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COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON GOVERNMENT OPERATIONS AND THE
SUBCOMMITTEE ON HEALTH CARE, BENEFITS AND ADMINISTRATIVE RULES**

“Restoring the Power of the Purse: Legislative Options”

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December 1, 2016

Chairman Meadows, Chairman Jordan, Ranking Member Connelly and Members of the Subcommittees:

Thank you for this opportunity to testify regarding H.R. 5499 and issues concerning federal spending outside the appropriation process.

The Committee on Oversight and Government Reform has a long bi-partisan record of supporting whistleblowers.¹ I am confident that as H.R. 5499 works its way through the legislative process, your subcommittees will ensure that whistleblowers are not inadvertently harmed by this legislation.

¹ For example, Chairman Jordan eloquently explained the “importance of whistleblowers to good government” in his Opening Statement during a joint oversight hearing: “These *brave individuals shed light on waste, fraud and abuse, often at great personal or professional risk* and make what we do in Congress a whole lot easier. We should always be grateful for the sacrifice these individuals make and proud of their contributions to the Nation. *Perhaps the most important tools that whistleblowers have are the qui tam provisions of the False Claims Act.* Senator Grassley, who we will hear from shortly, was instrumental in amending the False Claims Act in 1986 to ensure whistleblowers are protected. This year, of the \$4.9 billion of False Claims Act recoveries, \$3.3 billion came from whistleblower suits, a record amount.” Joint Hearing before the Subcommittee on Economic Growth, Job Creation and Regulatory Affairs of the Committee on Oversight and Government Reform, and the Subcommittee on the Constitution and Civil Justice of the Committee on the Judiciary, House of Representatives (May 7, 2013) (Serial No. 113–23) (Committee on Oversight and Government Reform) (Serial No. 113–6) (Committee on Judiciary) (emphasis added).

In its current form, H.R. 5499 could have a devastating impact on critical whistleblower laws, including the False Claims Act and other *qui tam* whistleblower laws.² The proposed changes to the appropriations process contained in H.R. 5499 do not take into consideration reward provisions contained in the False Claims Act and similar laws. H.R. 5499 would interfere with the well-established process for compensating whistleblowers who risk their careers, jobs and reputations to serve the public interest.

Before addressing the specifics of H.R. 5499, it is imperative to understand why the False Claims Act and its progeny have been so effective in protecting the taxpayers from fraud.

WHO REPORTS FRAUD?

The foundation of any effective anti-fraud/anti-corruption program is predicated on detection. Without the ability to detect and document frauds, crime pays. In the wake of the ENRON and WORLDCOM fiascos, respected trade associations and corporate-sponsored groups studied the science of fraud detection. Here is what they found:

First, as set forth in Chart 1,³ the heart of any successful fraud detection program is encouraging employee “tips.” Tips or whistleblower information is unquestionably the single most important source of information on frauds.

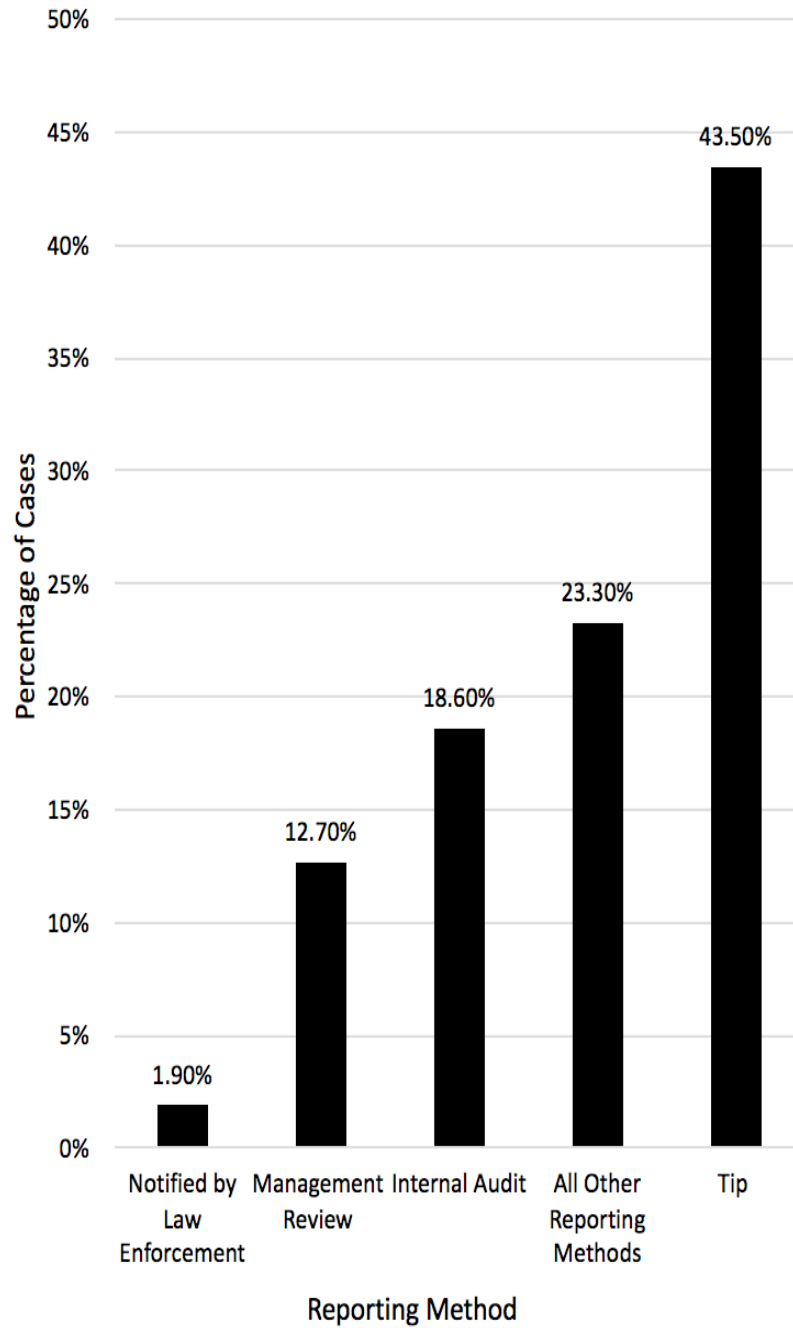
Without a program to encourage tips, fraud detection will be crippled.

