegation, not that the party will prevail with respect to its contention regarding the fact.”).

78. *Oliveri v. Thompson*, 803 F.2d 1265, 1275 (2d Cir. 1968).

*adjudication* of a case to determine whether sanctions are warranted.<sup>79</sup> The Advisory Committee Notes to the 1983 amendments to Rule 11—and the case law—also make clear that the issue of sanctions in the case of pleadings “normally will be determined at the end of the litigation.”<sup>80</sup>

Generally, defendants seek a Rule 11 determination before the plaintiffs have obtained any discovery, before producing a single document, and without having offered a single witness for deposition.<sup>81</sup> At a minimum, until discovery has been completed, a court simply cannot find that “no reasonable evidentiary basis for a factual claim was disclosed in pretrial proceedings or at trial”—the prerequisite for any examination of plaintiffs’ pre-filing inquiry.<sup>82</sup> Therefore, a Rule 11 motion filed during the stay of discovery, and while a motion to dismiss is pending, is premature and should be denied.

### *E. Defending a Rule 11 Motion*

If defendants threaten to file a Rule 11 motion, claiming that a particular CW has either recanted or claims not to have said what the allegations attribute to that CW, the first step counsel should take is to contact the investigator to confirm that the allegations accurately depict what the CW told counsel’s investigator. If counsel is confident that he or she properly quoted the CW or summarized accurately what the CW said to the investigator, counsel should vigorously defend the Rule 11 motion. The best way to defend the motion is to reach out to the CW again and confirm that the complaint properly reflects what the CW said. However, practically speaking, the CW may waiver on the facts because the defendants have most likely already succeeded in getting the CW to re-think his or her testimony.

Solutions to defending a Rule 11 motion include the following. The plaintiff’s attorney can file an affidavit from the CW attesting that the allegations in the complaint accurately reflect what the CW told the investigator. If the CW takes issue with the way the attorney worded the allegations, the plaintiff’s attorney should file an affidavit from the CW declaring that the complaint accurately states what the CW told the

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79. 5 U.S.C. § 78u-4(c)(1) (2012).

80. See *Jawbone, L.L.C. v. Donohue*, No. 01 Civ. 8066(CSH), 2002 U.S. Dist. LEXIS 11806, at \*19 (S.D.N.Y. June 28, 2002) (refusing to find, “at [an] early stage of the litigation, without the benefit of discovery and a thorough analysis of the merits of the case, that plaintiff’s factual allegations are completely without support”).

81. For two examples in which the defendant moved for sanctions prior to discovery, see *Katz v. Household Int’l, Inc.*, 36 F.3d 670 (7th Cir 1994), and *Zambrano v. Int’l Ass’n of Machinists & Aerospace Workers Local 1202*, No. 89 C 6109, 1992 WL 44403 (N.D. Ill. Feb. 19, 1992).

82. *Calloway v. Marvel Entm’t Grp.*, 854 F.2d 1452, 1470 (2d Cir. 1988), *rev’d in part on other grounds sub nom. Pavelic & LeFlore v. Marvel Entm’t Grp.*, 493 U.S. 120 (1989).

investigator, but that the CW did not mean it in that context.

If the CW refuses to sign anything, the lawyer or investigator should at least orally confirm that there are no misstatements in the complaint. Then, the investigator can sign an affidavit stating that: the allegations properly reflect what the CW told the investigator prior to filing the complaint; that interview notes were drafted contemporaneously with each witness; that a detailed memorandum of the interview was drafted shortly thereafter; that the interview notes and memoranda accurately reflect the allegations pertaining to the CW; and that the investigator has spoken with the CW after the filing of the Rule 11 motion and agrees that there are no inaccuracies in the complaint attributed to that CW. If plaintiff's counsel believes that defense counsel have filed a Rule 11 motion simply to harass lead plaintiff and/or lead counsel, plaintiff's counsel can do more than just defend against the Rule 11 motion: counsel can and should file a cross-motion for sanctions. There are a few different legal avenues plaintiff's counsel can undertake to have a court review a cross-motion in a timely manner.

