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Incentivizing Whistleblowing in the United States

Qui Tam, Anti-Retaliation and Cash-For-Information

Abstract

In the U.S., there are dozens of federal and state laws, as well as thousands of cases, addressing whistleblowing. It is impossible to classify these into one category because they target a wide range of industries and are structured with different goals. Some laws protect against anti-retaliation, while others offer financial incentives in exchange for cooperation in the investigation and prosecution of corporate misconduct. This last area has gained significant attention recently. The use of these "bounties" is controversial, mainly limited to the U.S., and has generated intense debate. Nevertheless, the U.S. experience with financial incentives has been successful and it does not appear that it will stop anytime soon.
Keywords: whistleblowing, bounty schemes, financial incentives, anti-retaliation, qui tam

A. Introduction

Whistleblowing has become headline news in recent memory. In September 2014, the Securities and Exchange Commission (SEC) announced its largest ever whistleblower award for $30 million.[1] This might seem small when compared to the $104 million the Internal Revenue Service (IRS) gave to an informant regarding a tax fraud case.[2] These jaw-dropping numbers are indicative of a trend developing whereby the U.S. government offers financial incentives to convince whistleblowers to cooperate in the investigation and prosecution of corporate crime. By definition, a financial incentive program (or bounty) allows a private informant to "receive a portion of any penalties the government receives from legal action taken based on the proffered information. The po-

1 *SEC Announces Largest-Ever Whistleblower Award*, Securities and Exchange Commission (Sep. 22, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543011290#.VC8sUvldXDs.
2 *Kocieniewski*, Whistle-Blower Awarded $104 Million by I.R.S., New York Times (Sep. 11, 2012), http://www.nytimes.com/2012/09/12/business/whistle-blower-awarded-104-million-by-irs.html.

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tential for payment is often large."[3] This often takes the form of a private right of action or cash-for-information.

Despite the enthusiastic efforts of U.S. government agencies in adopting these programs, other countries have not followed suit. If the U.S. is one of the only countries actively pursuing financial incentive programs, then this begs the question as to whether financial incentive programs are an efficient means in combatting corporate misconduct. This paper will provide an overview of a select few federal whistleblower laws before analyzing their overall effectiveness, with particular emphasis on incentivizing whistleblowing.

B. False Claims Act (FCA)

The FCA is the most well known whistleblowing law, particularly because of its long history and tendency for large rewards. Enacted during the Civil War, the purpose was to combat fraud undertaken by defense contractors against the federal government and Union Army.[4] What makes the FCA stand out is that it allows *qui tam* lawsuits.[5] The Latin phrase *qui tam pro domino rege quam pro se ipso in hac parte sequitur* means "he who brings the action for the king as well as himself." Under the FCA, a private citizen can initiate a lawsuit on behalf of the federal government against a company that is alleged to have committed fraud against the government. The private citizen is known as a relator because technically the government is still the plaintiff. Without *qui tam*, the lawsuit would normally be barred for lack of standing because the relator did not suffer an actual injury.[6] Instead, *qui tam* grants standing to the relator on the basis that the federal government can assign its right to another.[7]

As a result of its actions, the relator is entitled to a reward. Under the original FCA, this included double damages. However, a particular *qui tam* decision during World War II caused Congress to amend the FCA. This severely restricted the *qui tam* provisions by reducing the bounty and more importantly, an impossible hurdle was implemented that barred any *qui tam* case from going forward if the federal government knew of the fraud at the time the relator filed the action.[8] Consequently, the FCA was

3 *Ferziger & Currell* 1999, U. ILL. L. REV. 1142.
4 *Helmer Jr*. 2013, 81 U. CIN. L. REV. 1261, 1265.
5 For an in-depth history of *qui tam,* see WASH. U. L. Q. 81 (1972).
6 Article III of the U.S. Constitution limits federal jurisdiction to "cases" or "controversies." While there is no singular definition of standing, case law has developed three elements. *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 560-561 (1992) (plaintiff has the burden to prove that it suffered an "injury in fact", there must be a "causal connection between the injury and the conduct complained of," and it must be "likely" that the "injury will be redressed by a favorable decision").
7 *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 765, 773 (2000) ("We believe, however, that adequate basis for the relator's suit for his bounty is to be found in the doctrine that the assignee of a claim has standing to assert the injury in fact suffered by the assignor").
8 *Helmer* 2013*,* supra note 4, at 1270.

