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RETHINKING COMPLIANCE:
THE ROLE OF WHISTLEBLOWERS

Claire Sylvia and Emily Stabile*

Abstract

Among the more dubious conjectures in contemporary policy debates about deterring corporate fraud is that whistleblower reward programs undermine internal compliance programs. The suggestion is that the prospect of a whistleblower reward discourages employees from reporting fraud to their employers, inhibiting the ability of employers to timely address the problems. This conjecture has little basis in fact. Research shows that most whistleblowers report fraud internally first, typically turning to external sources only when internal compliance has failed. That whistleblowers do report internally should not be surprising given the pull of institutional loyalty and the extraordinary personal and financial costs of speaking out. Moreover, the conjecture misapprehends the critical, overarching policy goals of whistleblower reward programs: ferreting out, remedying, and deterring fraud, as opposed to promoting internal compliance programs for their own sake. Judged by the appropriate policy goals, whistleblower reward programs have proven extremely effective not only in addressing misconduct, but also in deterring future misconduct and encouraging more and better internal compliance programs. Whistleblower reward programs and internal compliance programs are complements, not substitutes, in promoting compliance.

I. INTRODUCTION

In the wake of the enactment of the Dodd-Frank whistleblower provisions in 2010, a curious debate ignited: would a whistleblower reward program undermine the expensive internal compliance programs in which companies invested as whistleblowers bypassed internal reporting for the prospect of a rich reward? The debate placed

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corporations in the ironic position of arguing that their compliance programs should be protected from robust competition from whistleblower programs, while whistleblower advocates argued that market forces should determine which programs were superior. The Securities and Exchange Commission (SEC) ultimately adopted final rules in 2011 that embodied a compromise—rewarding whistleblowers who invoked internal compliance programs before reporting to the government, but not requiring that a whistleblower do so as a condition of eligibility for an award.3

To date, internal compliance programs are still alive and well despite the existence of the Dodd-Frank whistleblower provisions. Nevertheless, the argument that whistleblower programs undermine internal compliance continues to be pressed in another context. Notably, in 2013 the U.S. Chamber of Commerce Institute for Legal Reform published a report entitled Fixing the False Claims Act, which argued that the False Claims Act whistleblower reward program undermines corporate compliance efforts.4 The report called for reduced damages and penalties for corporations that meet certain compliance standards—despite the dearth of evidence showing that compliance programs actually prevent and reduce fraud.5 Notably, although the report called for legislation to reward “gold plated” compliance programs, it did not identify any reason why companies would be prevented from adopting effective compliance programs or why avoiding False Claims Act suits might not be sufficient incentive to do so.

This Article argues that internal compliance programs and whistleblower reward programs are neither mutually exclusive nor antagonistic. Part II outlines the recent development of the theory that whistleblower programs undermine internal compliance efforts because whistleblowers are more likely to report directly to the Government to obtain a reward. Part III challenges that theory, noting the dearth of evidence that whistleblower programs have undermined internal compliance efforts.6

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3. 17 C.F.R. § 240.21F-1.
5. Id. at 2-4.
compliance programs and the substantial evidence that whistleblower reward programs have generated more and better compliance programs. Part IV discusses the substantial evidence that whistleblower reward programs have resulted in more actual compliance than compliance programs, which in comparison are not that effective at deterring and reducing fraud. When evaluated against the appropriate policy goal of deterring fraud, whistleblower programs and internal compliance efforts are complements, not substitutes in promoting compliance.

II. ORIGINS OF THE THEORY THAT WHISTLEBLOWER REWARD PROGRAMS UNDERMINE INTERNAL COMPLIANCE EFFORTS

A common refrain in recent years is that whistleblower reward programs undermine the efficacy and purpose of internal compliance programs. This refrain reached a crescendo in response to the SEC’s proposed rules on implementing the whistleblower provisions of the Dodd-Frank Act.

In 2010, in the wake of the Bernie Madoff scandal, where a whistleblower repeatedly brought to the attention of the SEC concerns about a Ponzi scheme but no enforcement action was taken, Congress adopted an SEC whistleblower reward program as part of the Dodd-Frank Act. The whistleblower provision authorized a person with information about violations of securities laws to report them directly to the SEC, which could then investigate the allegations or refer them to another enforcement agency. If the information led to a successful recovery of over $1 million for the SEC, the whistleblower would be entitled to a reward. Although generally fashioned after the successful federal False Claims Act, which had returned millions to taxpayers and...
the government, the SEC whistleblower provisions do not authorize a whistleblower to initiate a lawsuit on the government's behalf.

The Dodd-Frank Act also authorized the SEC to adopt implementing regulations for the whistleblower program, which the SEC did, promulgating proposed regulations in November 2010. Among the most contentious issues surrounding the proposed regulations was whether to require whistleblowers to report internally to their companies before reporting to the Government. The Dodd-Frank Act itself did not require that whistleblowers report internally before reporting violations to the Government, providing simply that "the Commission . . . shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action." Consistent with that provision, the SEC proposed implementing regulations for the law that, among other things, would permit a person to receive a reward for reporting violations even if they had not first relayed their concerns internally to their employer.

