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Whistleblower Qui Tam Laws: Key To Protecting Taxpayers

A Report to the House Judiciary Committee of the Maryland House of Delegates

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Summary of Findings

- Employees or "tipsters" are the single most important source of fraud detection.

- The overwhelming majority of employees are afraid to report fraud to the appropriate authorities.

- Robust whistleblower protection programs remain the safest and most effective method of ensuring that fraud is reported and properly addressed.

- The existence of employee rewards programs have successfully increased the government's ability to detect and punish fraud. Whistleblower reward programs that potentially pay large rewards have had a remarkably successful deterrent effect on wrongdoers and have stimulated voluntary compliance with key anti-fraud laws.

- Maryland stands to recover for the taxpayer billions of dollars in lost revenue from the enactment of a *qui tam* whistleblower law with protections equivalent to the federal False Claims Act

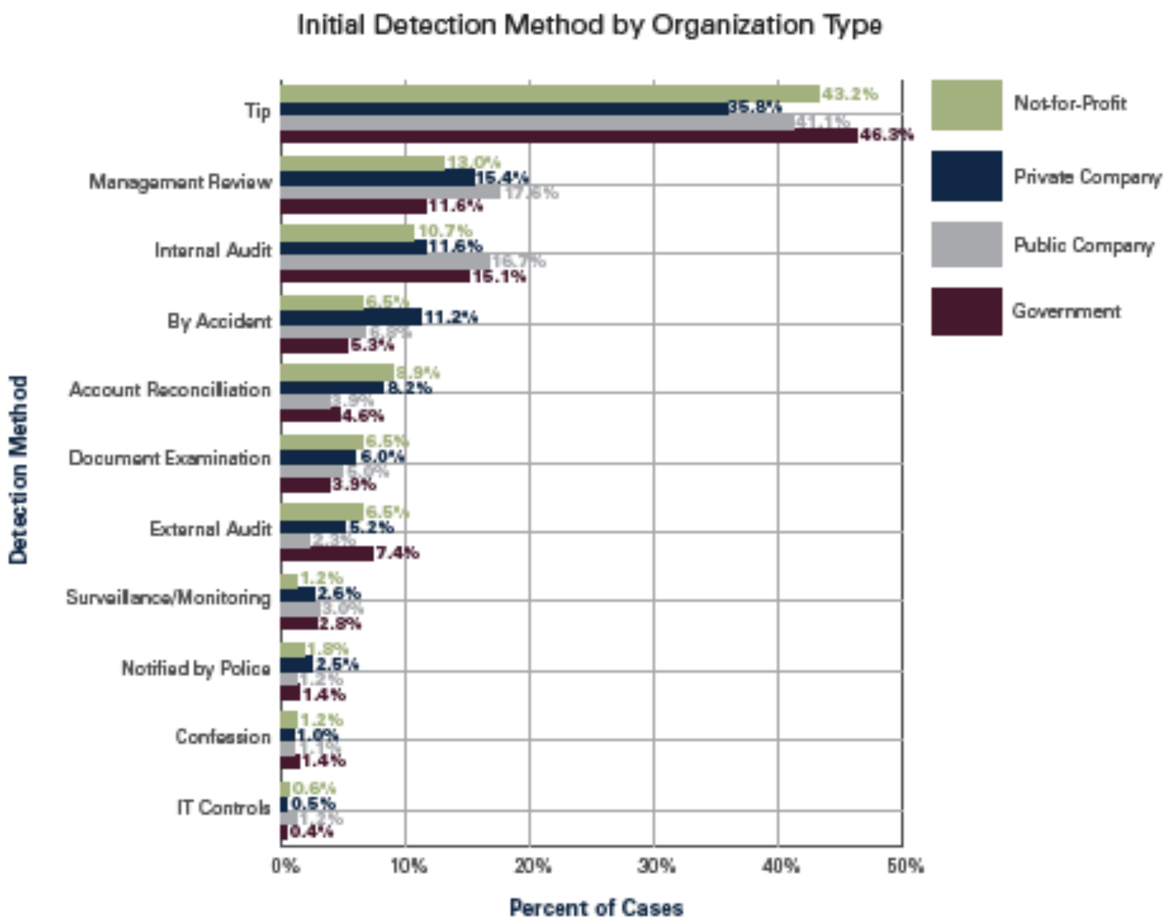
Part I:

Employee Disclosures are Essential for the Detection of Fraud

"While tips have consistently been the most common way to detect fraud, the impact of tips is, if anything, understated by the fact that so many organizations fail to implement fraud reporting systems."