² As noted in footnote 2, the *qui tam* provisions of the False Claims Act have played an invaluable role in incentivizing whistleblowers to report frauds. They permit whistleblowers to obtain a portion of the sanctions obtained directly from the criminal or fraudster. Whistleblowers are compensated for the risk they take and only obtain compensation when their “original information” is truthful, accurate and results in an actual conviction, settlement or plea agreement. Instead of using taxpayer monies to compensate the whistleblower, the whistleblower’s original information results in additional revenue to the United States, paid entirely by fraudsters. In addition to the False Claims Act, Congress has enacted other *qui tam* styled whistleblower laws, including provisions that incentivize reporting tax, securities and commodities frauds, illegal international wildlife trafficking, pollution on the high seas and, most recently, the Motor Vehicle Safety Whistleblower Act passed under the leadership of Senator John Thune in 2015.

³ Chart 1 is from the 2016 Annual Report of the Association of Certified Fraud Examiners (ACFE), a trade association with nearly 80,000 members. Their annual report, “Report to the Nations” is compiled from a valid statistical survey of its members, and is conducted annually. The numbers reported in 2016 are consistent with its reports since 2010, and before.

Chart 1:

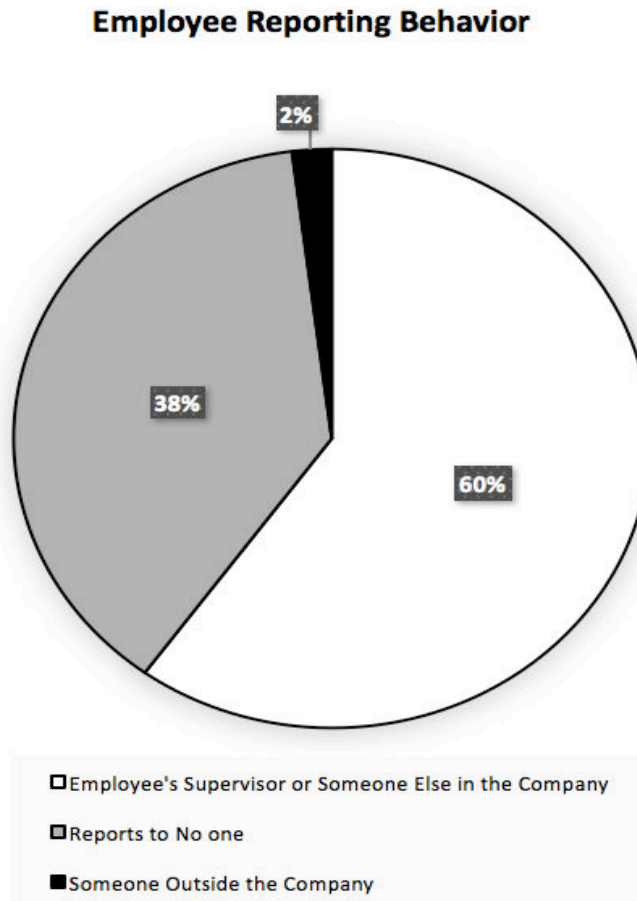
Fraud Detection Methods in Companies with 100 or More Employees



Source: Association of Certified Fraud Examiners, "Report to the Nations on Occupational Fraud and Abuse," (2016).

Chart 2 is based on the findings of the Ethics Resource Center and represents the reporting behavior of employees who witness misconduct at work.⁴ It demonstrates that strong plurality of employees never discloses the misconduct they witness. Only 2% report “outside” their organizations, which would include reports to non-law enforcement agencies. The number of employees who actually report misconduct to appropriate law enforcement agencies is miniscule.

Chart 2:



Source: Ethics Resource Center, "Blowing the Whistle on Workplace Misconduct," 2010.