The SEC's proposed rule quickly generated a large volume of comments from corporations arguing that the SEC should "[c]ondition award eligibility on the use of an available internal reporting system" because "[e]ffective compliance programs rely heavily on internal reporting of potential violations of law and corporate policy to identify instances of noncompliance." Commenters pressed the argument that without such a requirement, whistleblowers would rush to report to the Government to collect rich rewards, rather than report internally and allow the company to address problems more quickly and effectively. In addition, companies argued that they had invested significantly in compliance programs following the enactment of Sarbanes-Oxley in

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2002 and that those investments would have been in vain if whistleblowers were enticed to circumvent them.\textsuperscript{17} The U.S. Chamber of Commerce’s Center for Capital Markets Competitiveness (Chamber of Commerce) argued further that the interests of whistleblowers were “adverse to those of the company and its shareholders. The company and its shareholders have a strong interest in mitigating any future penalties and reputational harm, while the whistleblower would benefit financially from ‘letting the problem grow.’”\textsuperscript{18} One industry commenter went so far as to make the dire warning that adopting a rule that required internal compliance as a condition of obtaining a reward was “essential to prevent companies from being barraged with meritless lawsuits”\textsuperscript{19} and necessary “if corporate compliance programs are to remain effective after implementation of these Rules.”\textsuperscript{20}

After several rounds of comments, the SEC ultimately rejected a requirement of internal reporting and adopted a compromise that rewards whistleblowers who report internally without imposing any obligation to do so.\textsuperscript{21} In implementing the whistleblower rules, the SEC carefully considered both the advantages and disadvantages to internal compliance programs that direct reporting posed and came to the conclusion that whistleblowers are in the best position to balance the effectiveness of their company’s compliance program against the risks of reporting externally.

Undeterred, the Chamber of Commerce subsequently lobbied lawmakers to amend the Dodd-Frank statute itself to impose the requirement of internal reporting. The proposed amendment would have barred whistleblowers from receiving an award if they did not report internally first, required whistleblowers to file a complaint to the SEC within 180 days of reporting to the employer, changed the mandatory award provision to a discretionary award regime, and barred whistleblowers from reporting if their job duties included investigating and remedying the wrongdoing.\textsuperscript{22} The proposal was not adopted, and

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20. Id. at 2-3.

21. 17 C.F.R. \textsection\textsuperscript{240.21F-6}(a)(4) (participation in internal compliance system is a factor in increasing the amount of the award); id. \textsection\textsuperscript{240.21F-6}(b)(3) (interference with internal compliance a factor in decreasing amount of the award).

corporate compliance programs remained unprotected from the competitive forces of the whistleblower reward program.

III. WHISTLEBLOWERS OVERWHELMINGLY REPORT TO GOVERNMENT AFTER INTERNAL COMPLIANCE PROGRAMS HAVE FAILED

The concerns raised in response to the SEC’s proposed rules certainly seemed alarming. Adopting a rule that undermined programs whose stated intent is to help ensure compliance with the law surely would be bad policy. So what is the evidence that whistleblower reward programs have an adverse effect on internal compliance programs? Research shows that, in practice, most whistleblowers do report internally before taking their complaints to the Government. In 2011, the National Business Ethics survey found that only 3% of first reports by whistleblowers were made externally, with that percentage growing to 11% of reports made externally the second time whistleblowers reported. In total, only 18% of whistleblowers reported misconduct externally without bringing their concerns to corporate compliance. Another study conducted by the National Whistleblower Center found that 89.7% of employees who eventually filed a whistleblower case initially reported internally to supervisors or compliance personnel. The report concluded that “[t]he existence of a qui tam or whistleblower rewards program has no negative impact whatsoever on the willingness of employees to utilize internal corporate compliance programs or report potential violations to their managers.” While whistleblowers are under no obligation to report internally, it appears that most do so, at least initially.

These statistics make intuitive sense given the complex realities

24. Id.
25. Id.
27. See, e.g., SECS. & EXCHANGE COMM’N, SEC 2015 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 16-17 (2015), http://www.sec.gov/about/offices/owb/annual-report-2015.pdf (noting that 80% of the employee whistleblowers who received an award under the SEC’s program reported their concerns internally or understood that the violations were known before they reported). While the extent to which broad conclusions can be drawn from these studies was questioned, little countervailing evidence was produced to show that internal compliance programs are successful at preventing fraud or that whistleblowers do not use them.
potential whistleblowers face. The premise underlying the conjecture that whistleblowers will bypass internal compliance in favor of a potential financial reward is that whistleblowers face a simple binary choice: report internally so that the company can address the problem or blow the whistle and reap a large financial award. Framed that way, the concern that financial incentives might undermine internal efforts to address misconduct seems plausible. But the choices a whistleblower faces are far more complicated. Reporting internally does not necessarily mean a problem will be addressed. Moreover, many employees may face adverse career consequences just for having reported internally. Indeed, while some industry advocates were arguing in the legislative arena that employees should be required to report internally before going to the SEC so that companies could ensure better compliance, in the judicial arena companies were arguing that a person who reports internally and is fired before reporting to the SEC is not protected by Dodd-Frank’s anti-retaliation provisions.\(^28\) Reports of awards and career advancement for reporting misconduct by superiors are rare.