- *Association of Certified Fraud Examiners, Global Fraud Study 2010*

Association of Certified Fraud Examiners Findings: WHO DETECTS FRAUD?



Part II: Employees are Reluctant to Report Fraud

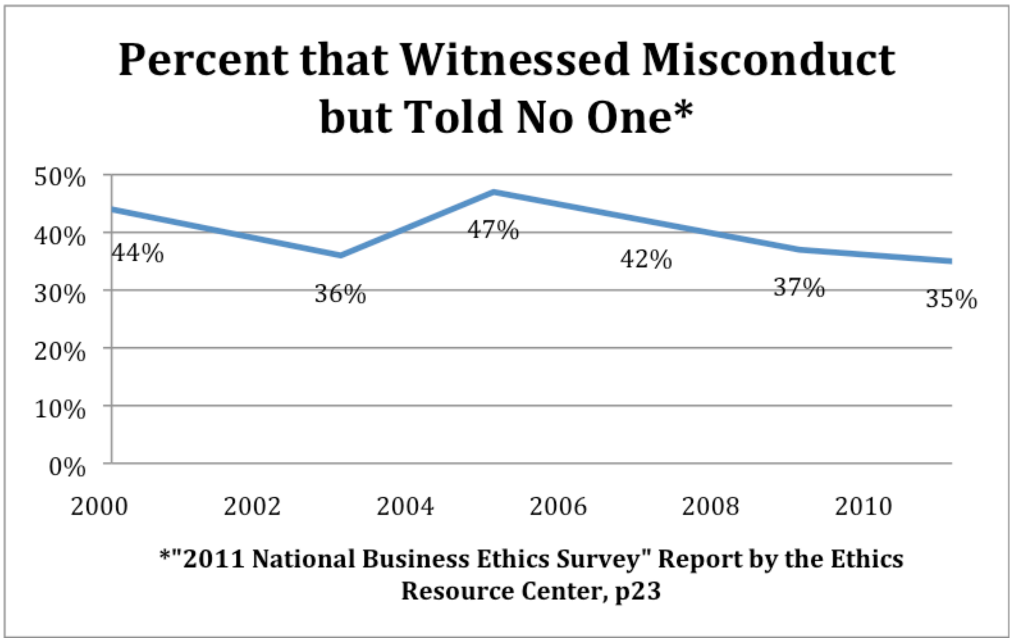
"One of the critical challenges facing both [Enforcement and Compliance] officers and government enforcement officials is convincing employees to step forward when misconduct occurs."

Ethics Resource Center Report "Blowing the Whistle on Workplace Misconduct," December 2010

Employee Reporting Behaviors

The Ethics Resource Center ("ERC") studied employee reporting behavior trends between 2000 and 2011. *See* ERC, "Blowing the Whistle on Workplace Misconduct," (2012).[1]