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largely ineffective over the next decades until new amendments were enacted in 1986 after many cases of fraud against the federal government were revealed. The amended FCA removed the original knowledge barrier and increased damages so that violators are liable for three times the amount that they defrauded the government plus additional civil penalties for each false claim. The relator receives between 15 and 25 percent of the recovery if the government intervenes in the action or between 25 and 30 percent if the government declines to intervene and the relator proceeds on its own.

The process for pursuing a *qui tam* case is detailed.[9] There is a statute of limitations for filing a claim that must be filed within six years from the date of the violation of the FCA or three years after the government knows about or should have known about the violation. A relator files a *qui tam* complaint under seal in federal district court, so only the DOJ is aware of the case during the initial investigatory period. This serves as a way to protect the relator from retaliation by the employer. After the claim is filed, the DOJ has 60 days to investigate, but it often requests and is granted extensions.

Following the initial investigation, the claim is unsealed and the DOJ has multiple options: it can intervene, settle the case, decline intervention, or move to dismiss the claim. In practice, the DOJ intervenes in 20 percent of cases.[10] This is crucial because when it intervenes, *qui tam* settlements and judgments have totaled more than $29 billion (with relator rewards coming in at $4.5 billion) compared to a smaller $1 billion when it declines (with relator rewards reaching just $210 million).[11] Thus, there are substantial benefits for the relator if the DOJ intervenes. Once the DOJ finishes its investigation, the seal is removed and the complaint must be served on each defendant in accordance with the Federal Rules of Civil Procedure. The defendant must file a reply and then formal discovery commences.

The effects of the 1986 amendments have been monumental. During the past 30 years, *qui tam* settlements and judgments have totaled more than $30 billion and the relator share stands at more than $4.7 billion.[12] It has been particularly useful in the healthcare industry, where 90 percent of fraud cases are *qui tam* lawsuits.[13] A sample of healthcare cases include: Tenet Healthcare paid $900 million in 2006; Merck settled a Medicaid fraud case in 2008 that included $360 million under the FCA; as part of a $2.3 billion settlement in 2009, Pfizer paid $668.5 million under FCA charges; and GlaxoSmithKline settled a case in 2010 that had $600 million under the FCA and an additional $150 million as a criminal penalty.[14]

9 For an overview of *qui tam* and the FCA, see *Doyle* (Aug. 6, 2009), https://www.fas.org/sgp/crs/misc/R40785.pdf; see also *Lipman* 2011.

10 *Lipman* 2011, supra note 9, at 149.

11 *Fraud Statistics – Overview*, Taxpayers Against Fraud (Nov. 20, 2014), *available at* http://www.taf.org/DOJ-FCA-Statistics-2014.pdf.

12 *Id.*

13 *Boyne* 2014, 62 AM. J. COMP. L. SUPP. 425, 445 (quoting New England Journal of Medicine).

14 For a summary of 10 FCA cases, see *The 1986 False Claim Act Amendments: A Look at Twenty-Five Years of Effectjve Fraud Fighting in America,* Taxpayers Against Fraud 12,

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C. Sarbanes-Oxley (SOX)

Congress passed SOX in 2002 following more corporate scandals. The Senate Judiciary Committee found that employees had tried to reveal the misconduct that occurred, but they were "discouraged at nearly every turn."[15] This emphasized the need for effective whistleblowing laws in public companies, which is why SOX includes a variety of relevant provisions:

- Section 301: requires audit committees to create internal whistleblowing mechanisms allowing employees to anonymously raise concerns about improper accounting or auditing.
- Section 806: permits corporate whistleblowers to file a claim if they were subjected to retaliation for having reported violations of SEC laws or regulations.
- Section 1107: allows the Department of Justice (DOJ) to impose criminal penalties on companies or individuals that retaliate against corporate whistleblowers. This can include a fine or up to ten years in prison.