Additionally, reporting to the Government to obtain an award is not an obviously superior choice for most whistleblowers. As an initial matter, the putative whistleblower may be unaware of this option. In the initial stages of reporting corporate misconduct, a whistleblower may not know that they have the option of obtaining an award.\(^29\) When discussing the 2009 amendments to the False Claims Act, Senator Grassley, the primary sponsor of the 1986 amendments to the False Claims Act, remarked:

> [Whistleblowing] is exactly what a lot of people have done without even knowing the false claims law exists....[E]verybody assumes the only reason [whistleblowers] brought it up is because they knew:
>
> Well, I can make a case out of this, and I can get a large award for bringing this to people’s attention. Most of the whistleblowers whom I know about did not even know about whistleblower protection laws, did not even know about false claims laws until they got into it.\(^30\)

The fact that most whistleblowers report internally first in an attempt to resolve issues through the company’s channels likely reflects this

\(^28\) See, e.g., Berman v. Neo@Ogilvy LLC, 801 F.3d 145 (2d Cir. 2015) (deferring to SEC interpretation and rejecting company’s argument that a person needs to have reported to the SEC to be protected by anti-retaliation provision); Asadi v. G.E. Energy United States, L.L.C., 720 F.3d 620 (5th Cir. 2013) (adopting company’s argument that person must report to the SEC to be protected by anti-retaliation provisions).

\(^29\) See Whistleblower Provisions, supra note 16.

informational imbalance.

Even if a whistleblower is aware of the option of reporting to the Government with the potential for an award, a whistleblower has no assurances that reporting would be financially rewarding, as a monetary award is by no means guaranteed. Nor is there any guarantee that the Government will address the problem once it is brought to its attention.

In addition to the speculative chances of recovery, the potential downsides of whistleblowing are extremely costly and far more likely to occur than a payout. Whistleblowers who report fraud are likely to suffer punishment by their employers, either by demotion, unfair discipline or treatment, or termination. The costs of employment retaliation may also follow a whistleblower after they leave their employer whether voluntarily or not. In many cases, whistleblowers are blacklisted from an entire industry and may have to abandon their chosen careers entirely.

Data on whistleblowers' employment bears out this grim outlook. One study on corporate fraud found that 37% of whistleblowers concealed their identity, "a clear sign that the expected reputational costs exceed the expected reputational benefits." Further data reveals that whistleblowers had good reason to desire anonymity, as "in 82 percent of cases, the whistleblower was fired, quit under duress, or had significantly altered responsibilities. In addition, many employee whistleblowers report having to move to another industry and often to another town to escape personal harassment." Startlingly, that statistic drew only on whistleblowers who had successfully recovered in their cases. Another study of whistleblowers in the pharmaceutical industry provided a more subjective analysis, finding that whistleblowers tended to view their awards as small relative to the time and personal costs of bringing a False Claims Act qui tam case. Whistleblowers may also

32. Id.
33. Id.
34. Aaron S. Kesselheim et al., Whistle-Blowers' Experiences in Fraud Litigation against Pharmaceutical Companies, 362 N. ENGL. J. MED. 1832, 1834 (2010). That assessment is not uncommon. For example, in a False Claims Act suit against his former employer, military contractor Northrop Grumman, whistleblower James Holzrichter won $6.2 million, of which he ultimately kept $2.3 million after the government's share, attorneys' fees, and taxes. However, the case took 16 years to resolve, during which time he was shut out of work as an auditor due to being viewed as a "snitch," was forced to work menial jobs to make ends meet, and at one point had to move his family into a homeless shelter. When asked if whistleblowing was ultimately worth it, Holzrichter appeared doubtful, stating, "I don't know if it was worth it. I have the money, but how can I give my children their childhood back?" Ben Hallman, Whistleblowers Beware: Most Claims End in Disappointment, Despair, HUFFINGTON POST (June 2, 2012), http://www.huffingtonpost.com/2012/06/04/whistleblower-law-false-claims-act-awards-james-holzrichter_n_1563783.html.
face lawsuits over the disclosure of company information, even if that information is provided only to the government to report unlawful conduct. 35

In addition to the financial risks to whistleblowers, the social costs of reporting are high. Whistleblowers often lose their work community once they report wrongdoing by their employer. 36 Not only are whistleblowers required to refrain from discussing an investigation with their current or former colleagues, but investigations impose burdens on those colleagues, who have to produce documents, attend depositions, and address other fallout from an investigation. 37 Social norms against “snitching” persist and whistleblowers trying to do the right thing may find their actions cause them to be ostracized rather than applauded. Faced with these options, most people would choose to do nothing.

In sum, there is little support for the notion that the choice of reporting internally or invoking a whistleblower reward program is a simple binary choice. Given the speculative nature of the award, the more immediate threat of employment retaliation, the lengthy nature of cases, and the personal costs whistleblowers endure, the speculative prospect of potential financial gain is unlikely to be the deciding factor for whistleblowers. Concerns that most whistleblowers will choose to bypass effective internal compliance programs if they have the prospect of a financial reward appear overblown.

Moreover, those whistleblowers who do bypass internal compliance programs may have good reason to do so. Not only is retaliation a serious risk, but if fraud permeates all levels of the corporate structure, reporting internally may be futile. For example, in Kuhn v. Laporte County Comprehensive Mental Health Council, the audit team for the whistleblowers’ employer was alleged to have been engaged in a widespread fraudulent scheme. 38 The whistleblowers reported that the


company's audit team had supplied the U.S. Department of Health and Human Services Office of the Inspector General (HHS OIG) with documents that had been altered in an effort to mislead HHS OIG auditors, "including substantive changes to progress notes, corrections made to billing codes, and the forged signature of a former employee." 39

One of the whistleblowers reported directly to the U.S. Attorney's Office. 40 Upon learning of this, the company fired both whistleblowers. 41 Given the nature of the allegations—that fraud permeated an entire department of the company, as well as the company's reaction—these whistleblowers appear to have been justified in concluding that reporting internally, which involved alerting the Board of Directors and the Medical Director, would have been fruitless.