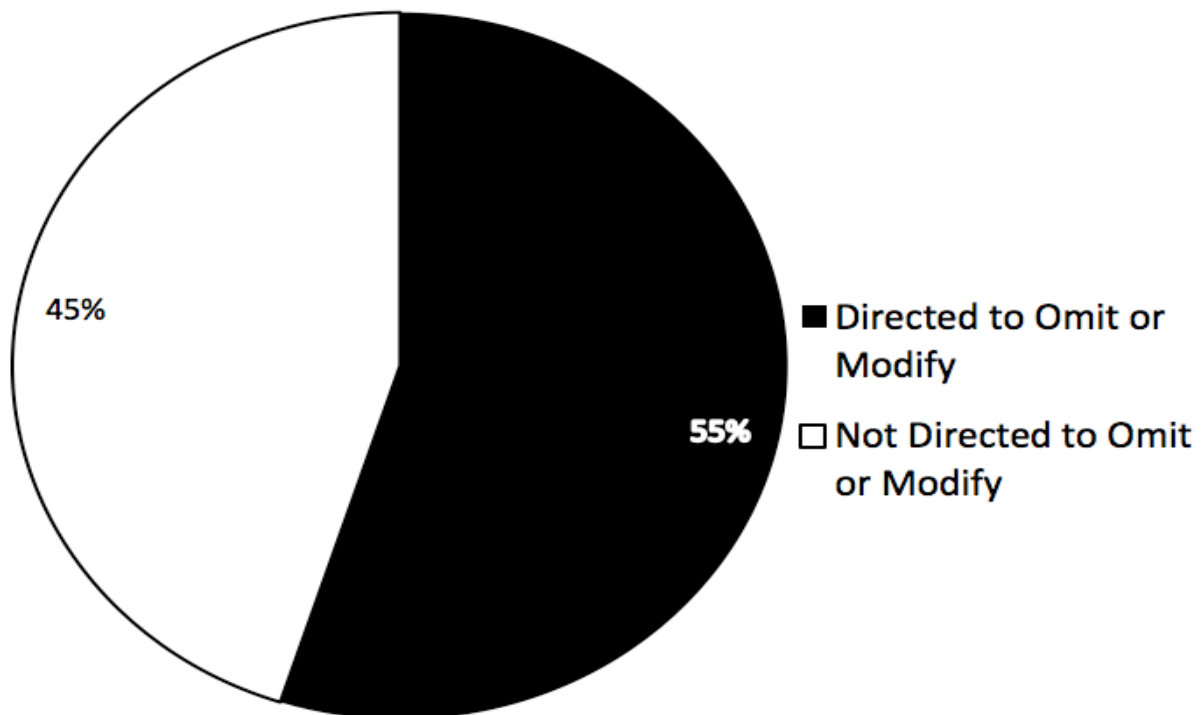
⁴ The Ethics Resource Center is the oldest corporate ethics organization in the United States. Chart 2 is based on the statistics from their report, *Inside the Mind of a Whistleblower: A Supplemental Report*, Ethics Resource Center, (2012) available at http://www.whistleblowers.org/storage/docs/Inside_the_mind_of_a_whistleblower.pdf. That report, was sponsored by Google, Boeing, the Deloitte Foundation, Walmart, Northrop Grumman, Altria, The Defense Industry Initiative, and Lockheed Martin.

Although employee tips are the most important source of fraud detection, the overwhelming majority of potential whistleblowers do not report their allegations to law enforcement.

Charts 3 and 4 further highlight the need to create programs that encourage reporting frauds and misconduct. Chart 3 demonstrates the day-to-day pressures placed on auditors to ignore material findings or alter their reports in a material manner. Over half of North American chief auditors working for companies with over 100 employees reported these improper pressures or demands.⁵

Chart 3:

North American Chief Auditing Executives Instructed to Omit or Modify an Audit Finding

