

When Employees Speak Up: The Role of Confidential Witnesses in Shareholder Litigation of Financial Disclosure Fraud

by Szu-fan Chen, Shiheng Wang, and Yue Zheng

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COI Disclosure: From time to time I serve as an expert witness in federal securities litigation, supporting defendants. Affiliated with Cornerstone Research.

Plaintiffs typically allege misrepresentations they claim create or maintain artificial stock price inflation (overly optimistic statements and/or failure to disclose adverse news, risks, etc.) and that the stock price subsequently drops at one or more “corrective” dates that reveal the “truth”

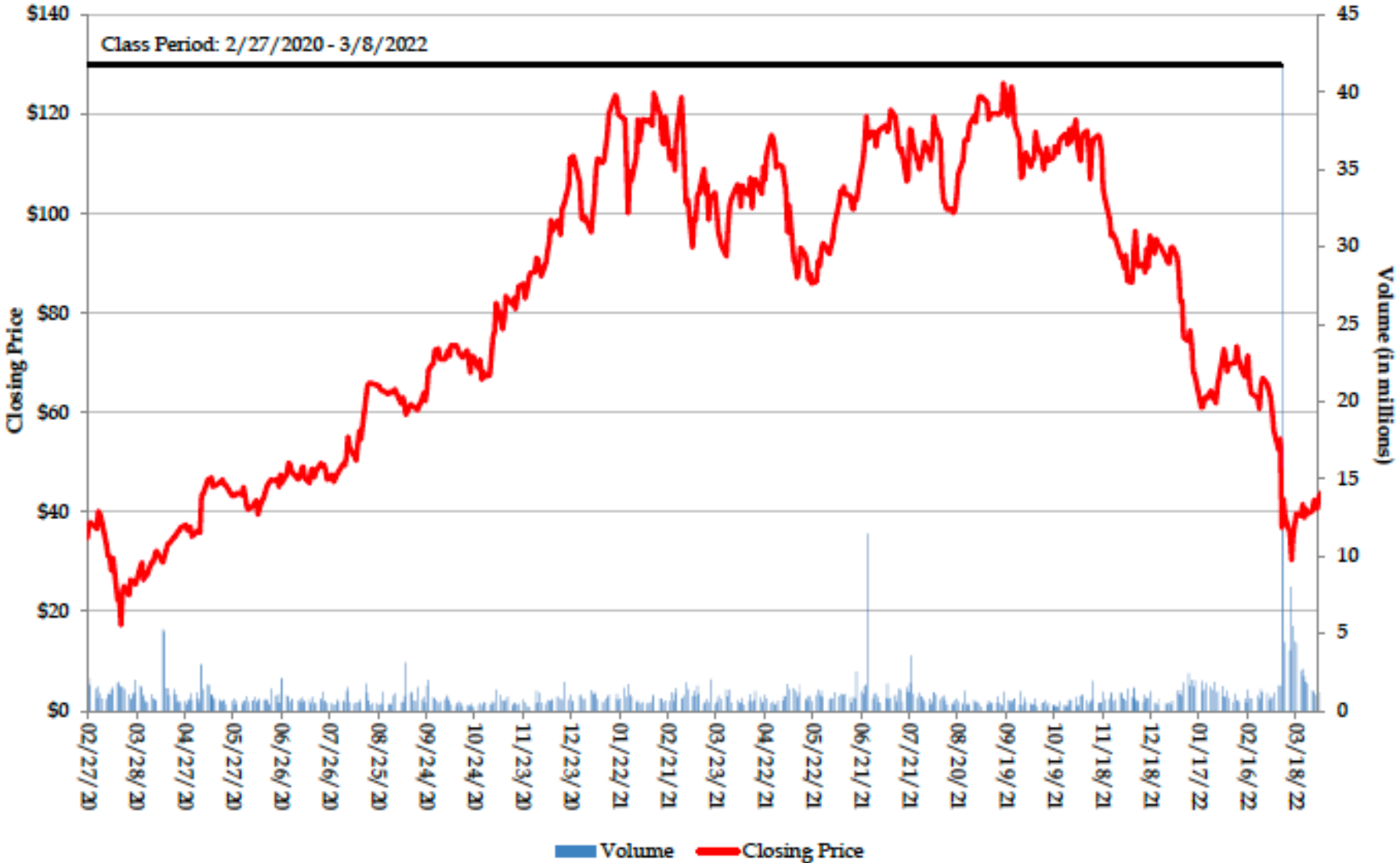


Figure 11: Allegations Box Score—Core Federal Filings

	Percentage of Filings				
	2021	2022	2023	2024	2025
Rule 10b-5 Claims	91%	83%	94%	95%	91%
1933 Act Claims	15%	28%	14%	9%	10%
Misrepresentations in Financial Documents	90%	89%	90%	94%	94%
False Forward-Looking Statements	43%	39%	46%	53%	56%
Trading by Company Insiders	6%	2%	2%	2%	6%
Accounting Violations	22%	24%	23%	24%	16%
Announced Restatements	3%	9%	10%	6%	4%
Internal Control Weaknesses	9%	13%	17%	12%	7%
Announced Internal Control Weaknesses	4%	8%	11%	7%	3%
Underwriter Defendant	10%	13%	4%	2%	6%
Auditor Defendant	0%	1%	2%	0%	2%

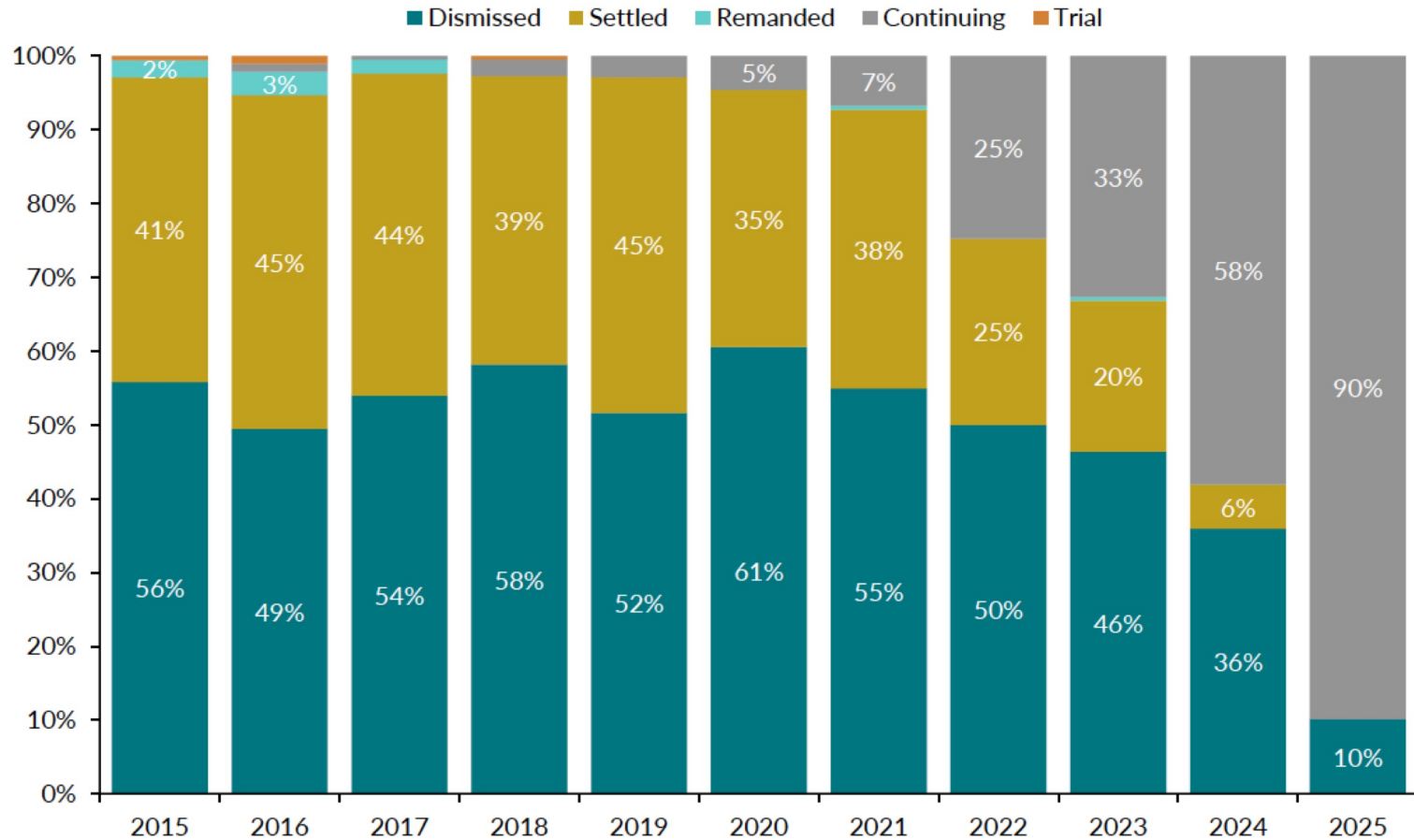
Note:

1. Core federal filings are all federal securities class actions excluding those defined as M&A filings. Allegations reflect those made in the first identified complaint (FIC). The percentages do not add to 100% because complaints may include multiple allegations. See Additional Notes to Figures for more detailed information.
2. In 2024, there was one filing with allegations against an auditor defendant.

How a typical 10b-5 case proceeds:

- Complaints filed, often by multiple plaintiffs/law firms (Bernstein Litowitz, Kessler Topaz, Labaton, Pomerantz, Robbins Geller). Revised, consolidated.
- Defendants file MTD (motion to dismiss).
- Court decides on MTD: Dismiss, allow suit to proceed, dismiss in part – Plaintiffs may amend complaint.
- Legal back-and-forth; may include appeals.
- Some level of discovery (expert reports).
- Class certification motions; court decision on class cert.
- Proceeds to “merits” stage (loss causation and damages).
- Settlement can occur at any point but not usually before court decides on MTD.

Figure 15: Status of Filings by Year—Core Federal Filings
2015–2025



Note: Percentages may not sum to 100% due to rounding. This analysis only considers federal filings. It does not present combined federal and state data, and lawsuits are not identified as parallel. This is different from Figures 1–3, 7–10, 12, and 17, and Appendices 1, 5, 7, and 8, which account for filings in federal courts that also have parallel lawsuits identified in state courts. In those analyses, when parallel lawsuits are filed in different years, only the earlier filing is reflected in the analysis.

Suits are either dismissed or settled with just over half dismissed.

How does court decide MTD?

- Judge is not making a determination on the merits at this stage – giving plaintiffs benefit of any doubt, have plaintiffs shown enough to make a *prima facie* case? Plaintiffs don't have to “prove” their case at this stage.
- Judge may dismiss some alleged misrepresentations and allow others, may shorten class period. Judge may give plaintiffs ability to refile their complaint to address deficiencies.
- Important here – adding confidential witnesses may help support claims, both that misreps were plausibly false (particularity) and scienter (intent).
- Likely depends on facts and circumstances.

How do plaintiffs establish scienter?

- Defendants' economic incentives (e.g., insider sales).
 - Defendants' repeated emphasis of key metrics (e.g., consistent statements about “strong” organic growth)
 - Alleged fraud centers on “core” business of company.
 - Defendants had access to relevant internal information (e.g., member of quality committees and attended meetings).
 - Proximity in time between alleged misreps and corrective disclosures.
 - Abrupt executive departures (e.g., CFO and CAO resign in conjunction with restatement announcement).
- ECWs may not be necessary.

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9 *and Glaziers' Union Local #27 Pension*
10 *and Retirement Fund*

11 [Additional counsel on signature page]

25 pages

Class period: 1.11.22 – 5.30.23

12 **UNITED STATES DISTRICT COURT**
13 **NORTHERN DISTRICT OF CALIFORNIA**

14 **GLAZING EMPLOYERS AND GLAZIERS'**
15 **UNION LOCAL #27 PENSION AND**
16 **RETIREMENT FUND, on behalf of itself and**
17 **all others similarly situated,**

18 **Plaintiff,**

19 **v.**

20 **IRHYTHM TECHNOLOGIES, INC.,**
QUENTIN BLACKFORD, BRICE
BOBZIEN, and DOUGLAS DEVINE,

Defendants.

Case No. 3:24-cv-706

COMPLAINT FOR VIOLATIONS OF
THE FEDERAL SECURITIES LAWS

CLASS ACTION

DEMAND FOR JURY TRIAL

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9 *Firefighters Pension and Retirement System*

83 pages
Class period: 11.5.21 – 8.9.24

10 [Additional counsel appear on signature page.]