A typical response to concerns that systemic fraud may justify bypassing internal compliance is that systemic fraud is an unusual situation, and fraud is more typically caused by "one bad actor" or rogue employee unilaterally committing fraud on his or her own without company knowledge or endorsement. This idea that fraud is carried out by "one bad actor" results in a perception in the compliance industry 42 that compliance programs should focus on rooting out individuals acting outside of company norms, as opposed to focusing on how to head off company-wide misconduct. 43

Although most of the discussion of the "one bad actor" theory focuses on criminal prosecutions, the argument and its implications carry weight in the civil context as well. 44 Indeed, the same motives underlie

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39. Id.
40. Id.
41. Id. at *2.
42. The compliance industry can be defined as those businesses that exist around ensuring adherence to legal regimes and limiting liability for businesses. This includes ethics and compliance consulting businesses, legal professionals, and even academics. See Krawiec, supra note 6, at 497.
44. See Geraldine Scott Moohr, Of Bad Apples and Bad Trees: Considering Fault-Based Liability for the Complicit Corporation, 44 AM. CRIM. L. REV. 1343, 1345-47 (2007) (explaining the genesis of the "one bad apple" defense and arguing that "the reality of corporate crime differs from assumptions about the ultimate responsibility of individual bad apples.").
criminal and civil wrongdoing. Corporate-level factors such as salary structures and bonus policies that emphasize performance goals—rather than how the goal is achieved—provide incentives to achieve company objectives with no counter-weight for consideration of ethical implications... Generous salaries and awards of stock options align the interests of executives and shareholders and encourage aggressive tactics designed to increase the value of the company’s stock.45

Instead of taking a broader view of the corporate culture and challenging widespread corporate practices effectively, the “one bad actor” approach leads compliance programs to focus on identifying the “rogue” employee. Upon becoming the subject of government investigation, a company may concentrate on trying to cast a certain employee as the bad actor, in order to pin responsibility on one individual instead of the company.46

Another common explanation for internal compliance failures is that, while most actors are trying to do the right thing, the regulatory landscape has become too complex to navigate, making it impossible for companies to fully comply even if they wanted to do so.47 This argument tends to ignore the fact that the largest and most harmful frauds, like the Madoff, Enron, and Cendant scandals, were not the result of confusion over complex regulations. These frauds were the work of executives, departments, and entire companies that created a corporate culture that perpetuated fraud. For example, in the case of Cendant, executives led by CEO Walter Forbes undertook a multi-year scheme to deliberately inflate the company’s value by falsifying $500

45. Id. at 1349.
46. Id. at 1346; see also Krawiec, supra note 6, at 502-03 (“[I]nternal compliance structures may be a useful device for demonstrating the organization’s attempts to comply with legal rules, thus painting the firm as the victim—as opposed to the perpetrator—of misconduct. This scapegoating defense has been especially common, though not always successful, in connection with various ‘rogue trading’ scandals.”); see, e.g., Dean Starkman, Pollution Case Highlights Trend to Let Employees Take the Rap, WALL ST. J. (Oct. 9, 1997), http://www.wsj.com/articles/SB876350099854168000.
47. See, e.g., Corporate Compliance Basics, WOLTERS KLUWER, https://ct.wolterskluwer.com/resources/guide/corporate-compliance-basics (last visited June 14, 2015) (“Today’s regulatory landscape is more and more complex, as state and local governments expand compliance requirements, increase fees and increase enforcement efforts. Even the most dedicated and conscientious business can find it overwhelming to keep up with the constant onslaught of new and changing requirements.”); Over-regulated America, THE ECONOMIST (Feb. 18, 2012), http://www.economist.com/node/21547789 (“But Dodd-Frank is far too complex, and becoming more so... financial firms in America must prepare to comply with a law that is partly unintelligible and partly unknowable... Sarbanes-Oxley, a law aimed at preventing Enron-style frauds, has made it so difficult to list shares on an American stockmarket that firms increasingly look elsewhere or stay private.”).
million in revenue. As the CEO who succeeded Forbes stated of the scandal, "[t]he investigation has identified how a group of people at CUC deliberately deceived and misled investors and business partners—and reveals a corporate culture that encouraged this behavior." Walter Forbes was eventually convicted of falsifying reports to the SEC and sentenced to jail for his role in the scandal. Bernard Madoff was also convicted of fraud and sentenced to prison.

These frauds were not the result of regulations being too complex or the result of business actors attempting to do the right thing. The perpetrators were often acting in concert with others, highly placed within the companies, and were aware of the illegal nature of their actions, as evidenced in part by their efforts to conceal them. Although some corporate mistakes are surely made in trying to navigate the intricate interplay of governing laws, violations of the laws enforced through whistleblower reward programs typically require a level of intent beyond mere negligence. Like the scapegoating of individual "rogue" employees, casting compliance problems in this light places the blame on external forces instead of addressing systemic failures within companies.