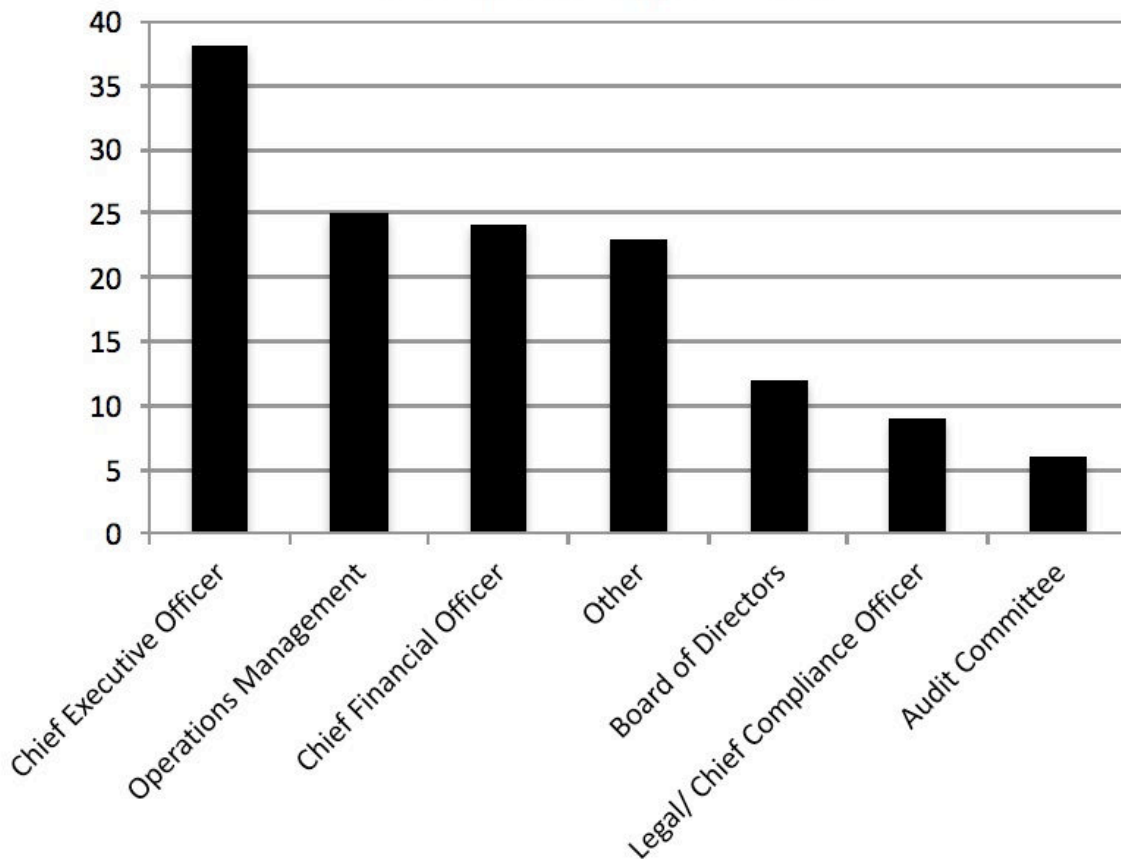


Source: IIA Research Institute, "Political Pressure Intense on Internal Audit," (Mar. 10, 2015).

Chart 4 represents where the requests to alter or falsify material audit findings originated.

Chart 4:

Sources of Direct Requests to the Chief Audit Executive to Surpass or Significantly Modify a Valid Internal Audit Finding on a Regular Basis*



Source: IIA Research Foundation, Global Internal Audit Practitioner

* Total percentage is greater than 100 because more than one person can make a request.

A breakthrough study, originally published by the University of Chicago's Booth School of Business, was authored by three leading economists.⁶ They studied, "in depth all reported

⁶ See Alexander Dyck, Adair Morse & Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?* University of Chicago Booth School of Business (2006), available at <http://faculty.chicagobooth.edu/luigi.zingales/papers/research/whistle.pdf>.

fraud cases in large U.S. companies between 1996 and 2004” in order to determine the most effective mechanisms for detecting corporate fraud. They determined that whistleblowers were the key to fraud detection. Like the ACFE study, the Booth School study also found that “*employees clearly have the best access to information*. Few, if any, fraud can be committed without the knowledge and often the support of several of them. Some might be accomplices, enjoying some of the benefits of the fraud, but most are not.”

They also found that retaliation was prevalent in the workplace: “Not only is the honest behavior not rewarded by the market, but it is penalized.” Thus, “**given these costs, however, the surprising part is not that most employees do not talk; it is that some talk at all.**”

The Booth School economists then reviewed the positive impact the False Claims Act *qui tam* whistleblower reward provisions had on employee behavior, and recommend that these types of laws be expanded: “The idea of extending the *qui tam* statute to corporate frauds (i.e. providing a financial award to those who bring forward information about a corporate fraud) is very much in the Hayekian spirit of sharpening the incentives of those who are endowed with information.”

The False Claims Act *qui tam* provisions (the only major whistleblower reward law in place during the study) was the key to developing these indispensable sources.

Their findings speak for themselves:

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

“Having . . . monetary rewards has a significant impact on the probability a stakeholder becomes a whistleblower.”

“[T]here is no evidence that having stronger monetary incentives to blow the whistle leads to more frivolous suits.”

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

DOES WHISTLEBLOWING WORK?

Chart 5 quantifies the recoveries obtained by the U.S. taxpayers over the 30-year history of the modernized False Claims Act.⁷ It quantifies how important the reward laws are to addressing the problems identified in Charts 1-4⁹.

⁷ Charts 5 and 6 are based on the fraud recovery statistics annually reported by the U.S. Department of Justice. See *Fraud Statistics - Overview*, U.S. Department of Justice (2015) available at <https://www.justice.gov/opa/file/796866/download>.