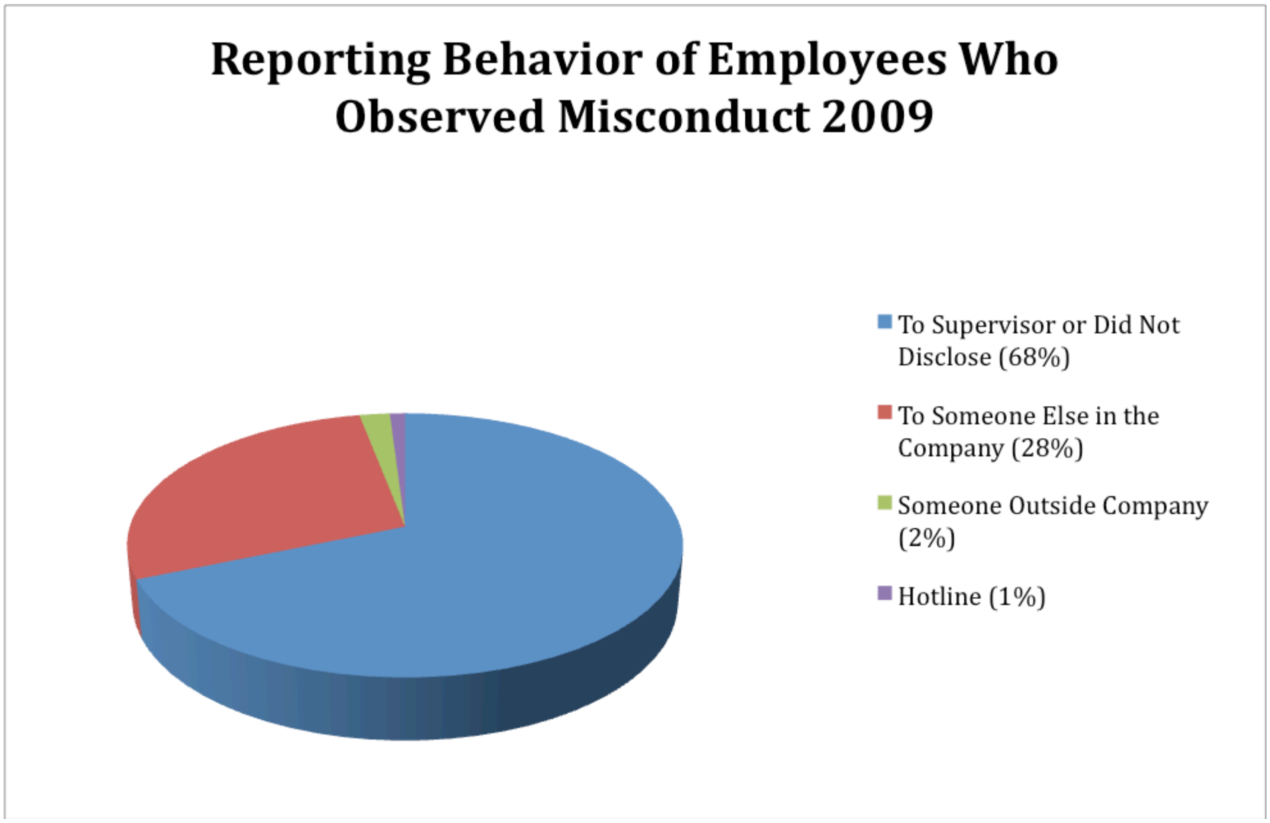
As set forth in the following chart, over a ten-year average, 40.2% of employees who witness fraud or misconduct *do not report this misconduct to anyone*. T The numbers reported have remained relatively constant, even after the enactment in 2002 of section 301 of Sarbanes-Oxley Act, the law that mandated every publicly traded corporation to establish an employee concerns program that accepted confidential submissions from employees.



[1] The ERC was founded in 1922 and describes itself as "America's oldest nonprofit organization devoted to the advancement of highly ethical standards and practices in public and private institutions". According to its website, ERC is predominantly sponsored by the regulated community including corporations such as BP, Raytheon, Dow, Lockheed, Martin, and Lilly. Many of these companies have been successfully prosecuted under the FCA.

Disclosing Misconduct

The ERC also studied the reporting behavior of the approximately 60% of workers who were willing to report misconduct. Based on these surveys the following picture emerges regarding the actual willingness of employees to report misconduct to *anyone*.



*Based Directly on the 2010 ERC Whistleblowing Report, *See* Exhibit 15

Based on these numbers the Ethics Resource Center concluded that the "critical challenge" facing both "corporate compliance programs" *and* "government enforcement officials" is to "convinc(e) employees to step forward when misconduct occurs."

In other words, the overwhelming majority of employees who detected fraud and misconduct failed to report their observations to hotlines and other internal compliance programs. They also failed to report their concerns to appropriate law enforcement officials.

Failure of Employees to Disclose Misconduct Directly to the Government is a Significant Regulatory Concern

Only 2% of all employees who are willing to report misconduct eventually disclose that misconduct “outside” their company. It is unclear from the ERC statistics as to how many of the 2% reported their concerns to the appropriate regulatory agencies, or simply when to non-governmental organizations or employment discrimination agencies.