#### *F. Consider Filing a Cross-Motion for Sanctions*

It is well established that “the filing of a motion for sanctions is itself subject to the requirements of the rule and can lead to sanctions.”<sup>83</sup>

Many times, the only purpose of a Rule 11 motion in this context is to intimidate lead counsel and his or her clients into dismissing a viable securities fraud action. In situations where counsel can show that the motion was filed for an improper purpose, counsel should consider moving for cross-sanctions.<sup>84</sup>

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83. FED. R. CIV. P. 11 advisory committee's note, *reprinted in* 146 F.R.D. 583, 591 (1993); *see* *Meeks v. Jewel Cos.*, 845 F.2d 1421, 1422 (7th Cir. 1988) (holding defendant's request for sanctions frivolous); *In re Cent. Ice Cream Co.*, 836 F.2d 1068, 1070 (7th Cir. 1987) (holding the request for sanctions as “sanctionably frivolous”); *see* *Local 106, Serv. Emps.' Int'l Union v. Homewood Mem'l Gardens, Inc.*, 838 F.2d 958, 961 (7th Cir. 1988) (holding unwarranted motion for Rule 11 sanctions is itself sanctionable); *Gaiardo v. Ethyl Corp.*, 835 F.2d 479, 484–85 (3d Cir. 1987) (stating that courts may impose sanctions when Rule 11 is invoked for improper purpose, such as additional tactic of intimidation and harassment); *Lewandowski v. Two Rivers Pub. Sch. Dist.*, 711 F. Supp. 1486, 1499 (E.D. Wis. 1989) (finding that “defendants should have conducted a reasonable inquiry into the law bearing on their own position” prior to filing a Rule 11 motion); *Quaker Oats Co. v. Uni-Pak Film Sys.*, 683 F. Supp. 1186, 1189 (N.D. Ill. 1987) (stating that if Rule 11 motion is not warranted by existing law and fact, appropriate sanctions may be assessed, warning that “counsel would do well to choose their Rule 11 battles with more care”).

84. *See* FED. R. CIV. P. 11(b)(1) (describing “improper purposes” as including “to harass, cause unnecessary delay, or needlessly increase the cost of litigation”); FED. R. CIV. P. 11 advisory committee's note, *reprinted in* 146 F.R.D. 583, 590 (1993) (stating that Rule 11 should not be used “to intimidate an adversary into withdrawing contentions that are fairly debatable”). Pursuant to Rule 11(c)(2):

Sanctions may also be imposed pursuant to 28 U.S.C. § 1927, which notes that an attorney “who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys’ fees reasonably incurred because of such conduct.”<sup>85</sup> The purpose of § 1927 “is to deter frivolous litigation and abusive practices by attorneys, and to ensure that those who create unnecessary costs also bear them.”<sup>86</sup> Ultimately, “when an attorney recklessly creates needless costs the other side is entitled to relief.”<sup>87</sup> Further, unlike Rule 11, sanctions under § 1927 do not require a hearing.<sup>88</sup> Where defendants have recklessly created needless cost and expense to plaintiffs in responding to defendants’ baseless Rule 11 motions, defendants should bear the costs and expenses plaintiffs have incurred in responding.

#### CONCLUSION

When assessing whether to use a CW’s potential testimony, plaintiffs’ attorneys need to weigh the credibility of the witness against the benefit of the testimony. If an attorney and his or her investigator believe that the court will have problems with the CW later in the litigation, it is probably best not to use the CW’s testimony in the complaint. Plaintiffs’ attorneys need to make sure to disclose to the CW that his or her testimony is not confidential. While it is plaintiffs’ attorneys’ job to make inferences from the CW’s testimony, they need to make sure that those inferences are reasonable in light of the evidence gathered to date.

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“[S]ervice of a cross motion under Rule 11 should rarely be needed since under the revision the court may award to the person who prevails on a motion under Rule 11—whether the movant or the target of the motion—reasonable expenses, including attorney’s fees, incurred in presenting or opposing the motion.”

Boim v. Quranic Literacy Inst., No. Civ. 00 C 2905, 2003 WL 1956132, at \*3 (N.D. Ill. Apr. 24, 2003) (alteration in original) (quoting advisory committee notes to the Rule 11 1993 amendments). Moreover, “[c]ompliance with the safe harbor provision is not required when a party merely receives attorneys’ fees and costs for successfully defending against a Motion for Sanctions.” *Id.*

85. 28 U.S.C. § 1927 (2012).

86. Kapco Mfg. Co., Inc. v. C & O Enters., Inc., 886 F.2d 1485, 1491 (7th Cir. 1989) (internal citations omitted).

87. IDS Life Ins. Co. v. Royal Alliance Assoc., Inc., 266 F.3d 645, 654 (7th Cir. 2001) (quoting *In re TCI Ltd.*, 769 F.2d 441, 446 (7th Cir. 1985)).

88. Hill v. Norfolk & W. Ry. Co., 814 F.2d 1192, 1201 (7th Cir. 1987).