IV. EVIDENCE SUGGESTS THAT WHISTLEBLOWER REWARD PROGRAMS ENCOURAGE COMPLIANCE

Far from undermining compliance, whistleblower reward programs encourage and help achieve compliance with the law, but in a different way than internal compliance programs. Whistleblower reward programs encourage compliance through deterrence, by increasing the likelihood that violations will be detected and thereby increasing the cost of committing them.

Congress recognized the deterrent value of whistleblowers when it amended the False Claims Act in 1986 and when it shaped the whistleblower provisions of the Dodd-Frank Act. In discussing the 1986 amendments to the False Claims Act, Senator Grassley explained

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49. Id.
52. See, e.g., 31 U.S.C. § 3729(b)(1) (defining "knowingly" under the False Claims Act); Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 341-42 (2004) (holding that securities fraud requires "scienter, i.e., a wrongful state of mind.").
that "the Committee feels that the active enforcement of this statute will not only result in recovery of losses resulting from fraud, but that it will also serve as a deterrent to those who otherwise might consider defrauding the Government." 53 When Congress amended the False Claims Act again in 2009, Senator Leahy explained that "[t]he only way you are going to stop [fraud] is to show you are going to stop it. The only way you are going to deter it is if you act to deter it, if you investigate the people, if you go after them, if you make them pay, and if we recover money for American taxpayers." 54 Although quantifying the deterrent value of the law is an imprecise science, the General Accounting Office estimated that from 1986 to 1998, the False Claims Act deterred over $300 billion in fraud. 55

Deterrence was a strong motive for passing the whistleblower provisions of the Dodd-Frank Act as well. In implementing the provisions, the SEC explained that they expected the final rule to lead to "earlier detection of violations and increased deterrence of potential future violations." 56

The SEC also viewed the whistleblower program as an important component of increasing compliance. The agency explained that allowing direct reporting to government enforcers would allow "whistleblowers [to] balance the potential increase in the probability and magnitude of an award by participating in an effective internal compliance mechanism against the particular risks that may result from doing so." 57 The SEC recognized that whistleblowers could complement internal compliance efforts, as "issuers who previously may have underinvested in internal compliance programs may respond to our [whistleblower] rules by making improvements in corporate governance generally, and strengthening their internal compliance programs in particular." 58

The impact that the whistleblower provisions of the False Claims Act and other enforcement efforts have had on compliance efforts and deterrence can be assessed by looking at industries that have historically

53. H.R. REP. NO. 99-660, at 18 (1986). See also id. at 63 (former Assistant Attorney General John R. Bolton also remarked on the great deterrent power of the False Claims Act, stating that "[t]he civil fraud remedies contained in the False Claims Act are an essential element in our efforts to prevent fraud... [T]he aggressive use of our civil remedies is a significant deterrent as well as an aid to making the government whole for losses to fraudulent claims.").
57. Id. at 237.
58. Id. at 239.
suffered from high levels of misconduct. The defense, pharmaceutical, and securities industries each provide a window into how whistleblower reward programs have shaped deterrence, prosecution, and industry compliance efforts.

A. The Defense Industry

The defense industry has a long history with fraud, stemming from the original passage of the False Claims Act (Act). The Act was passed in 1863 as a response to rampant military contracting fraud during the Civil War.59 The law was used, albeit infrequently, until World War II when amendments rendered it largely ineffective.60 However, by the 1980s fraud had "grown to previously unimaginable proportions."61 During this time, the Department of Defense suffered from a number of high-profile procurement scandals including paying $1,118 for a 26-cent stool cap; $38 for a 38-cent screw; and $640 for a toilet seat.62 By 1984, the Department of Defense had 2,311 active fraud investigations—a 30% increase from two years prior.63 In 1985, Joseph Sherick, then Defense Department Inspector General, testified that 45 of the 100 largest defense contractors, including 9 of the top 10, were being investigated for fraud.64 The Department of Defense estimated that, at that time, it was likely losing somewhere between $1 to $10 billion a year to fraud.65

Spurred by the immense level of defense contracting fraud, Congress felt that "the growing pervasiveness of fraud necessitated modernization of the Government’s primary litigation tool for combating fraud."66 In response, Congress amended and modernized the False Claims Act in 1986, making it more effective.67 In the years following the amendments, the percentage of recoveries involving defense contracting rose, and from 1987-1995 generally formed the largest percentage of total False Claims Act recoveries per year.68 Since then, the numbers of

61. Id. at § 2:9.
63. Id.
65. Id.
66. Id. at 1.
67. SYLVIA, supra note 60, at § 2:9.
68. William E. Kovacic, Whistleblower Bounty Lawsuits As Monitoring Devices in Government Contracting, 29 LOY. L.A. L. REV. 1799, 1802 (1996) (see Table 2 for the percentage of defense...
defense contracting cases have fallen as a percentage of total False Claims cases filed. Although federal spending in military procurement declined throughout the mid to late 1990s, it rose again sharply throughout the 2000s. Despite this, the percentage of whistleblower cases involving defense procurement fraud continues to dwindle, but it is unclear if this is due to a decline in actual fraud. What is clear is that the Act, along with other developments spurred the defense industry to significantly increase its compliance efforts. In fact, the rise of the compliance industry stemmed from the defense contracting scandals of the 1980s. In response to the scandals, a large group of contractors created a defense contracting ethics code, the Defense Industry Initiative, and began hiring compliance officers. Around the same time, the Federal Sentencing Guidelines for Organizations were passed, imposing criminal sentencing, penalties, and fines on organizations committing federal crimes. Because the Guidelines offered leniency for organizations with compliance programs, this stimulated further formalization of the emerging compliance industry.