These sections demonstrate two distinct types of protection. On the one hand, Section 301 creates structural channels through which employees can report alleged misconduct.[16] As mentioned, a main problem was that employees were discouraged from exposing fraud or their concerns were easily dismissed. Under SOX, publicly traded companies must have mechanisms for "receipt, investigation, and tracking of anonymous employee complaints," which ensures that employee complaints are taken seriously.[17] To satisfy this end, it is most common for companies to contract with an independent tip hotline.[18]

In addition, SOX provides anti-retaliation measures. This approach differs greatly from financial incentive programs. In accordance with Section 806, a public company[19] cannot take unfavorable action against an employee that provided information about a specific set of securities actions or assisted in an investigation by a federal agency, Congress, or internal investigators. Unfavorable action encompasses many things such as firing, laying off, blacklisting, demoting, denying overtime hours, failing to promote, withholding benefits, issuing threats, and reducing pay or hours.

If a whistleblower alleges that the employer took retaliatory measures, the employee can file a claim with the Occupational Health and Safety Administration (OSHA), which is an agency within the Department of Labor (DOL). The original filing period was 90 days,[20] which began running when an alleged SOX violation occurred or the date on which the employee became aware of the violation. In the case where OSHA

available at http://taf.org/public/drupal/TAF-fca-25anniversary_12%281%29.pdf (last visited Sep. 15, 2015).

15 S. Rep. No. 107-146, at 4-5 (2002).

16 *Rapp* 2007, 87 Bos. U. L. Rev. 91, 115.

17 *Westman* 2005, 21 The Labor Lawyer 141, 149.

18 *Dworkin* 2007, 105 Mich. L. Rev. 1757, 1761.

19 It is a public company if registered under Section 12 or files its report under Section 15(d) of the Securities Exchange Act.

20 The statute of limitations was increased to 180 days.

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determines that the employer retaliated, OSHA can require the employer to offer monetary and non-monetary remedies (ex. reinstatement, back pay, or front pay), compensatory damages for certain torts, or special damages (ex. legal costs).[21] The fact that employees cannot recover punitive damages is startling because studies have shown that whistleblowing increases when statutes offer this.[22]

At first glance, it appears that SOX offers significant protection for whistleblowers that suffered retaliation. However, many employers found ways around this by including employee waivers or arbitration agreements in their contracts that prevented employees from suing.[23] But even when cases proceeded, two studies by Richard Moberly found that employees were usually unsuccessful. In 2007, his first study on retaliation claims brought under SOX concluded that employees were victorious in just 3.6 percent of the cases during the initial OSHA investigation and in 6.5 percent of those cases brought before an administrative law judge in the appeals process.[24] When he updated these statistics in 2012, there had been a decrease in the success rate.[25] He attributed these results to various factors: cases were decided by rigidly interpreting SOX and OSHA misapplied the burden of proof regarding causation to the detriment of employees.[26] If anti-retaliation measures are supposed to convince employees to expose alleged corporate wrongdoing by offering them protection in the event of retaliation, such a low success rate will do little to persuade employees that they are adequately protected.

D. Dodd-Frank Wall Street Reform and Consumer Protection Act

The financial collapse of 2008 led to more regulation. Dodd-Frank sought to address many of the deficiencies associated with SOX by creating a cash-for-information incentive scheme, as well as expanding anti-retaliation protections. Technically speaking, the relevant whistleblowing protections under Dodd-Frank are found in Section 922, which insert Section 21F ("Securities Whistleblower Incentives and Protection") into the Securities Exchange Act of 1934.[27] The new rules require the SEC to pay a financial reward between 10 and 30 percent to any whistleblower that provides original information about a violation of federal securities law leading to an enforcement action of sanctions worth more than $1 million. It is up to the SEC to decide which percentage in this range to award the whistleblower. This new bounty scheme is a stark departure from SOX where employees could only collect remedies designed to make them whole. Dodd-Frank instead allows for the potential of a very hefty reward. Although

21 *Hesch* 2011, 6 Liberty U. L. Rev. 51, 102-103.
22 *Dworkin* 2007, supra note 18, at 1763.
23 This is addressed under Dodd-Frank.
24 *Moberly* 2008, 49 Wm. & Mary L. Rev. 65.
25 *Moberly* 2013 64 S. C. L. Rev. 1.
26 *Moberly* 2013, supra note 24, at 67-68.
27 The full text of Section 922 can be found at: https://www.sec.gov/about/offices/owb/dodd-frank-sec-922.pdf.