Chart 5:

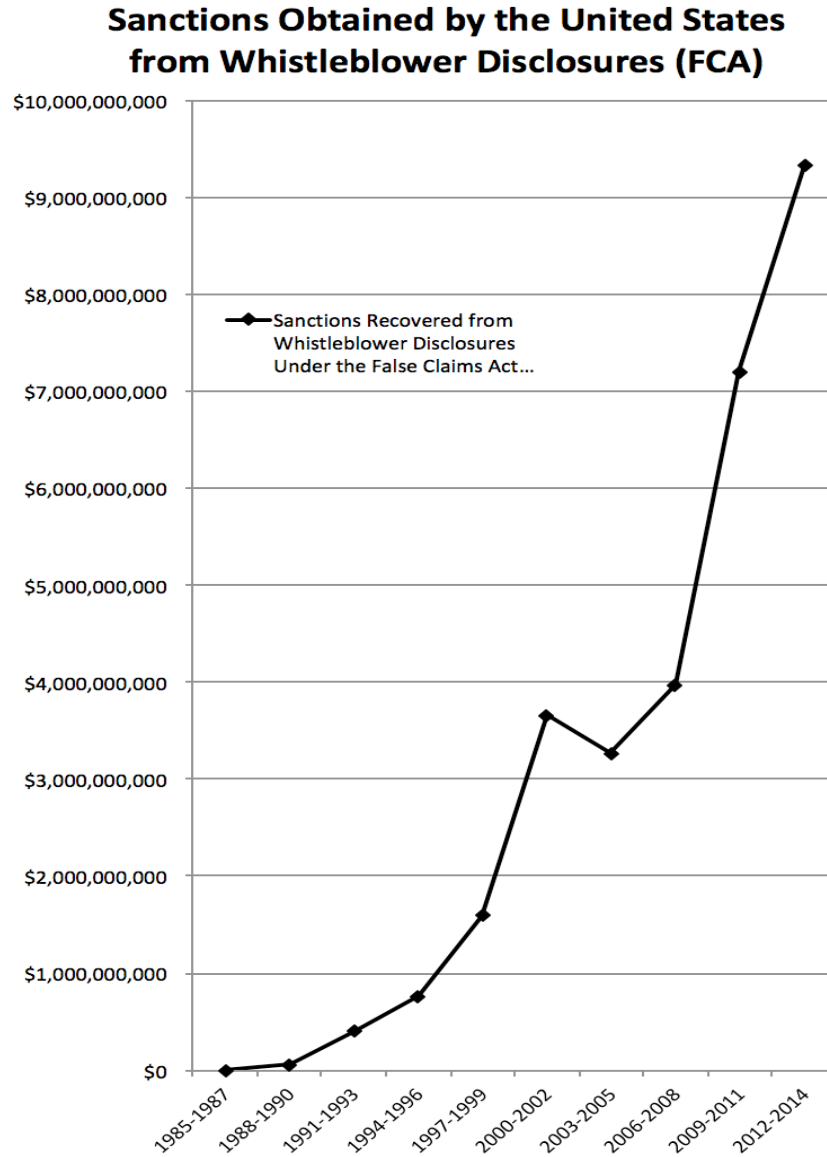
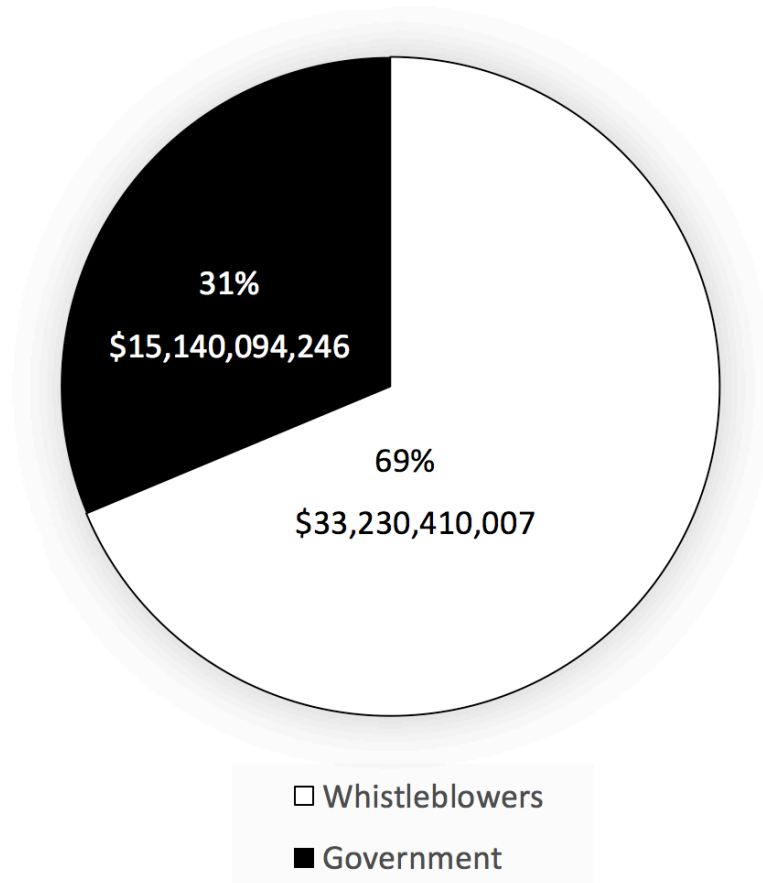


Chart 6 demonstrates that incentivizing whistleblowers is extremely successful in generating high quality tips that result in successful prosecutions. Because the government must pay a reward when the whistleblower's information leads to a successful enforcement action, civil fraud cases prosecuted by the Justice Department are categorized. Chart 6 reflects that fact that over the 30-year history of the False Claims Act whistleblowers disclosures account for over 70% of the fraud recoveries from corrupt government contractors. These numbers will further increase over time.