Part III:
The False Claims Act is a Successful Model for Improving the Disclosure of Fraud

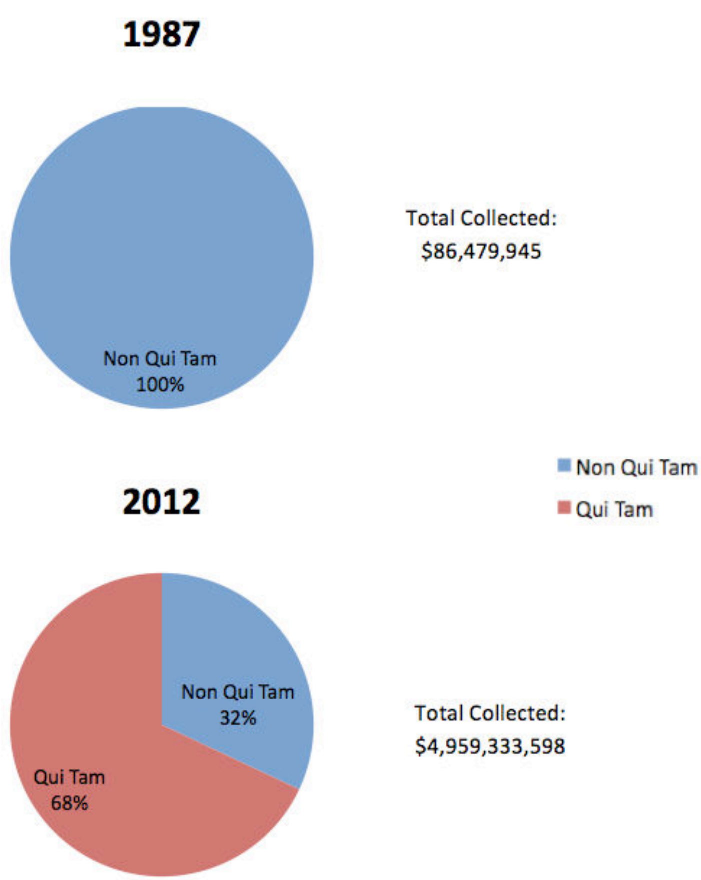
The False Claims Act was originally enacted in 1863. In 1943, it was amended and the ability for employee whistleblowers to utilize the law was effectively eliminated. In 1986, the FCA was amended again, resurrecting the *qui tam* provisions in the original 1863 act. The Act was further strengthened in 2009 and 2010.

The False Claims Act: It Works

Objective statistics published every year by the US Department of Justice Civil Fraud Division[2] unquestionably demonstrate that whistleblowers have actually recovered billions of dollars for taxpayers and that whistleblowers are the single most important source of information permitting the United States to recover funds from corrupt contractors.

As can be seen from the above charts, since the enactment of the FCA, the amount of overall civil recoveries obtained by the United States has dramatically increased from 89 million in 1986 (prior to whistleblower rewards program) to the $4.95 billion dollars in 2012.