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Dodd-Frank and the FCA are financial incentive programs, there is a major difference in their structure because Dodd-Frank does not yet allow *qui tam* actions. This is something the SEC has considered, but it ultimately found that it is "premature to introduce a private right of action…since the program is relatively new and has only been in place since August 2011."[28] Nevertheless, the SEC has left the door open to *qui tam* in the future.[29]

In practice, a whistleblower submits a tip via website, mail or fax to the Office of the Whistleblower (OWB), which is an agency within the SEC. The OWB tracks the investigation and posts a Notice of Covered Action (NoCA) on its website once an action results in more than $1 million in sanctions.[30] From when the program began in 2011 until the end of 2014, there have been 570 NoCAs posted.[31] It is up to the whistleblower to follow-up on the NoCA by submitting a form within 90 days if the whistleblower believes that it is entitled to an award and this will be analyzed by the OWB. There have been 18 awards since the program began and they total more than $50 million, including the largest-ever SEC award for $30 million in 2014 and another for $14 million in 2013.[32]

Beyond the new bounties, Dodd-Frank expanded anti-retaliation protection. It began by amending SOX. First, it explicitly clarified that coverage extends to employees of subsidiaries and affiliates of public companies.[33] Second, it doubled the statute of limitations for employees to file a claim from 90 to 180 days. This is significant because many claims were rejected for failing to fulfill the statute of limitations and one study found that half of the claims that were rejected for failing to meet the 90-day deadline were actually filed within the 180-day period.[34] Third, it prohibits employee waivers and arbitration agreements that keep employees from initiating an action. In addition to amending SOX, Dodd-Frank created its own anti-retaliation measures. It overlaps SOX in many ways, although there are some salient differences: the claimant can bypass the administrative process and go directly to federal district court, the statute of

28 *Evaluation of the SEC's Whistleblower Program,* SEC Office of Inspector General 28 (Jan. 18, 2013), https://www.sec.gov/about/offices/oig/reports/audits/2013/511.pdf.

29 In the 2013 report, the SEC concluded that it would need another two or three years to properly analyze the effectiveness of the new whistleblower program. It would then be in a better position to determine if a private right of action is needed.

30 For a listing of NoCAs, see Notices of Covered Action – Cumulative, SEC Office of the Whistleblower, available at https://www.sec.gov/about/offices/owb/owb-awards/nocas-all.shtml (last visited Sep. 15, 2015).

31 *Annual Report to Congress on the Dodd-Frank Whistleblower Program*, SEC 13 (2014), http://www.sec.gov/about/offices/owb/annual-report-2014.pdf.

32 *SEC Pays More Than $3 Million To Whistleblower,* SEC (Jul. 17, 2015), http://www.sec.gov/news/pressrelease/2015-150.html; *SEC Announces Largest-Ever Whistleblower Award,* SEC (Sep. 22, 2014), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543011290.

33 This was not explicitly stated under SOX, though the Supreme Court addressed it in *Lawson v. FMR LLC,* 134 U.S. 1158 (2014) (coverage extends not only to employees of public companies, but also to employees of private companies performing work for public companies).

34 *Moberly* 2013, supra note 24, at 132-133.

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limitations is longer, and greater damages are available. Although the program is quite new, the SEC announced its first award in a retaliation case in April 2015.[35]

There have been criticisms of Dodd-Frank. Perhaps the most interesting is that it favors external reporting to the SEC over internal reporting to the company's compliance system.[36] This is problematic for the company because internal reporting allows the company to investigate and correct wrongful conduct while minimizing the costs of external whistleblowing (conversely, it could also allow the company to cover up wrongdoing).[37] Under Dodd-Frank, there is no explicit language requiring whistleblowers to first utilize internal compliance to be eligible for an SEC award. This was considered, but ultimately not adopted.[38] Instead, the SEC tries to encourage whistleblowers to go through their company's system when calculating the award: participation in the internal compliance system can increase the amount and interference with internal compliance can decrease the amount. Nevertheless, the SEC has gone on record to say that a whistleblower can receive the maximum award possible "regardless of whether the whistleblower satisfied other factors such as participating in internal compliance programs."[39]