11
12 **UNITED STATES DISTRICT COURT**
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14 **NORTHERN DISTRICT OF CALIFORNIA**

15 GLAZING EMPLOYERS AND GLAZIERS'
16 UNION LOCAL #27 PENSION AND
17 RETIREMENT FUND, on behalf of itself and
18 all others similarly situated,

19 Plaintiff,

v.

IRHYTHM TECHNOLOGIES, INC., et al.,

Defendants.

Case No. 3:24-cv-706-JSC

**SECOND AMENDED CLASS ACTION
COMPLAINT FOR VIOLATIONS OF
FEDERAL SECURITIES LAWS**

DEMAND FOR JURY TRIAL

CLASS ACTION

Assigned to: Honorable Jacqueline Scott
Corley

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12 **UNITED STATES DISTRICT COURT**
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14 **NORTHERN DISTRICT OF CALIFORNIA**

15 GLAZING EMPLOYERS AND GLAZIERS'
16 UNION LOCAL #27 PENSION AND
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19 Plaintiff,

v.

IRHYTHM TECHNOLOGIES, INC., et al.,

Defendants.

Cases may span several years (class period and have dozens of alleged misrepresentations, i.e., alleged false statements and omissions) and one or more alleged corrective disclosure events (where the stock drops substantially).

83 pages

Class period: 11.5.21 – 8.9.24

Case No. 3:24-cv-706-JSC

**SECOND AMENDED CLASS ACTION
COMPLAINT FOR VIOLATIONS OF
FEDERAL SECURITIES LAWS**

DEMAND FOR JURY TRIAL

CLASS ACTION

Assigned to: Honorable Jacqueline Scott
Corley

13 75. *Third*, further unknown to physicians and patients, the Zio AT failed to consistently
14 provide “near real-time” notifications because it regularly had a “lag time” of around *four hours*
15 or more. FE 3—a former iRhythm Zio AT technician from before the Class Period through
16 November 2022—explained that because of this lag time, the Zio AT was not live and did not
17 notify physicians of arrhythmias right away. According to FE 3, it took four hours for any
18 arrhythmia events transmitted from the Zio AT to show up in a “queue” for technicians’ review.
19 Then, the technicians had to work their way down this queue to analyze the events one by one,
20 which added on additional “lag time” to the four hours it took just for events to make it into the
21 queue. Worse, on weekends and overnight, the queue built up even more because there were not
22 as many technicians during those shifts. FE 3 further explained that it sometimes took more than
23 four hours to even receive the arrhythmia data in the queue. The queue would suddenly be
24 bombarded with new arrhythmias, and FE 3 could never figure out why this happened.

25 76. These failures of the Zio AT had serious consequences. Troublingly, FE 3 stated
26 that technicians could see patients dying while wearing the Zio AT monitor. FE 3 stated that many
27 patients should not have been wearing the Zio AT device and should have been monitored live
28 instead. FE 3 wanted to look at critical and end-of-life arrhythmias first in the queue, but there was

Here, hearsay evidence from ECWs was added to the complaint as the case proceeded through the process – not clear why: was it just “nice to have” or was it because it was necessary to support plaintiffs’ claims?

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11 **UNITED STATES DISTRICT COURT**
 12 **NORTHERN DISTRICT OF CALIFORNIA**
 13 **SAN FRANCISCO DIVISION**

14 STEAMFITTERS LOCAL 449 PENSION
 15 & RETIREMENT SECURITY FUNDS, on
 16 Behalf of Itself and All Others Similarly
 17 Situated,

18 Plaintiffs,

19 v.

20 **EXTREME NETWORKS, INC.**,
 21 EDWARD B. MEYERCORD III, RÉMI
 THOMAS, CRISTINA TATE, KEVIN
 RHODES, NORMAN RICE, JONAS
 BROWN