Chart 6:

Total U.S. Civil Recovery: From Whistleblowers and Government Investigation

October 1, 1987 - Sept. 30, 2015



Civil Division, U.S. Department of Justice, "Fraud Statistics - Overview," (Oct. 1, 1987 - Sept. 30, 2015).

Charts 5 and 6 objectively demonstrate that whistleblower reward laws work. Every government official with responsibility for overseeing the False Claims Act, or similar reward laws, have praised these programs as having “profound” impact,⁸ and recognize that the laws are “the most powerful tool the American people have to protect the government from fraud.”⁹ Whistleblower reward programs are the most effective mechanism for encouraging citizens to report criminal activities.¹⁰

CURRENT WHISTLEBLOWER REWARDS ARE MODELED ON LAWS ENACTED BY THE FOUNDING FATHERS

At the heart of all of the whistleblower reward programs is a simple mechanism in which the whistleblower obtains a portion of the “collected proceeds.” This payment is not part of any formal appropriations process. Instead, the relevant executive agencies authorize the payment of the reward if the whistleblower’s information conforms to the requirements that Congress established when it enacted the relevant whistleblower law. The proceeds can come from the Treasury Department or a specialized fund established to pay rewards, but there is no requirement under any whistleblower law for Congress to pass a special appropriation. Such a requirement is not necessary, is not constitutionally required, and is inconsistent with both the U.S. Constitution and the specific practices endorsed by the Founding Fathers of the United States.

In a landmark decision authored by U.S. Supreme Court Justice Antonin Scalia (and endorsed by all nine members of the Court), the whistleblower reward provisions of the False Claims Act were upheld after a vigorous assault on a whistleblower’s “standing” to pursue a claim under the law’s *qui tam* provisions. Justice Scalia carefully reviewed the history behind whistleblower reward laws and explained that there was a “long tradition of *qui tam* actions in

⁸ The “impact” of the reward laws “has been nothing short of profound. . . . Some of these [False Claims Act cases] may have saved lives. All of them saved money,” Attorney General Eric Holder, U.S. Department of Justice, “Attorney General Eric Holder Speaks at the 25th Anniversary of the False Claims Act Amendments of 1986” (Jan. 31, 2012).

⁹ Assistant Attorney General, U.S. Department of Justice, “Remarks at American Bar Association’s 10th National Institute on the Civil False Claims Act and Qui Tam Enforcement,” (June 5, 2014) (Whistleblower reward laws are “the most powerful tool the American people have to protect the government from fraud”).

¹⁰ See, *Remarks at the Securities Enforcement Forum*, Securities and Exchange Commission Chairman (Oct. 9, 2014) (The “whistleblower program . . . has rapidly become a tremendously effective force-multiplier, generating high quality tips, and in some cases virtual blueprints laying out an entire enterprise, directing us to the heart of the alleged fraud”); “Information of this nature is otherwise difficult, if not virtually impossible to obtain [without help from the whistleblower]” (U.S. Department of Justice, *USA v. Consultores De Navegacion S.A*, 1:08-cr-10274, (Sept., 22, 2009) (US District Court, Massachusetts) (filing in support of whistleblower reward application).

England and the American Colonies.”¹¹ He pointed to numerous laws passed by the First Congress of the United States in 1789-90, in which many of the drafters of the U.S. Constitution participated as members of Congress approving informant reward laws, paid directly by federal officials, with no appropriation from Congress. Justice Scalia held:

Qui tam actions appear to have been as prevalent in America as in England, at least in the period immediately before and after the framing of the Constitution . . . Moreover, immediately after the framing [of the Constitution], the First Congress enacted a considerable number of informer statutes. Like their English counterparts, some of them provided both a bounty and an express cause of action; others provided a bounty only.

In upholding the constitutionality of the False Claims Act Justice Scalia explained that the payment to these whistleblowers (or informants) was not effectuated by an appropriation, but instead constituted an “assignment” of interests, a well-known procedure in the common law in which the rights of one party are transferred, in whole or in part, to another party in exchange for valuable consideration. Justice Scalia held that “the False Claims Act can reasonably be regarded as effecting a partial assignment of the Government’s damage claim.”

As far back as the First Congress, in which numerous drafters of the U.S. Constitution were prominent members, including Elbridge Gerry, Rufus King, Robert Morris and James Madison, it was clear that paying an informant’s reward was not dependent upon an appropriations process. Indeed, the First Congress passed 18 such laws, none of which were dependent upon the Congressional appropriations process. *See* Addendum. As the U.S. Supreme Court has noted, the actions of the First Congress can provide “contemporaneous and weighty evidence” of the Constitution’s “true meaning.”¹² Many of the major revenue laws enacted by the First Congress, in order to generate the revenues for which Congress could eventually appropriate, contained whistleblower reward laws, including the laws establishing the Treasury Department, the United States Bank, and regulating the collection of duties on the tonnage of ships and merchandise.¹³

For example, the fifth law passed by the First Congress (relating to the collection of customs duties), had a special section concerning the distribution of “penalties, fines and forfeitures recovered” from those who violated the law. The collected proceeds from these sanctions was divided as follows: one-half was sent to the U.S. Treasury and one-half was equally divided between the “collector, naval officer and the surveyor by virtue of this act.” However, if any “person” gave “information” that resulted in the United States obtaining the collected proceeds, that person would receive one-half of the total amount not remitted to the Treasury Department. In

¹¹ *Vermont Agency of Natural Res. v. U.S. ex rel. Stevens*, 529 U.S. 765 (2000).