FCA Recoveries: 1987 and 2012



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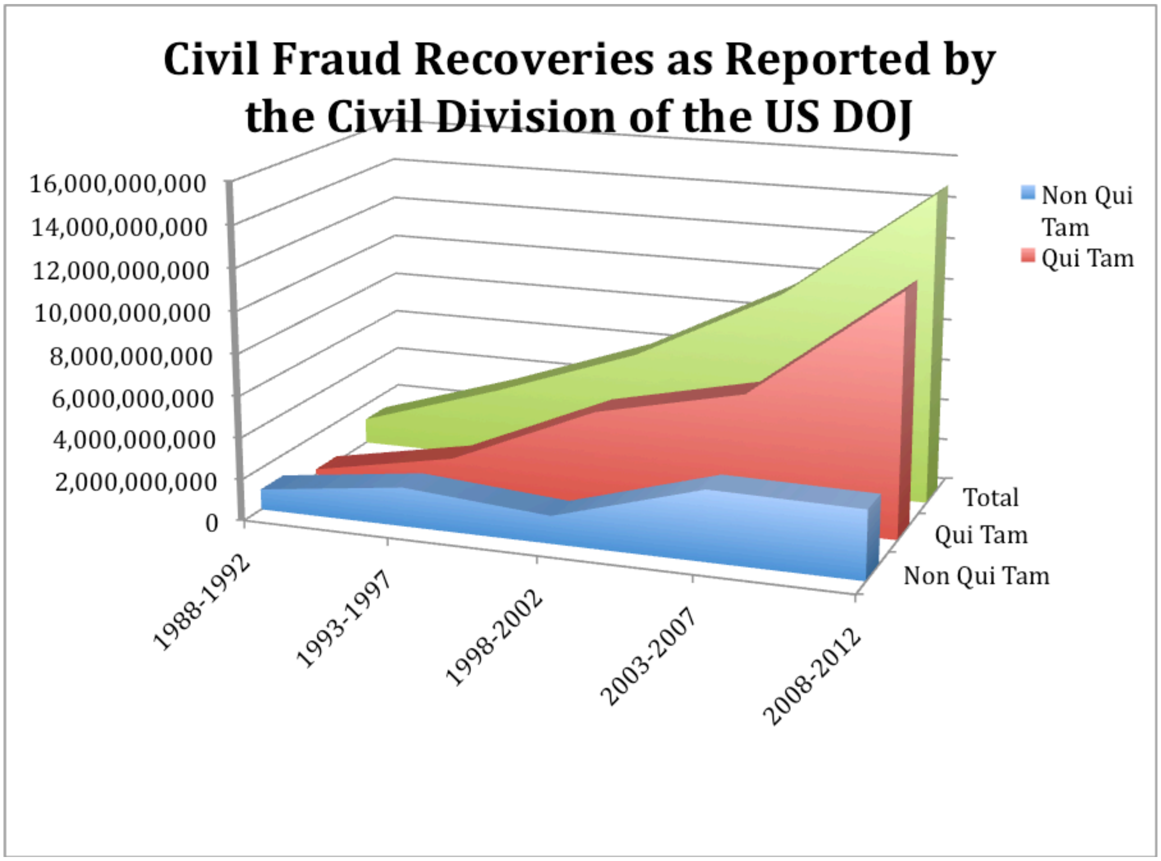
[2] Justice Department Statistics, *See* Exhibit 19



The Act's statistics actually undervalue the contribution of whistleblowers. The threat that an employee will report fraud under the FCA to the government creates a powerful incentive for companies to ensure compliance with the law. The deterrent value of the FCA is not subject to objective quantification.

Part IV: Monetary Incentives: Key to Successful Whistleblower Program

The University of Chicago Booth School of Economics conducted the most comprehensive and objective study into whether whistleblower reward programs work.[3] Their study was based on an "in depth" study of "all reported fraud cases in large U.S. companies between 1996 and 2004."

There conclusions clear:

"**Employees clearly have the best access to information**."

"[W]e find that in 82 percent of cases, the whistleblower was fired, quit under duress, or had significantly altered responsibilities."

"Not only is the honest behavior not rewarded by the market, but it is penalized."

"A strong monetary incentive to blow the whistle does motivate people with information to come forward."

"[M]onetary rewards [have] a significant impact on the probability a stakeholder becomes a whistleblower."

"Monetary incentives seem to work well, without the negative side effects often attributed to them."

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[3] *Who Blows the Whistle on Corporate Fraud,* by professors Alexander Dyck (University of Toronto), Adair Morse (University of Chicago) and Luigi Zingales (University of Chicago).

Part V:

Ethics Resource Center: "Retaliation Against Whistleblowers at All-Time High"

The ERC's conclusion was direct and blunt: ***"Retaliation against whistleblowers at all-time high."***

Part VI:

State Whistleblower *Qui Tam* Laws have been Successfully Used to Protect Taxpayers

The following are a sample of recoveries States have obtained from whistleblower suits filed under State *qui tam* laws:

* $323.67 million: State of California against Senior Care Action Network for Failure to Provide Financial information needed for Capitation Rates.

* $158 million: State of Texas against Johnson & Johnson for downplaying harmful side effects of an illegally promoted drug.

* $241 million: State of California against Quest Diagnostics for illegal kickbacks in Medicaid program.

* $187 million: State of California against BankAmerica for improperly retaining unclaimed municipal bonds.

* $43.1 million: State of California against Strategic Resource Solutions for fraud in the installation of heating and cooling equipment in San Francisco schools.

* $3.4 million: State of California against Mandated Cost Systems for submitting false and inflated bills.

* $30 million: State of California against Toshiba for selling defective computers to the State and its political divisions.