Case No. 3:24-cv-05102-TLT

CLASS ACTION

**SECOND AMENDED CONSOLIDATED
 COMPLAINT FOR VIOLATIONS OF THE
 FEDERAL SECURITIES LAWS**

1 E. Procedural History Of This Action

2 22. On December 30, 2024, the Court appointed Oklahoma Police, Oklahoma Fire,
3 Oakland County VEBA and Oakland County ERS as Lead Plaintiffs and Labaton Keller Sucharow
4 as Lead Counsel (ECF No. 51). On February 14, 2025, Lead Plaintiffs filed an Amended
5 Consolidated Complaint for Violations of the Federal Securities Laws (“Amended Complaint”) (ECF
6 No. 59). On April 15, 2025, Defendants filed a Motion to Dismiss the Amended Complaint (ECF No.
7 74), which Lead Plaintiffs opposed (ECF No. 81). On August 15, 2025, after oral argument held on
8 August 12, 2025, the Court granted the motion to dismiss with leave to amend by September 9, 2025
9 (ECF No. 92) (the “Order”).

10 23. In the Order, the Court addressed whether the Amended Complaint adequately alleged
11 the falsity of the challenged false and misleading statements and omissions. While the Court
12 determined that the Amended Complaint’s allegations “regarding manipulative sales practices are
13 close to sufficient” to establish falsity and identified certain allegations it found “to be sufficiently
14 particularized,” the Court noted that “[m]ore particularized allegations regarding specific dates,
15 specific communications, and specific transactions are required,” “the timeline of allegations needs
16 to be stated clearer,” and “[a]dditional corroborating details from FEs of distributors would also
17 strengthen the allegations.” *Id.* at 19. The Court also stated: “If Plaintiffs are able to provide more
18 particularized allegations regarding manipulative sales practices toward Defendants’ largest
19 distributors, then their allegations will be sufficient to allege that these practices affected revenue.”

22 to corroborate the practices that were omitted.” *Id.* at 20. The Court specifically identified the
23 relevance of FE-7’s allegations but noted that while “FE-7’s pre-Class Period allegations are reliable
24 to provide what Defendants knew during the Class Period [they] must be stated with greater
25 particularity.” *Id.*

26 24. Lead Plaintiffs respectfully submit that the wealth of additional information contained
27 in the Second Amended Complaint addresses and far exceeds the types of additional allegations the
28 Court discussed in the Order. Specifically, FE-1, FE-2, FE-4, FE-7 and FE-11 provide compelling

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SECOND AMENDED CONS. COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS
CASE NO. 3:24-CV-05102-TLT

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1 additional testimony and documentary evidence that provides the “particularized allegations
2 regarding specific dates, specific communications, and specific transactions,” including specific
3 channel stuffing transactions rushed in at the end of each fiscal year within the Class Period, one of
4 which was for a whopping \$102 million. These allegations “provide more particularized allegations
5 regarding manipulative sales practices toward Defendants’ largest distributors,” which the Court
6 noted would be “sufficient to allege that these practices affected revenue.”

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4 which was for a whopping \$102 million. These allegations “provide more particularized allegations
5 regarding manipulative sales practices toward Defendants’ largest distributors,” which the Court
6 noted would be “sufficient to allege that these practices affected revenue.”

This tells us that the decision to find and include claims from ECWs may, at least in some cases, be an endogenous choice, driven by plaintiff law firms that seek to bolster the strength of their claims.

It seems plausible that the nature of the case (allegations, facts and circumstances) affects plaintiffs' strategy and arguments, including their use of ECWs, and the ultimate outcome.

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For example, consider a relatively simple case involving an accounting restatement (e.g., overstatement of revenue and organic growth) where falsity and scienter are easy to plead versus a case alleging a defective medical product that ultimately led to an FDA recall (in which plaintiffs allege that managers knew about the defects several years prior based on patient complaints and internal company testing and failed to disclose).

How to measure outcomes

Authors use whether case dismissed and duration of litigation.

- Whether dismissed makes sense.
- Length of litigation may, on average, be related to merits/strength of plaintiffs' case (cases that survive MTD will necessarily be longer).
- Holding MTD decision constant, outcome that matters is *settlement amount*, standardized by damages exposure (depends on length of class period, trading volume, magnitude of back-end stock drop(s), etc.)

Overall:

- Agree with authors that not much is known about the role of ECWs.
- Authors provide some interesting evidence that sheds light on this.
- Be interesting to dig into this more, e.g., through interactions with plaintiff law firms that do this.
- There seems to be an association between the use of ECWs and outcomes but direction of causality clouded by fact that choice to use ECWs may, at least in some cases, be endogenous.

Thank you!!