¹² *Wisconsin v. Pelican Ins. Co.*, 127 U.S. 265 (1888)(because “many “of the “members” of the “first Congress” had “taken part in framing that instrument,” that Congress’ actions are “contemporaneous and weighty evidence” of the Constitution’s “true meaning”).

¹³ *See* First Congress. Sess. I. Ch. 5 (July 31, 1789)(collecting duties); Ch. 11 (Sept. 1, 1789)(regulating coastal trade); Ch. 12 (Sept. 2, 1789)(establishing Treasury Department); Sess. II, Ch. 35 (Aug. 4, 1790)(collection of duties).

other words, the whistleblower would obtain 25% of the monies collected as a result of his or her finishing the information.

The First Congress provided as follows:

That all penalties, fines and forfeitures, recovered by virtue of this act (and not otherwise appropriated), shall, after deducting all proper costs and charges, be disposed of as follows: One moiety shall be for the use of the United States, and paid into the treasury thereof; the other moiety shall be divided into three equal parts, and paid to the collector, naval officer and surveyor of the district wherein the same shall have been incurred . . . provided nevertheless, That in all cases where such penalties, fines and forfeitures shall be recovered in pursuance of information given to such collector, by any person, other than the said naval officer and surveyor, the one half of such moiety shall be given to the informer, and the remainder shall be disposed of between the collector, naval officer and surveyor, in manner and form as above limited and expressed.¹⁴

In consideration of the risk and effort undertaken by the whistleblower/informant to provide high quality information to the government, the First Congress assigned to these persons a future interest in a portion of the proceeds actually collected by the government based on his or her sacrifices/contribution. These monies were not part of an official appropriation by Congress, but were assigned by a statute approved by Congress for direct payment to the whistleblower. The payment of the 25% informant share would be made by members of the executive branch of government, before (or simultaneous to) these officials transmitting to the United States Treasury its 50% portion of the sanctions.

Because the whistleblower's right to the collection of a reward arises from an assignment of interests, not from a formal appropriation, any interference with such a lawful assignment would itself raise a host of legal and constitutional issues.

TRANSPARENCY

The modern whistleblower reward process is extremely transparent, with numerous checks and balances. For example, the False Claims Act has strict limits on a whistleblower's ability to dismiss a case or settle a case, and the court has authority to approve settlements (which include specific provisions setting forth an amount of any reward) over a whistleblower's objection, if such settlements are determined to be "fair, adequate and reasonable."¹⁵ In practice, False Claims Act settlements are done in public, the Department of Justice places on the public record the terms of each settlement, including the amount of money assigned to the whistleblower. These settlement agreements are all publicly disclosed before a court dismisses an action. In the 30 plus years of the False Claims Act, this witness is unaware of Congress taking issue with the validity of a reward paid to a whistleblower under that Act.

¹⁴ First Congress, Ch. 5, Section 38 (July 31, 1789)(emphasis in original).

¹⁵ 31 U.S.C. § 3730((c)(2)(A) and (B).

The False Claims Act, and similar laws, create a safe, effective, and highly successful method for employees to disclose fraud in government programs to the appropriate authorities. The method for compensating whistleblowers for their original information, whether the rewards are paid for from specialized funds, by court order, or directly from the federal treasury, are irrelevant. Once it is adjudicated that the whistleblower provided the service directed by Congress, and once monies are obtained as fines and penalties from the wrongdoer, the entitlement for payment is effectuated. The whistleblower has a right to collect on the portion of the sanction assigned to him or her by law. Interference with this lawful payment, mandated by the government's partial assignment of interest, would undermine the whistleblower laws, cripple effective anti-fraud programs, destroy the whistleblower's confidence in the reward system and violate the whistleblower's constitutionally protected property interest in the partial assignment.

CONCLUSION

Thank you again for this opportunity to testify. The Founding Fathers were true visionaries. They understood the importance of using the citizens as a bulwark for the enforcement of laws and ensuring accountability. On July 30, 1778 the Continental Congress passed America's first whistleblower, stating that it was the "duty of all persons" to give "the earliest information" to "proper authority of any misconduct, frauds or misdemeanors."¹⁶ After the formation of our current government, the First Congress reinforced the message it sent on July 30, 1778, and enacted 18 separate whistleblower reward laws, covering many important laws. I am certain that it was not the intent of the authors of H.R. 5499 to interfere with the whistleblower reward programs. The National Whistleblower Center stands ready to assist this Committee in ensuring that no government whistleblower reward program is harmed by the passage of H.R. 5499.