Despite the proliferation of compliance programs and efforts, however, the defense industry continues to be a source of fraud. Whistleblowers continue to bring to light numerous violations by defense contractors, which internal compliance has failed to address. In fact, the same entities have been the subject of repeated False Claims Act cases and recoveries.

B. The Healthcare Industry

The healthcare industry, and in particular the pharmaceutical industry, provides a more recent look at how whistleblowers have affected fraud prevention, recovery, and compliance efforts. As Government takes a

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recoveries from 1987-1995).


71. Troy et al., supra note 69.

72. SYLVIA, supra note 60, at § 2:14.

73. Krawiec, supra note 6, at 497.

74. Id.

75. Id. at 497-98.

76. Id. at 498.

77. See Hall of Shame: An Index of Repeat FCA Offenders, TAXPAYERS AGAINST FRAUD EDUC. FUND, www.TAF.org/paying-it-forward (noting companies subject to multiple False Claims Act suits) (last visited Apr. 7, 2016).
more active role in providing health coverage and pours more money into the healthcare industry, greater opportunities for fraud abound. The Federal Bureau of Investigation estimates that between three to ten percent of all healthcare expenditures are fraudulent.78 Most healthcare frauds—approximately 41%, by one study—are discovered by employees, underscoring how crucial whistleblowers are to uncovering fraud.79 In comparison, employees’ whistleblowing in other industries accounts for only around 14% of fraud cases.80 The upward trend in the volume of healthcare fraud and recoveries began in the mid-1990s and continued throughout the 2000s, likely driven in part by growing healthcare spending by the government.81 A $430 million settlement of off-label marketing allegations against Warner-Lambert in 2004 marked the beginning of a spate of such off-label marketing fraud recoveries over the next decade and beyond.82 On the surface, it appears that the pursuit of healthcare fraud cases has had a deterrent effect on fraud in this industry, as “[m]ajor settlements with large recoveries have a ripple effect that reduces the likelihood of similar fraud.”83

One positive trend suggesting whistleblowers are effective in reducing healthcare fraud is the inverse correlation between the Medicare error rate and an increase in False Claims Act enforcement.84 The Medicare error rate corresponds to the percentage of total Medicare fee-for-service spending caused by fraud, waste, and abuse.85 Although the error rate includes technical billing mistakes as well as fraud, generally a downward trend in the rate indicates a decrease in fraud.86

79. Dyck et al., supra note 31, at 3.
80. Id.
84. MEYER & ANTHONY, supra note 81, at 21-24.
85. Id.
86. Id. ("Downward trends in the error rate reflect the success of a number of government policy
Between 1996 and 2000, the error rate fell from 14% to 6.9%—meaning that the dollar amount lost to fraud every year plummeted from approximately $23.2 billion in 1996 to around $11.9 billion in 2000. This downward trend in the error rate inversely correlates roughly with the rising number of whistleblower health care cases, which rose from 15% of total whistleblower cases filed in 1992 to 61% in 1998. By 2000, two-thirds of all False Claims Act cases involved healthcare spending. The Congressional Budget Office has stated that the decrease in the rate of growth of Medicare spending during the same time period could mostly be credited to greater government enforcement and compliance efforts, including both False Claims Act prosecutions and their larger deterrence effects.

Increased prosecution of healthcare fraud has also motivated greater compliance efforts including the widespread adoption of compliance programs. Department of Justice officials noted that “the period since the 1986 amendments to the FCA has seen a tremendous push by industries doing business with the government to adopt effective compliance programs and to prioritize corporate ethics.” As a result of the surge in whistleblower cases against the pharmaceutical industry, the industry group Pharmaceutical Research and Manufacturers of America (PhRMA) adopted the PhRMA Code on Interactions with Healthcare Professionals (Code) in July 2002. The Code guides pharmaceutical companies on how to prevent and avoid False Claims and Anti-Kickback Act violations, and HHS OIG has stated that compliance with the code will “substantially reduce the risk of fraud and abuse and help demonstrate a good faith effort to comply with the applicable federal health care program requirements.” Initially, fifteen of the US’s largest pharmaceutical companies endorsed the Code.

87. Id. at 41.
88. Id. at 38.
90. MEYER & ANTHONY, supra note 81, at 42.
94. Davis, supra note 92, at 40.
updated in 2009 and now has over fifty signatory companies. 95

Another effect of increased enforcement has been increased transparency, which, in turn, has its own compliance effects. For example, the Affordable Care Act includes a provision that requires manufacturers of drugs, medical devices, and biologicals that participate in federal health care programs to report certain payments to physicians and teaching hospitals. 96 Although such payments are not necessarily prohibited, the requirement to report them may lead some providers to avoid conduct they would have engaged in if not in the public eye. 97

The whistleblower reward programs also serve an important role in shining a spotlight on the failures of internal compliance programs. For example, although the Code successfully secured endorsement from most major pharmaceutical companies, these same companies have had significant compliance issues since signing onto the Code. 98 Of the thirteen companies represented by the initial members of the executive committee that endorsed the PhRMA code in 2002, all but two have subsequently settled fraud suits concerning conduct that occurred after implementation of the Code. 99 In addition, many pharmaceutical and


98. The failure of the PhRMA code is consistent with the lack of data supporting the efficacy of ethics codes as a means to deter and prevent unlawful activity. See Krawiec, supra note 6, at 511.

healthcare companies operating under Corporate Integrity Agreements (CIAs) have later been found to be in violation of their CIAs. For example, in *United States ex rel. Matheny v. Medco Health Solutions, Inc.*, the Court of Appeals upheld a lower court decision to enforce a CIA. The Defendants had signed a CIA in November 2004 with the Department of Health and Human Services as part of the settlement of a whistleblower lawsuit. Subsequently, the employees became aware in 2006 that Medco supervisors were concealing around $69 million dollars in overpayments that, under the CIA, should have been returned to the government.