Conclusion: State Governments are Incentivized to Enact Whistleblower Qui Tam Laws Because they are Essential for Fraud Detection

The United States Senate Committee on the Judiciary carefully studied the most important whistleblower protection law in the United States, the False Claims Act.[4] The Judiciary Committee report unanimously concluded as follows:

⇒ "[I]nsiders who are willing to blow the whistle are the only effective way to learn that wrongdoing has occurred."

⇒ "Information from insiders is the only way to effectively and efficiently piece together what happened and who is responsible."

⇒ "Insiders can provide invaluable assistance during an investigation by identifying key records and witnesses, interpreting technical or industry information, providing expertise, and explaining the customs and habits of the business or industry."

⇒ [T]he presence of effective qui tam provisions [i.e. the whistleblower reward provisions] in the FCA has a deterrent effect on those who seek to defraud the Government.

Michael Hertz, the U.S. Deputy Assistant Attorney General, summarized the importance of whistleblower protections in his testimony before the

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[4] Senate Report 110-507 (2d Session), "The False Claims Act Correction Act of 2008, Committee on the Judiciary, September 25, 2008 (legislative day, September 17, 2008).

Senate Committee: "**Whistleblowers are essential to our operation. Without them, we wouldn't have cases**."

Based on the success of the federal False Claims Act the U.S. Congress created monetary incentives for states to enact equivalent legislation designed to promote the detection of fraud in state and local government spending. *See* Deficit Reduction Act of 2005, 42 U.S.C. § 1396h. A copy of this provision is reprinted below:

42 U.S. Code § 1396h - State false claims act requirements for increased State share of recoveries

(a) In general -- Notwithstanding section 1396d (b) of this title, if a State has in effect a law relating to false or fraudulent claims that meets the requirements of subsection (b), the Federal medical assistance percentage with respect to any amounts recovered under a State action brought under such law, shall be decreased by 10 percentage points.
(b) Requirements --For purposes of subsection (a), the requirements of this subsection are that the Inspector General of the Department of Health and Human Services, in consultation with the Attorney General, determines that the State has in effect a law that meets the following requirements:
(1) The law establishes liability to the State for false or fraudulent claims described in section 3729 of title 31 with respect to any expenditure described in section 1396b (a) of this title.
(2) The law contains provisions that are at least as effective in rewarding and facilitating qui tam actions for false or fraudulent claims as those described in sections 3730 through 3732 of title 31.
(3) The law contains a requirement for filing an action under seal for 60 days with review by the State Attorney General.
(4) The law contains a civil penalty that is not less than the amount of the civil penalty authorized under section 3729 of title 31.
(c) Deemed compliance -- A State that, as of January 1, 2007, has a law in effect that meets the requirements of subsection (b) shall be deemed to be in compliance with such requirements for so long as the law continues to meet such requirements.
(d) No preclusion of broader laws --- Nothing in this section shall be construed as prohibiting a State that has in effect a law that establishes liability to the State for false or fraudulent claims described in section 3729 of title 31, with respect to programs in addition to the State program under this subchapter, or with respect to expenditures in addition to expenditures described in section 1396b (a) of this title, from being considered to be in compliance with the requirements of subsection (a) so long as the law meets such requirements.

About the National Whistleblower Center

The National Whistleblower Center (NWC) is a non-partisan, non-profit organization based in Washington, DC. Its website is located at *www.whistleblowers.org*. For twenty-five years the NWC has advocated for the protection of employees to lawfully disclose fraud and violations of law to the appropriate authorities.

Stephen M. Kohn serves *pro bono* as the Executive Director of the NWC. He is a partner in the Washington, D.C. law firm of Kohn, Kohn and Colapinto, LLP (*www.kkc.com*). Mr. Kohn has represented whistleblowers for nearly 30 years. Most recently he successfully represented the first major tax whistleblower, Mr. Bradley Birkenfeld, whose documentation of illegal Swiss banking practices has resulted in the recovery of billions of dollars for the U.S. taxpayers. Mr. Kohn is the author if the first legal treatise on whistleblower law. His seventh book on whistleblowing is, *The Whistleblower's Handbook: A Step-by-Step Guide to Doing What's Right and Protecting Yourself* (Lyons Press, 3rd ed. 2013).

For further information please email: *whistle@whistleblowers.org*.