Furthermore, the statutory language has led to confusion as to whether or not employees who report internally are protected by the anti-retaliation provisions. The Fifth Circuit found that they only apply to employees that report to the SEC and not to those that report internally.[40] This creates a two-tiered system whereby employees who go the internal route receive lesser protection than those that report directly to the SEC.[41] Other courts have interpreted the statute more broadly and declared that internal whistleblowers are indeed protected.[42] But because there has not yet been a Supreme Court ruling, there is no uniform rule across the country.

E. Analysis of Financial Incentive Programs

With *qui tam* and cash-for-information, it is evident that the U.S. has embraced financial incentive programs in its fight against corporate fraud. The question then remains: if the U.S. is employing such tactics, do they work? If analyzed from the perspective of

35 *SEC Announces Award to Whistleblower in First Retaliation Case,* SEC (Apr. 28, 2015), https://www.sec.gov/news/pressrelease/2015-75.html.

36 *Recent Legislation,* 124 Harv. L. Rev. 1829, 1832 (2011) (note on Dodd-Frank); *Vega* 2013, supra note 14 (his premise is that this is the greatest failure of the SEC).

37 *Dworkin* 2007, supra note 18, at 1760.

38 *Final Rule: Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934*, SEC 5 (May 25, 2011), *available at* https://www.sec.gov/rules/final/2011/34-64545.pdf.

39 *Vega* 2013, supra note 14, at 504.

40 *Asadi v. GE Energy USA LLC*, 720 F.3d 620 (2013).

41 *Hesch* 2011, supra note 21, at 105-106.

42 *Alexander et al.* 2015, 35 Pace L. Rev. 887, 901 (discussing district court cases that have taken different approaches to *Asadi*).

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information generation, then one can definitively answer in the affirmative.[43] During recent years, the number of whistleblowing cases has skyrocketed and the government has recovered billions of dollars that would have otherwise been lost.[44] Furthermore, whistleblower tips have increased each year since Dodd-Frank began, with the SEC having received a total of 10,193 tips during this time.[45]

The reason for an increase in whistleblowing is attributed to a cost-benefit analysis performed by employees aware of corporate misconduct.[46] There are significant monetary and non-monetary costs associated with whistleblowing that prevent employees from wanting to disclose wrongdoing. As a result, it is necessary to offer a substantial benefit that can tip the balance the other way and make it worthwhile for the employee to report misconduct. Anti-retaliation measures are unrealistic incentives because experience under SOX showed that these cases are largely unsuccessful and they only offer compensatory damages to return the employee to the position he or she was at from the beginning. On the other hand, a financial incentive scheme has the ability to put the employee in a superior financial position than before, which therefore has a greater ability to outweigh the negative costs associated with whistleblowing.

With so many tips being generated, it might seem that bounties encourage frivolous claims by those wanting a quick dollar while also increasing administrative costs associated with investigation. This has been disproved. Generally speaking, administrative costs are lower in FCA *qui tam* cases because the relators carry out much of the litigation rather than the DOJ.[47] Another economist compared the cost of investigation and prosecution of *qui tam* lawsuits in the healthcare field with the total amount returned to the federal government minus the relator reward.[48] The conclusion was that $20 was returned for every $1 spent on investigation, which demonstrates that these cases are actually a valuable way to return money originally taken from the government under fraudulent premises. Concerning frivolous lawsuits, *qui tam* cases are expensive, time-consuming, and technical, so there is little advantage to be gained by filing a frivolous claim.[49] The DOJ does not intervene in the majority of *qui tam* cases, but intervention by the DOJ significantly improves the relator's chances at receiving a substantial reward. Therefore, it is in the best interests of the relator to submit a proper claim because the relator would want the DOJ fighting on its side.[50] The DOJ can also move to

43 Similar conclusion found by: *Rapp* 2007, supra note 16, at 96-97; *Ferziger & Currell* 1999, supra note 3, at 1143; *Bucy* 2002, 76 S.C. L. Rev. 1, 61.