C. The Financial Industry

Although the Whistleblower Provisions of the Dodd-Frank Act are relatively new in comparison to the False Claims Act, evidence suggests that strong enforcement efforts by the SEC have had a positive impact on deterring financial related fraud and shaping companies’ behavior. SEC enforcement actions, for example, have been found to result in significant reductions in discretionary accruals over an extended period of time. Because discretionary accruals correspond to the anticipated liability a company expects it will have, smaller accruals indicate that companies are engaging in less risky and potentially fraudulent behavior. Furthermore, sustained, repeated enforcement activity by the SEC has been effective at changing firms’ behavior. There is also evidence that even a perceived increase in government enforcement deters investors from illegally trading on material information. In one


100. United States ex rel. Matheny v. Medco Health Solutions, Inc., 671 F.3d 1217 (11th Cir. 2012).

101. *Id.* at 1220.


104. *Id.*

105. Diane Del Guercio et al., *The Deterrence Effect of SEC Enforcement Intensity on Illegal
study of SEC enforcement activity from 1981 to 2011, the authors found a strong statistical correlation between the intensity of enforcement and decreases in insider trading, demonstrating a deterrent effect on the industry. The authors also compared their results to a previous study that used the same methodology to analyze SEC enforcement activities in the 1980s. By comparing the two studies, the authors found that returns from insider trading had decreased on average, suggesting that over time the SEC’s enforcement activities resulted in an overall decrease in insider trading.

The role whistleblowers have played in revealing misconduct demonstrates their critical role in both delivering effective fraud prosecutions and deterring others from similar actions. Under the False Claims Act, whistleblowers have returned over $40 billion to taxpayers since 1986 and played significant roles in reigning in the defense industry, bringing to the Government’s attention new types of pharmaceutical fraud, and assisting with uncovering notorious secretive financial fraud schemes. All of this has happened at the same time as increased compliance efforts by companies. As former Assistant Attorney General Stuart Delery stated, “[t]he period since the 1986 amendments to the FCA has seen a tremendous push by industries doing business with the government to adopt effective compliance programs and to prioritize corporate ethics.” Contrary to the compliance industry’s fears, giving whistleblowers an active role in detecting and prosecuting fraud appears to have invigorated corporate compliance efforts and inspired greater attempts from businesses to deter fraud investigations and prosecution.

V. WHISTLEBLOWERS AND COMPLIANCE EFFORTS COMPLEMENT EACH OTHER

One way to compare the impact of whistleblowers with that of internal compliance programs is to contrast the number of False Claims Act cases with cases of corporate self-reporting. In the U.S. Chamber of Commerce Institute for Legal Reform’s 2014 proposal to overhaul the False Claims Act, the Chamber argued that “[b]usinesses are best placed

106. Id. at 41-42.
107. Id.
109. Delery, supra note 91.
to detect and prevent wrongdoing . . . the statute should incentivize
companies to take the lead in curbing and reporting fraud."\textsuperscript{110} The
Chamber reasoned that whistleblower claims result in "post hoc
enforcement" that is "imbalanced and ineffective," and proposes that
reforms favoring internal compliance will "incentivize businesses . . . to
prevent, identify, and disclose wrongdoing . . . generating significant
savings to taxpayers though less expensive but more effective
government investigations, and less litigation."\textsuperscript{111} Businesses with
compliance programs, according to this argument, should be rewarded
for their efforts, which are more efficient and a better use of resources
than Government investigations and litigation prompted by
whistleblowers.

But there are a number of self-reporting programs, and these have
been traditionally underutilized. For example, the False Claims Act
That section provides that a person or entity that self-reports and
cooperates with the investigation in compliance with the provision
will be subject to a maximum of double, rather than treble damages. The
Affordable Care Act also established a self-disclosure for violators of
the Stark Law, which can form the basis of a False Claims Act case.\textsuperscript{112}
The HHS OIG also has a protocol for self-disclosure of fraud by
healthcare providers.\textsuperscript{113} Corporations thus already have numerous
incentives to ensure that they have strong compliance programs so that
they can use self-disclosure protocols. Self-disclosure of potential
violations helps companies avoid other potential consequences such as
being subject to a Corporate Integrity Agreement, or performing other
remediation.\textsuperscript{114} The HHS OIG’s Self-Disclosure Protocol states that

\textsuperscript{110} See, e.g., David W. Ogden & Jonathan G. Cedarbaum, Ideas for Reforming the False Claims
compliance program" and self-disclose); U.S. CHAMBER OF COM. INST. FOR LEGAL REFORM, FIXING
THE FALSE CLAIMS ACT: THE CASE FOR COMPLIANCE-FOCUSED REFORMS 2 (Oct. 2013),

\textsuperscript{111} Id. at 8-9.