Respectfully submitted,

/s/

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¹⁶ Kohn, "The Whistleblower's Handbook: A Step-by-Step Guide to Doing What's Right and Protecting Yourself," (Lyons Press, 2011)(setting forth the complete history behind Congress' enactment of the July 30th resolution, found at *Journal of the Continental Congress*. XI, p. 732). Also see, Senate Resolution 522 (114th Congress, 2nd Session), setting forth July 30, 2016 as National Whistleblower Appreciation Day, in honor of contributions made by whistleblowers and the foresight of the Founding Fathers.

ADDENDUM

LAWS PASSED BY THE *FIRST CONGRESS* AUTHORIZING INFORMANT/WHISTLEBLOWERS REWARDS NOT PAID THROUGH THE CONGRESSIONAL APPROPRIATIONS PROCESS

ACT OF JULY 31, 1789, CH. 5, §29, 1 STAT. 44—45 (Giving informer full penalty paid by customs official for failing to post fee schedule).

ACT OF AUG. 4, 1790, CH. 35, §55, 1 STAT. 173 (SAME).

ACT OF JULY 31, 1789, CH. 5, §38, 1 STAT. 48 (Giving informer quarter of penalties, fines, and forfeitures authorized under a customs law).

ACT OF SEPT. 1, 1789, CH. 11, §21, 1 STAT. 60 (Same under a maritime law).

ACT OF AUG. 4, 1790, CH. 35, §69, 1 STAT. 177 (Same under another customs law).

ACT OF SEPT. 2, 1789, CH. 12, §8, 1 STAT. 67 (Providing informer half of penalty upon conviction for violation of conflict-of-interest and bribery provisions in Act establishing Treasury Department).

ACT OF MAR. 3, 1791, CH. 8, §1, 1 STAT. 215 (Extending same to additional Treasury employees).

ACT OF MAY 31, 1790, CH. 15, §2, 1 STAT. 124—125 (Allowing author or proprietor to sue for and receive half of penalty for violation of copyright).

ACT OF MAR. 1, 1790, CH. 2, §6, 1 STAT. 103 (Allowing census taker to sue for and receive half of penalty for failure to cooperate in census).

ACT OF JULY 5, 1790, CH. 25, §1, 1 STAT. 129 (Extending same to Rhode Island).

ACT OF MAR. 1, 1790, CH. 2, §3, 1 STAT. 102 (Allowing informer to sue for, and receive half of fine for, failure to file census return).

ACT OF APR. 30, 1790, CH. 9, §§16, 17, 1 STAT. 116 (Allowing informer to conduct prosecution, and receive half of fine, for criminal larceny or receipt of stolen goods).

ACT OF JULY 5, 1790, CH. 25, §1, 1 STAT. 129 (Extending same to Rhode Island).

ACT OF JULY 20, 1790, CH. 29, §§1, 4, 1 STAT. 131, 133 (Allowing private individual to sue for, and receive half of fine for, carriage of seamen without contract or illegal harboring of runaway seamen).

ACT OF JULY 22, 1790, CH. 33, §3, 1 STAT. 137—138 (Allowing private individual to sue for, and receive half of goods forfeited for, unlicensed trading with Indian tribes).

ACT OF AUG. 4, 1790, CH. 35, §4, 1 STAT. 153 (Apportioning half of penalty for failing to deposit ship manifest to official who should have received manifest, and half to collector in port of destination).

ACT OF FEB. 25, 1791, CH. 10, §§8, 9, 1 STAT. 195—196 (Providing informer half or fifth of fines resulting from improper trading or lending by agents of Bank of United States).

ACT OF MAR. 3, 1791, CH. 15, §44, 1 STAT. 209 (Allowing person who discovers violation of spirits duties, or officer who seizes contraband spirits, to sue for and receive half of penalty and forfeiture, along with costs, in action of debt).

BIOGRAPHICAL SUMMARY

Stephen M. Kohn is a founding director of the National Whistleblower Center (www.whistleblowers.org) and a partner at Kohn, Kohn & Colapinto, LLP (www.kkc.com). For the past 32 years he has been a trailblazer in establishing protections for whistleblowers, winning numerous precedent setting cases on behalf of government and private sector whistleblowers. Mr. Kohn has written eight books, including the first-ever legal treatise on whistleblower law (published in 1985) and the highly popular *Whistleblower's Handbook: A Step-by-Step Guide to Doing What's Right and Protecting Yourself* (Lyons Press, 3rd edition, 2013). Mr. Kohn was ranked by the *National Law Journal* as one of the fifty top plaintiff's lawyers in the United States and was selected as one of the "100 Most Influential People in Business Ethics" by *Ethisphere*. His historical research, conducted while writing *The Whistleblower's Handbook*, resulted in the re-discovery of America's first whistleblower case. The U.S. Senate has commemorated these first whistleblowers by recognizing July 30th as National Whistleblower Appreciation Day every year since 2013. In addition to practicing law, Mr. Kohn teaches an annual course on whistleblowing at the Northeastern University School of Law. Mr. Kohn obtained his B.S. degree from Boston University, and M.A. degree from Brown University and his J.D. from Northeastern University. He is married to the artist Leslie Rose, and has two children, Max and Nataleigh.