44 *Vega* 2013, supra note 14, at 491-492 (studies of case law highlight that prior to 1977, there were only three reported cases dealing with whistleblowing, and this rose to 300 cases in the 1980s, 2,207 cases in the 1990s, and more than 7,700 cases since the 2000); *Fraud Statistics Overview*, supra note 23 (recalling that more than $30 billion has been recovered since the FCA amendments in 1986).

45 SEC Annual Report FY 2014, pg. 20, http://www.sec.gov/about/offices/owb/annual-report-2014.pdf (There were 334 tips in 2011, 3001 in 2012, 3238 in 2013, and 3620 in 2014).

46 *Rapp* 2007, supra note 16, at 111.

47 *Id.* at 137.

48 *Meyer* Oct. 2013, *available at* http://www.taf.org/TAF-ROI-report-October-2013.pdf.

49 *Rapp* 2007, supra note 16, at 133.

50 *Bucy* 2002, supra note 43, at 69.

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dismiss a case after its initial investigation, which serves to prevent frivolous *qui tam* lawsuits from continuing. Lastly, another study found that while the healthcare industry has been a major field in which employees have brought *qui tam* actions, the amount of frivolous lawsuits was actually lower in the healthcare industry as compared to others.[51]

Despite the fact that financial incentive programs have generated vast quantities of information leading to more prosecution of corporate fraud and the recovery of billions of dollars, there is still derogatory rhetoric associated with these programs. The terms "bounty scheme" or "bounty hunter" are often used and these conjure up negative images of greedy employees that are only after big paydays. However, this is not the reality. Most rewards are not multimillion-dollar paychecks. The average award is $150,000 and this should take into account that it might be split between multiple whistleblowers and might have to cover litigation or other costs.[52] For employees that find difficulty finding other work in their field as a result of their whistleblowing actions, a small reward is probably not a huge incentive to become a so-called bounty hunter that targets vulnerable companies. Moreover, because so many whistleblowers cannot find additional work, it seems impossible to become a career bounty hunter because no other company will hire or trust the person.

One critic argues that financial incentives suppress "real whistleblowing" because they discourage internal whistleblowing and over-incentivize external whistleblowing.[53] Yet practical experience has discredited this, as many employees prefer to report internally rather than going directly to the government. A recent study of *qui tam* cases filed between 2007 and 2010 found that almost 90 percent of employees that initiated the lawsuit reported internally first.[54] This is further corroborated by a study of *qui tam* cases involving the pharmaceutical industry that concluded that nearly all whistleblowers initially attempted to utilize internal measures.[55] Thus, the "greedy" whistleblower is a myth. It has been said that the primary motive for whistleblowers is actually the urge to do "the right thing."[56] Furthermore, whistleblowers are generally "above-average performers who are highly committed to the organization, not disgruntled employees out for revenge."[57] So if whistleblowers are indeed reporting internally first, perhaps criticism should instead be directed to the companies that engaged in or failed to correct the underlying misconduct rather than deflecting attention by trying to vilify whistleblowers.

51 *Dyck et al.* 2010, 65 J. OF FIN. 2213, 2246.
52 *Lipman* 2011, supra note 9, at 5.
53 *Vega* 2013, supra note 14, at 509.
54 *Impact of Qui Tam Laws on Internal Compliance: A Report to the Securities Exchange Commission,* National Whistleblowers Center (Dec. 17, 2010), http://www.whistleblowers.org/storage/whistleblowers/documents/DoddFrank/nwcreporttosecfinal.pdf.
55 *Id.* at 5-6 (summarizing a 2010 study from the New England Journal of Medicine).
56 *Rapp* 2013, 54 S. TEX. L. REV. 53, 59.
57 *Grant* 2002, 39 J. OF BUS. ETHICS 391, 392.

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A final thought to consider was raised by Geoffrey Rapp, who finds it surprising that companies have not implemented financial incentives in their internal compliance programs, especially since they offer bonuses for other corporate actions.[58] Because financial incentives work in encouraging employees to bring information to the government, then it makes sense for companies to offer a similar payment if they report internally. While this could probably never reach the level of some of the multi-million dollar rewards offered by the government, it would still serve as a way to offer sufficient financial incentives to employees without the only option being reporting to the government.

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