\textsuperscript{112} The Stark Statute prohibits physicians from making referrals for certain government funded
health care services to health care entities in which the physicians have a financial interest and prohibits
the health care entities from billing the Government for such services. 42 U.S.C. § 1395nn. Section
6409 of the Affordable Care Act provides a self-disclosure protocol for violation or potential violations

\textsuperscript{113} OFF. OF INSPECTOR GENERAL, U.S. DEP’T OF HEALTH & HUMAN SERVS., UPDATED
PROVIDER SELF-DISCLOSURE PROTOCOL (Apr. 17, 2013), http://oig.hhs.gov/compliance/self-disclosure-
info/files/Provider-Self-Disclosure-Protocol.pdf.

\textsuperscript{114} See, e.g., Our Lady of Lourdes Memorial Hospital Has Paid More Than $3.37 Million to
http://www.justice.gov/usao-ndny/pr/our-lady-lourdes-memorial-hospital-has-paid-more-337-million-
good-faith disclosures and cooperation “are typically indications of a robust and effective compliance program” which results in a presumption against Corporate Integrity Agreements.\footnote{115} Self-disclosing entities are also subject to a minimum damages multiplier of 1.5 (as opposed to 3), and may not be subject to the 60-day rule for returning overpayments to Medicare and Medicaid.\footnote{116} Thus, businesses can reduce their damages greatly and escape costly and burdensome integrity agreements and other oversight through self-disclosure.

Despite these reasons for businesses to self-report, self-disclosure is still a rare event. Between 2008 and 2013, the HHS OIG resolved 235 cases through the self-disclosure process. In comparison, between 2008 and 2013, whistleblowers filed 2,225 cases where the Department of Health and Human Services was the primary client.\footnote{117} Even crediting an assumption that many of these cases lacked merit, this still leaves a significant gap between the amounts of fraud brought to light by self-disclosure and those brought to light by whistleblowers. Greater corporate incentives to self-disclose in recent years do not appear to have caused a decrease in whistleblower cases, and self-disclosure remains a minority of fraud cases. Indeed, lack of success of voluntary disclosure was one incentive for the adoption of mandatory disclosure provisions for certain categories of violations of law by defense contractors.\footnote{118} Given the apparent disuse of these provisions, the argument that greater emphasis on self-disclosure to reduce and deter fraud will achieve better compliance than whistleblower programs that have recovered billions of dollars for taxpayers appears overstated.\footnote{119}

In addition to existing incentives for businesses to self-report, it seems unlikely that more leniency is necessary to encourage compliance efforts, given that the potential threat of whistleblower suits is a great motivator to create effective compliance programs. This is what occurred with the defense industry in the wake of the 1986 False Claims Act amendments and has more recently occurred after the Dodd-Frank


116. Id.


whistleblower provisions passed. Truly effective programs that are viable options for employees to use without fear of retaliation and are not window-dressing can compete effectively with whistleblower programs.\textsuperscript{120}

Requiring whistleblowers to report internally before reporting to the Government would actually risk less compliance. Companies could use the opportunity not to correct the problem and self-report, but rather to circle the wagons and avoid government scrutiny.\textsuperscript{121} Instead of working with regulators and whistleblowers to remedy the fraud, retaliation against the whistleblower is the more likely outcome. Indeed, there is a growing trend of defendants suing whistleblowers for allegedly taking documents, disclosing and stealing trade secrets, and violating nondisclosure agreements in the course of bringing the fraud to a regulator’s attention.\textsuperscript{122} In the securities context, companies have attempted to use their employee contracts and nondisclosure agreements to prevent employees from reporting fraud. In response, the SEC recently stepped up efforts to review companies’ agreements with their employees and expressed concern about these types of agreements.\textsuperscript{123}

VI. CONCLUSION

Ultimately, there is little evidence that compliance programs are superior at preventing and deterring fraud such that they should be prioritized at the expense of whistleblower programs. Whistleblower programs have proven valuable at rooting out and deterring fraud and have resulted in the recovery of billions of taxpayer dollars. In contrast, there is little evidence that internal compliance programs are as effective

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\textsuperscript{120} See, e.g., Daryl M. Shapiro & Stephen L. Markus, Protecting Corporate Compliance Programs from SEC Whistleblower Incentive Payments, Client Alert, PILLSBURY WINTHRUP SHAW PITTAN (May 25, 2011) https://www.pillsburylaw.com/siteFiles/Publications/EnergyFinanceClientAlertDoddFrankWhistleblower_052511_final.pdf ("[W]here there is a perceived distrust of corporate policies and an absence of effective alternative paths, employees will regard the SEC as the best option in the first instance.").

\textsuperscript{121} See Krawiec, supra note 6 (arguing that internal compliance structures do not deter prohibited conduct within firms and may largely serve a window dressing function leading to under-deterrence and proliferation of costly but arguably ineffective compliance structures).


at deterring or remedying fraud. Unless whistleblowers have the alternative option of taking their complaints directly to the Government, much of their information may not see the light of day and actual compliance will be undermined. Whistleblower programs provide accountability and lead to actual compliance. Neither whistleblowers nor compliance efforts work at cross-purposes. Rather, they can, and do, work in synergy for the ultimate goal of remedying fraud and deterring future such conduct.